PETER LISAGOR:

Good evening. The American dollar has been a stable part of international monetary transactions for some time, but now threats to this stability have arisen. Gentlemen, how serious are these threats? That is, how much danger is the dollar really in?

MILTON FRIEDMAN:

The dollar isn’t in any danger. The danger arises from the policies we’re following about the dollar.

PAUL SAMUELSON:

I think that the dollar is pretty far from equilibrium at the present time and that we have quite a serious problem here.

LISAGOR:

Disagreement as we have seen about the danger and how to combat it runs wide and deep among the experts. Tonight we’ll discuss this complex issue with two nationally known economists—Professor Milton Friedman has taught at several major universities here and abroad, was a consultant to Republican presidential candidate Barry Goldwater, and is now Professor of Economics at the University of Chicago.

Professor Paul Samuelson was an economic advisor to the late President Kennedy. He is the author of widely used textbooks and is currently Professor of Economics at MIT.

Both gentlemen are columnists for Newsweek Magazine.

Now, let’s go to the audience for the first question. Gentleman over there.

QUESTION:
… I would like to know what would the effect be on the dollar as an international vehicle currency if the U.S. put an embargo on purchases and sales of gold.

FRIEDMAN:

The effect depends on what else we did. If we also removed any restrictions on foreign investment, on lending by banks and the like, I think the effect would be to make the dollar more widely used as a vehicle currency than it is now. Because it would then be true that if we did not restrict people in the use of the dollar, that countries all over the world and people all over the world would rely primarily on the dollar. They don’t use gold now, they use the dollar.

SAMUELSON:

If we stopped selling gold at $35 an ounce, the price of gold would rise in world markets. If we stopped buying gold and announced that policy there would be no immediate effects, but at a later time it could cause the price of gold to fall.

FRIEDMAN:

Do you think there’s really any serious chance that during my lifetime the price of gold is really going to fall below $35 an ounce?

SAMUELSON:

Yes, quite a good chance. For example, if gold ceases to be the principal reserve for international trade, and if so called paper gold, special drawing rights come to pass, I think there’s a pretty good chance that they will, it’s quite possible that the price of gold could fall. I wouldn’t hold my breath, however.

FRIEDMAN:

I think you’re a pessimist in thinking that that can come about. It would be a bad thing if it did come about, but I think the chances of a significant SDRs is very small, because every
country is in favor of the general principle of SDRs provided it’s set up so that that country can borrow as much as possible and is required to lend as little as possible.

LISAGOR:

Professor Friedman, for the uninitiated and uninformed, would you explain to us what SDR is?

FRIEDMAN:

It stands for Special Drawing Rights. It’s a fancy term that is supposed to describe a new form of international money, paper gold, which it is hoped countries will be willing to hold as reserves instead of real honest-to-God gold.

LISAGOR:

Thank you. Let’s have another question from the audience. Gentleman back here.

QUESTION:

How do you gentlemen feel about devaluation of the dollar, both short run and in the long run, and what would you consider the most viable alternatives?

SAMUELSON:

Well I don’t think that the present price of $35 an ounce of gold, buying and selling, which is our announced policy, will necessarily last indefinitely. I think that any speculator who bets that in the next couple of years that price is going to change is going to lose his shirt, because as I’ve said, the dollar isn’t in equilibrium. The dollar was in very bad shape in 1959 and 1960. It improved steadily up till 1964 because prices were rising abroad much faster than they were here, and we were becoming more competitive. Since 1964, we’ve made very little progress, but let’s suppose that we are very pessimistic and the dollar gets in greater dis-equilibrium, then I think we’ll have more direct controls of the sort which we already have seen, rather than the speculator’s holiday which he, on borrowed money, makes an overnight killing.
FRIEDMAN:

I think the difficulty with this question is that the word devaluation is used in two very different senses, and you have to distinguish between them. Devaluation is sometimes used to mean a change in the price of gold from $35 to some other. Now if all countries in the world simultaneously raised the price of gold, that would not affect the rates of exchange between the different countries. In the second sense in which devaluation is used, is a sense in which the British devalued, changing the price of the pound in terms of the dollar. In the second sense of devaluation, therefore, there’s a change in the price of the dollar in terms of foreign currency. With respect to the price of gold, I disagree with Paul. I don’t think there’s any conceivable chance that we can hold the price of gold at $35 very much longer.

