"A Dollar is a Dollar"

By Milton Friedman

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A dollar is a dollar is a dollar. But why should it also be exactly 7 English shillings, 1 penny, and 3 farthings; 4 French francs and 94 centimes, and 4 German marks?

The explanation is very different today than it was in an earlier era. In 1913, for example, anyone could take $20.67 to the U.S. Treasury and exchange it for one fine ounce of gold. He could take the ounce of gold to London, go to the Bank of England, and exchange it for 4 pounds, 4 shillings, 11 pence, and 1 farthing; or he could take it to Paris, go to the Bank of France, and exchange it for 107 francs and 10 centimes. As a result, the price of the pound could not vary much from its then official parity of $4.8665 or the franc from its then official parity of $0.1930.

If the pound became appreciably more expensive than $4.8665, alert U.S. financiers would get pounds, not by buying them on the market, but by exchanging dollars at the U.S. Treasury for gold, shipping the gold to London, and converting it into pounds at the Bank of England. If the pound became appreciably cheaper than $4.8665 (i.e. the dollar became more expensive) alert British financiers would get dollars by reversing the process. In this way, the cost of shipping gold set narrow limits—termed the "gold points"—on the price of the pound sterling.

That was a real gold standard. Gold circulated in the form of coin and gold certificates. Britain and the U.S. in effect had a common currency differing only in the names attached to an ounce of gold. Individuals were free to buy or sell dollars for pounds or pounds for dollars at any price. The price of the one currency in terms of the other stayed within narrow limits for the same reason and in the same way that the price of sugar in New York never deviates much from the price of sugar in Chicago—because if it did deviate, it would pay private traders to ship sugar.

The situation today is very different. The dollar and the pound are no longer names for different amounts of gold. They are names for separate national currencies. There still are official prices of gold. But these official prices serve primarily as a means to calculate the official price of the pound in terms of dollars ($2.80). Holders of paper money cannot automatically exchange it for gold at the official prices—indeed, since 1934, when the official U.S. price was raised to $35 an ounce, it has been illegal for U.S. residents to hold gold, except for numismatic or industrial purposes. Gold is now a commodity whose price is supported by governmental action—like butter. Gold no longer determines the quantity of money.

The price of the pound sterling is kept at $2.80, not by market forces, but by the British and U.S. governments who peg it at that level by buying and selling dollars and pounds at the official price. They can succeed only by controlling the amount people offer to buy and sell. In Britain, it is illegal for residents to trade pounds for dollars except with the permission of a government official. The U.S. still does not have explicit exchange control, but we have extensive informal controls—ask the businessman who seeks to invest abroad or the banker who seeks to lend abroad.

The pegging of exchange rates is the basic reason for our balance-of-payments problem—just as the pegging of rents is the basic reason for the housing "shortage" in New York City; the pegging of the price of silver for the rapid depletion of our silver reserves; the pegging of the price of butter for the accumulation of stocks of butter.

We should set the dollar free and let its price in terms of other currencies be determined by private dealings. Such a system of floating exchange rates would eliminate the balance-of-payments problem, thereby enabling us to abolish the income-equalization tax and informal exchange controls, and to move unilaterally toward freer trade.

Paradoxically, most leaders of the financial community are against this free-market solution. They confuse the present use of gold as window dressing with a real gold standard. Staunch opponents of government price-fixing in other areas, they support it in this one. They need to examine their clichés.

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