

If a country decides to let the exchange rate float, it evidently has concluded that it will neither accumulate dollar balances nor dispose of any that it owns, and that it will let the price of the dollar be determined in the free market. This excludes the possibility of further deficits and surpluses in its transactions with the United States (if the balance of payments is calculated on the basis of "reserve transactions"). It does not exclude the use of fixed exchange rates vis-a-vis the currencies of other countries (some of which may be more significant in the trade relations of the country concerned).

The three possibilities do not exhaust the range of options open to a country. Another option involves the use of multiple exchange rates. A country may decide to maintain the present fixed exchange rate for current-account dollars, that is, for dollars arising from, or used for, trade in goods and services, but to let dollars arising from inflows of capital depreciate. The execution of this decision to split the market would probably require foreign-exchange controls of the most stringent sort, because capital transactions can be disguised as payments for goods and services. The introduction of such controls would be regrettable, but from the American point of view one may say that controls abroad are less objectionable than controls at home. Still, this outcome would be deplorable and one can only hope that most foreign governments would realize how much harm can be caused by such measures.

The chief purpose of the link-cutting action would be achieved no matter what other countries decide to do. For, convertibility of dollars in gold having been abolished, the confidence problem as a threat of reserve destruction would no longer exist.

The use of the dollar as an international transactions currency would not be impaired by the action. Banks and trading firms hold dollar balances because they need them in their business and because the reservoir of goods which the dollar can buy at relatively stable prices is larger than that of any other currency. With the fear of "convertibility crises" removed, the usefulness of the dollar in international trade may even increase.

Some traditionalists fear that the abolition of gold reserves and of a firm link between dollar and gold would invite inflationary policies; they believe some monetary discipline is exercised by the link to gold. In fact, gold-reserve requirements and gold-convertibility rules do not give us more discipline—we do what we would do in any case—they only create guilt feelings.

One genuine drawback of this solution of the confidence problem is that the link-cutting action is unilateral and, therefore, offends the spirit of international monetary cooperation. For this reason, this approach should be regarded as inferior to a negotiated, multinational arrangement. Some economists though, believe that, in the absence of convertibility of dollars in gold, the United States would have less need for international cooperation.

THE LIQUIDITY PROBLEM

We now come to a much happier subject. While we still grope for solutions of the problems of adjustment and confidence, we have found and agreed on a solution of the liquidity problem. And a very neat, most satisfactory solution it is.

I have just completed a long study—over a hundred pages—of the Rio Agreement with all its details and implications. I have concluded that the scheme is superior to any of the alternatives that have been discussed in the last ten years, and that it should work well once it is activated.

NEW PRINCIPLES

The system of Special Drawing Rights embodies novel features based on sound principles of monetary economics.

The Special Drawing Rights (SDR) are deliberately created and distributed among participants in agreed proportions. They will be owned reserves—not borrowed reserves. They can circulate only among the participating monetary authorities—hence, cannot go outside the group of participants. They cannot be extinguished or destroyed—what one holder loses another gains.

The SDR's are not created by acts of lending or investing, nor by decisions to borrow or to make use of an overdraft facility. They do not constitute anybody's debt, indeed, the Special Drawing Account owns nothing and owes nothing, but acts merely as a bookkeeper and a source of information. Finally, the age-old myth of "backing," which economists for hundreds of years have vainly tried to exorcise, has at last been punctured. There is no asset that could be said to