SAMUELSON:

Would you date your prediction?

FRIEDMAN:

Yes, I think sometime within the next three to four years the price of gold will be higher than $35 an ounce. Maybe the U.S. government won’t announce officially that it’s over $35 an ounce, but in the London gold market or if there, maybe London will close the gold market, wherever the gold market reappears, the price will be higher than $35 an ounce. On the other hand I share Paul’s view that it may be that so far as the exchange rates are concerned, we will not in fact change exchange rates. I think what we ought to do is to let both exchange rates and the price of gold go free and be free prices and in order to be able to get away from precisely those direct controls that Paul referred to. Which would you rather have, Paul, if you had your choice—a widespread exchange control of the kind we’re developing, or a free market price or exchange rates?

SAMUELSON:

I think I would not like the capital controls.
Could I summarize what the two major problems are in this field? They’re two separable problems. One, there’s the problem of the dollar, and the exchange rate of the dollar in comparison to the mark and the franc, and the big question is, at the current levels is the dollar over-valued? So that it’s a very poor bargain. And that’s a problem which I said was very intense in 1959, is better than it was at that time.

Separate from that, though, is the long-run gold problem. World trade is increasing in physical terms at five, six or seven per cent per year. In money terms it’s increasing at seven, eight or nine per cent per year. But what about gold mining? The only places where gold is mined is in South Africa and in the Soviet Union. There are four mines running in the United States, three of them unprofitably, and there certainly will be a problem. Now, if we have new international liquidity reforms, this, we can have a substitute for gold, and this is the paper gold, whether it be special drawing rights or anything else.

Now, if the dollar had been in equilibrium in 1960, that first problem weren’t a problem, I have no doubt that today we would have paper gold. The United States would have strong bargaining power in their conferences with De Gaulle and with others. We would long since have had this agreement. I don’t think that Professor Friedman is at all correct on the real politic of what’s keeping us from having these reforms.

Now, the … .

FRIEDMAN:

These changes … .

SAMUELSON:

These changes, yes … and this is what we have to live with. Now Professor Friedman doesn’t see any problems because he’s perfectly prepared to talk about things that aren’t going to happen. Let’s suppose that the IMF changes its spots. Let’s suppose that the U.S. government changes its policies, let’s suppose all the other leaders of the world do, let’s suppose through his persuasive voice, we have faulty exchange rates all around. If that
happens, and the chance that Professor Friedman even with his eloquence can make it happen, is not one in ten billion, if that happens, I will look upon the situation and rather approve, because ninety per cent of us academic economists, when we’re academic say that that’s a very interesting setup and may be better than the present one.

It isn’t going to happen. I don’t know whether we should waste the time of adults in discussing this … .

FRIEDMAN:

If anyone is talking about what’s not going to happen, which I think is a silly level on which to argue, but if anyone is talking about that, I think that you are if you think that there is more than a chance of … . a snowball in a famous place, if you think that there’s more of a chance than a snowball in that place that you’re going to have any extensive development of SDRs or paper gold. I think that clearly is not going to happen. The other thing that is not going to happen is that the price of gold is going to be held at $35 an ounce.

But I would like to make one thing clear. I think it’s a mistake to discuss the problem in terms of devaluation. The real problem is that we are imposing restrictions on American citizens with respect to how much they can invest abroad, what they can do with their currencies. From my point of view, I would say the important thing is to get rid of those restrictions. Set the dollar free. Then if France, other countries, want to keep the exchange rates where they are now, fine, let them. The only way they can do so is by either absorbing dollars or by adjusting their own policies to our policies. The objective is not to have exchange rate changes or devaluations. That’s not the objective. The primary objective is to have people free to use the dollar as they will in foreign transactions.

LISAGOR:

Could I ask a question at this point of each of you. Could you as succinctly as possible, tell us what you regard as the causes of this imbalance in our international payments account?

