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The Great Debate Over a Strong Dollar

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Does the U.S. need a strong dollar policy?

The Kaufman Center played host to a debate on monetary policy Wednesday night. Officially the resolution under consideration was "America Doesn't Need a Strong Dollar Policy"—although what it really ended up being about was the wisdom of the gold standard.

The sponsor of the Wednesday night's debate was an outfit called Intelligence Squared U.S., which turns these things into podcasts, and public radio and television broadcasts.

On the floating rate, anti-gold standard side were Frederic Mishkin, professor of banking and financial institutions at Columbia Business School, and John Taylor, chairman and founder of FX Concepts. Steven Forbes and James Grant, editor and founder of Grant's Interest Rate Observer, argued for international fixed rates and a gold standard.

The audience was clearly more persuaded by Mishkin and Taylor. At the start of the debate, an electronic poll measured the audience as being 24 percent for floating rates, 29 percent against and 47 percent undecided. After the debate, a substantial portion of the audience had been won over to the anti-gold standard side, so that 54 percent of the audience was for Miskin-Taylor, 37 percent for Forbes-Grant and just 9 percent undecided.

I'm significantly more sympathetic than most financial journalists to the arguments for a gold standard. I used to be a hardcore gold standard advocate, although now I consider this position a bit like being against the printing press. Sure there are lots of negative consequences of making literature widely available but there's no realistic way of smashing the printing press. Better to concentrate on how to survive in a world of mechanically printed books (or digitally pixelated books) and fiat money than otherwise.

One of the arguments marshaled in the debate by the gold standard side, however, struck me as worth a bit more discussion. Grant argued that the status of the dollar as the global reserve currency was a disadvantage for the United States because it made the temptation to consume more than we produce irresistible—with the consequence that we have a perpetual trade deficit.

This is a point that sounds sensible to a lot of people—although it really shouldn't. At the national level, imports are benefits, exports a cost. When you import more than you export—that is, when you run a trade deficit—the benefits outweigh the costs.

Imagine for a moment that you are going to market in a barter society. You bring whatever it is you make with your craft, hoping to trade it with other folks who have what you need. Your goal is to leave the market with stuff worth at least as much as you produce. Optimally, you want to leave with stuff worth more than you produce—in other words, you seek a trade deficit. If you leave the market with less than you produce, you have a trade surplus, and you've lost out on market day.

The introduction of money does not transform this calculus. Neither does the extension of the model to the nation. We still want the stuff we send out to the rest of the world to be worth less than what we take from the rest of the world. If having a floating rate, nonconvertible fiat currency that is used as a reserve currency by central banks around the world helps us accomplish this goal, that's a benefit not a cost.

You don't have to be a free market fundamentalist to see this point. Even if you think that it's important to preserve, say, manufacturing jobs in the United States, your argument doesn't have to turn on the balance of trade. But it is weird to see the side most associated with free markets, the gold standard folks, relying on this kind of thinking.

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