SYMPOSIUM ON

Capital Flows, the IMF's Institutional View and Alternatives

Introduction

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John Taylor asked me to chair this session. He knows that I'm an outsider, so he gave me permission to make a few remarks from the perspective of an outsider on the topic here: capital controls and the IMF.

First of all, I spent about twelve years on the faculty at the University of Chicago, where one of my great friends was George Stigler. He and I were golfing buddies. George's office was across the hall from mine, and Milton was often there, so I got to know Milton and George, and I listened to them. They were out of my league—but still, I absorbed some ideas: for example, the marketplace is pretty good at sorting things out.

When I was secretary of labor, I was looking at changing our view of emergency disputes, discrimination in the workplace, and so on. One of my most interesting experiences was managing for the president the desegregation of schools in the South. That was a fascinating thing to do.

Then, all of the sudden, I'm the first director of the Office of Management and Budget. So suddenly it's a different world of taxes, revenues, and the like. When I arrive, I find that there's a big financial company called Penn Central that has badly mismanaged its affairs and is about to go bankrupt. Arthur Burns, chairman of the Fed, thought that if that happened, it would be a severe blow to the financial system. I thought it was a mistake; maybe it was the Milton and George in me. But as I'm arguing with Arthur, half of me is thinking, "What is a lousy labor economist doing arguing with Arthur Burns about financial markets?" All of the sudden, in comes a man named Bryce Harlow, one of the smartest, savviest political advisers ever in Washington. Bryce says, "Mr. President, the Penn Central, in its infinite wisdom, has just hired your old law firm to represent them in this matter. Under these circumstances, you can't touch this with a ten-foot pole." So there was no bailout, and what happened? The financial markets were strengthened. Yes, there was some kerfuffle, but everybody had to look at their hole card and say, "Hey, we'd better get straightened out because they're not going to bail us out," so it improved matters. It made an impact.

Before long, my friend Paul Volcker tells me there's going to be a run on the bank. I asked, "What do you mean?" He says, "There are more dollars out there than there is gold at Fort Knox. We're going to have to close the gold window." That led to a dramatic set of announcements by President Nixon of his new economic policy. I told him, "You'd better be careful, Mr. President, because that's what Lenin called his policy. It may not work." I thought it was a bad policy—wage and price controls, and so on—but I lost that battle.

At any rate, the exchange rate system at that point was in a total mess. John Connally was secretary of the Treasury. They negotiated something called the Smithsonian Agreement, which didn't work. So I asked the Treasury people, "What is your plan?" They said, "It's a secret." When, all of a sudden, I become secretary of the Treasury and I ask, "Okay, what is your plan?" they say, "We don't have one." I said, "Okay, I thought that was the case."

So we had to work on this problem, and I thought, going back to my Chicago days, that a floating exchange rate was the best answer.

Paul Volcker said, "Well, the Europeans and the Japanese want a par value system." I thought about that, and I called Milton, and we had a long series of telephone conversations. We decided on a program that was a floating exchange rate system in the clothing of a par value system. It was pretty neat. We worked on that, and I think as things evolved, it was a sort of sloppy, managed float, so here we are.

But then, a couple of decades or so ago, the IMF gets involved in countries that are in bad shape, and it bails them out. I'm thinking, "Hey, Penn Central: same old idea, same problem. The IMF is out of its jurisdiction. It's supposed to be about exchange rates." I wrote an article with Walt Wriston, who was head of Citicorp, and Bill Simon, who was my successor, saying that the IMF was way out of line and we ought to just get rid of it. Of course, nobody took that seriously.

At any rate, I now see that the IMF is worrying about capital flows, and I say, "Wait a minute, it's the same old problem. The problem isn't capital flows; the problem is the central banks creating more money than is useful in their own countries, and it's slopping around." So let's get it straight.

I have a suggestion. I've been to the bank fund meetings and they're lots of fun. The clan gathers. Why is it? Because both the IMF and the bank have money. But thinking about money is the wrong mindset for the IMF because it was put into place originally as a result of the currency manipulation and the protectionism during the Great Depression, and it was supposed to worry about the currencies. So it seems to me that the IMF is the other side of the coin of the trading system. The meeting should be between the WTO and the IMF. So my suggestion is: let the banks have monetary meetings. The structure of the meetings will get the IMF to think about its basic job, which is the trading system.