FRIEDMAN:
Well you have two problems, as I think we both have agreed. The gold problem, and the payments, the exchange rate problem. In both cases in my opinion, the basic cause is identical—price fixing. We pegged the price of gold at $35 an ounce, and everytime you peg a price, whether it be of gold or of housing or of silver or of wheat, you either have surpluses or shortages, and you’ve driven to controls, and similarly, on the exchange rate side, we’ve pegged the price of the dollar in terms of the pound, the franc, and again we have a price fixing problem.

If we were willing to let the whole domestic economy go up and down in order to make those prices viable prices, that would be possible. We were at one time willing to do that. That’s why the price of gold was $20.67 an ounce from 1879 to 1933, because we were willing to let the rest of the economy adjust, but we’re not willing to do that anymore, and so I think the basic source of our problem is that we’re engaging in attempting to peg some prices and consequently we get all the rest of the difficulty.

SAMUELS:

I think there are three causes of the dollar problem that we’ve been discussing. First there is the Cold War. I include in that the Vietnam expenditures, and our other military expenditures abroad. Second, there is the fact that there’s been a revolution in productivity abroad in the less than most affluent countries, in France, Italy, the Common Market countries and Japan, and although exchange rates were about right, sometime after 1949 the productivity changes abroad have been so vast compared to wage rate changes, that that’s the second basic cause. The third cause which is related to the second is that there’s very profitable investments in the Common Market countries. Unfortunately American capitalism, cool money, doesn’t go automatically to underdeveloped parts of the world, but goes to where it can make the highest profit.

Now, given those three situations, the situation for the dollar looked quite bleak in 1959; there was a good chance that we were improving because of the open inflation which has been going on in the Common Market countries much faster than in the United States. Now that
we’ve got back towards full employment, however, and we’re having our own degree of open inflation and some measure of fiscal irresponsibility, I hope that Congressman Mills is listening—the, we’ve been marking time and perhaps losing ground. Now it isn’t a hopeless situation and I wouldn’t go junking the present setup just because of this situation, but as I said at the beginning it’s a very serious problem.

FRIEDMAN:

We’ve had a revolution in productivity at home in producing television sets. Why don’t we have a television crisis? We’ve had, the television industry has been a very profitable industry in which it invest. Why haven’t we got a television crisis?

These things that you’re describing are things that would have made for a different price of the dollar in terms of foreign currencies if we had had a price that was free to adjust in the market, just as the revolution in productivity in television has made for a lower price of television sets. And that’s why I agree with you that these are the reasons why the price that was fixed and pegged before didn’t remain the pegged price, but the fundamental reason for our difficulty is that we have no adjustment mechanism. We are not willing to adjust by letting the whole internal economy move up and down, and we’re not willing to adjust by having exchange rates move and therefore, we are forced to adjust by controls.

LISAGOR:

Professor Friedman, I’d like to ask you whether or not you’re getting away from the pegged price would not create such great uncertainties in the daily market operations that you wouldn’t know where you were.

FRIEDMAN:

You think that the business man who doesn’t know whether he’ll get a permit to make capital investment abroad is free from uncertainty? You’ve got a choice of uncertainties if you have exchange control, if the government, if some government official is going to tell you how many dollars you may spend somewhere, that’s a source of uncertainty. The exchange
rate change would also be a source of uncertainty, and the question is which uncertainty is more disturbing to the society.

SAMUELSON:

As a matter of fact, as I’ve been listening here, Professor Friedman is so persuasive, that it has occurred to me that we should have more of this good thing, and each of the fifty states should have a different value of the currency, and we’ll have even faster adjustments between the states, every day, I will go to my newspaper and find out what Maryland currency is selling for in terms of Massachusetts, and although it might make commerce difficult, I have to face the fact that life is tough and there are always uncertainties, and everything is … better than exchange control.

FRIEDMAN:

It’s certainly freer rates of exchange between our states would be far better than exchange controls between the states, that’s true … .

The crucial point, you know that’s really a debating ploy rather than a point … because the crucial point is the question of where is the central monetary authority. The crucial point is to distinguish between a unified currency and a collection of national currencies linked by artificial pegged rates. The fact of the matter is that we have a single central monetary authority, namely the federal reserve system in this country, that we have no tariffs and no inhibitions on the movement of men and goods from state to state, and therefore, we do have and we can have and it’s desirable to have a unified currency for the fifty states of the United States. In order to have a comparable thing on the world scale, you would need an international central bank comparable to the Federal Reserve bank, which on political grounds I would find it extremely difficult to be in favor of because I do not believe that we ought to give enormous power to international civil servants of that kind, and in addition it would be highly desirable if you were going to have a unified currency for the world, to have a free movement of goods and men.
When the gold standard was in operation in its full form in the 19th century and early 20th century, you had a far greater degree of freedom of migration of people than you have now; you had far less intervention by government into the affairs, and unfortunately if you're going to have separate national monetary policies, you have introduced a real change in the situation.

SAMUELSON:

May I bring us back to earth and to this decade … .

LISAGOR:

Please do.

SAMUELSON:

Let's all stipulate as the lawyers say, that if there were flexible exchange rates, things would be different from what they are now. But now, on the supposition that we're not going to get those for the next 57 years, and we have a problem, let's consider some alternative. One proposal that's been made is to widen the area of fluctuation around existing parities. Keynes had proposed that in the 1920s and that's been taken up by quite a number of people. Modify the international monetary fund agreement so that you can have fluctuations of more than ten per cent.

The trouble with that is with currencies now not in equilibrium I think you would go to the floor or the ceiling as the case may be, of these limits. So this leads to another proposal that quite a number of economists have made and that is, for gradual change in the parities according to long-run supply and demand. Let, for example, exchange rates be adjustable one per cent per year. This is not enough to make it terribly juicy for speculators to pile on the bandwagon as Professor Friedman commented in connection with Canada, but it is enough in a decade or fifteen years to get you a fifteen per cent change.

Now if classical economists are right, that there's a great deal of elasticity of demand and supply in international trade, fifteen per cent changes over a decade should be in the right
direction. I wouldn’t hold my breath that the world’s about to accept this reform either, but it seems to me that it’s a more promising item to put on the agenda in terms of the real politic of the situation.

FRIEDMAN:

I am reminded very much of a radio program in the old days, back in 1950, there was a University of Chicago Roundtable. The name of it was “Dollars Across the Border,” and I participated in this program in Canada, ‘49 or ‘50, and I was told then by the Canadian participants, that it was utterly unrealistic for me at that time to be talking about Canada having a floating exchange rate. One year later she had a floating exchange rate. One of the people whom we all regard very very highly … .

SAMUELSON:

Would you, by the way, plan a trip to Germany and France, please.

FRIEDMAN:

I remember as another story, this business of trying to predict what’s realistic rather than doing what our job as economists is, which is to say what’s right and best, I think that’s a dangerous bet. I tell my own story on that, but I also tell the story of Keynes, which Professor Samuelson knows very well. In 1931 Keynes came out in favor of a tariff in Britain because he said it was politically unfeasible to go off gold, which was what he really wanted to do. He really wanted to have Britain go off gold and two weeks or so after one of his articles about why they should have a tariff because it’s politically unfeasible to go off gold, Britain went off gold, And then Keynes wrote an article saying, gee, it was funny, some of the people he had had the hardest time persuading to be in favor of a tariff, he now had the hardest time unpersuading when it was no longer necessary.

Now this is the same exact problem here. If we first adopt a system of extensive exchange control and then are driven as we will be driven to changes in the exchange rate, you see we’ve already had devaluations, don’t kid yourself. The dollar has been devalued. The
question isn’t whether the dollar should be devalued, the question is should it be open or concealed. Should we have a multiple exchange rate system? After all, if you want to take some dollars, if some foreigners want to acquire some dollars by borrowing in this country, they have a different exchange rate than the official exchange rate on account of the interest equalization tax. There’s a different exchange rate for foreign aid. There’s a different exchange rate for the military. Congress is just now going to devalue with respect to tourism. That’s a devaluation.

LISAGOR:

Professor Friedman, may I interrupt. I’ve heard it said that we have several kinds of dollars, sir. Is this what you’re saying? The dollar for the tourist who’s coming here from Europe? The dollar for the investor in Europe?

FRIEDMAN:

That’s right, if a man wants to come and borrow here, he has to pay the so-called interest equalization tax. That means that in effect, the number of foreign units he gets for a given number of borrowing dollars is less than it would otherwise be. Or again, let me give you another example. When the military decide whether to buy something in Germany or in the United States, they are told to figure out the cost of that purchase in dollars at the official exchange rate both ways. If the cost in the United States exceeds the cost in Germany by less than fifty per cent, they are instructed to buy at home in order to save dollars.

SAMUELSON:

Let me add by the way that we tie our foreign aid, which is another device of the same sort …

LISAGOR:

Professor Samuelson mentioned the cold war as one of the factors in our difficulty. Don’t we come down today to the balance of payments deficit being basically due to the security
arrangements we still have to maintain abroad, especially keeping troops in Europe, or the war in Vietnam. Is this not in the end what counts in a basic way for our present outlook?

SAMUELSON:

I don’t think you can say that because we have a basic dis-equilibrium and any one of the factors in the balance of payments, if it were different, would change that basic dis-equilibrium. The Cold War is one such factor, the desire to invest abroad is another such factor, cost differences that have not yet been equalized are another. I’ve noticed on the balance of payments that everything the people don’t want, they use the balance of payments as an excuse to get rid of. If you don’t like the Vietnamese war, then you use the balance of payments argument. Now the business of economics is to give the electorate what it wants, and if it’s desirable for security reasons, I’m not pronouncing on this at all, then the, if the people want to have the foreign aid program, you know lots of people are against the foreign aid program, they say that’s the straw that breaks the camel’s back. Well every straw adds up and counts as one straw.

FRIEDMAN:

I’m delighted to agree with Professor Samuelson on this. It seems to me one of the worst things that has happened, one of the worst consequences of the policies we followed about the dollar is that we do not consider our national policies on the right basis.

We can afford whatever is in the national interest to spend on foreign aid, on foreign military activity and the like. It’s absurd that our foreign policy should be made to depend on whether we happen to have a dollar surplus or shortage. Would anybody who has been arguing that it’s the Cold War that’s creating your dollar problem, suppose for a moment that we happen to have a dollar surplus. Would they say that’s a reason for going in for more military adventures abroad? That’s absurd. You’re swinging the dog around by his tail instead of the other way. We ought to decide our foreign policy on the basis of the interests of the nation. We ought to decide how much foreign aid to give on the basis of whether it does good
or harm. We ought to decide each of these issues on their own right and then we ought to let the market take care of whatever the consequences are for the balance of payments.

LISAGOR:

Would you accept that, Professor Samuelson?

SAMUELSON:

Yes, I would. I will even applaud the day when we, when the statesmen of the world change the present system. Within the present system, I think up to that day that we have to do quite a lot of temporary …

LISAGOR:

We haven’t very much time. I’d like to ask a quick question of you. We have solved many of our problems in the past through the free play of market forces, also through expansionary devices. Today it seems to a great many people that we’re trying to solve them through contraction. Professor Samuelson, is that a valid statement?

SAMUELSON:

No, I think that we let the international balance of payments in fact interfere very little with our domestic prosperity in the 1960s. We’ve been urged to use deflation. That’s really what deGaulle and the surplus nations central bankers have asked. They want us to make the adjustment, they want us to make the adjustment by unemployment. We’ve refused to do so and we’re not in very bad shape on that account.

LISAGOR:

Gentlemen, I’m sorry, but we’ve run out of time. I would just like to summarize briefly here, it seems to me that Professor Friedman favors a free movement of men and goods and flexible exchange rates as solutions to our problems. Professor Samuelson seems to suggest that some measure of controls are necessary. The price of gold ought to continue to be
controlled. Both men agree that, as we’ve seen, that the problem is terribly complicated, not one simple cause, not one simple solution.

I want to thank our two guests for this evening, Professor Milton Friedman of the University of Chicago and Professor Paul Samuelson of MIT. And I also want to thank our audience for their questions.

Next week, our topic on Great Decisions will be “American Power and Foreign Policy.”

I’m Peter Lisagor. Good evening.

Notes