

September 9, 2002

The Dollar Standard and Its Crisis-Prone Periphery: New Rules for the Game

by

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After the financial debacles in Argentina and Brazil, commentators of all political stripes have criticized Paul O'Neill, the U.S. Secretary of the Treasury, and the International Monetary Fund. Alan Meltzer of the no bailout school, whose report for reforming the International Monetary Fund was submitted to the U.S. Congress in 2000, is predictably critical [*WSJ*, 7 Aug 2002]. But also critical is Ricardo Hausmann of the traditional IMF "let us consider each distressed country on its merits" school [*FT*, 14 Aug 2002].

In order to forestall losses of confidence in troubled international debtor economies, Hausmann and others want the IMF to intervene earlier rather than later—with much of the money given up front to prevent interest rates on domestic debt from rising to impossible levels. But Meltzer and company counter with the standard moral-hazard argument: First, if foreign creditors know that an agency like the IMF will provide new money in a crisis to make repayment more likely, they are more likely to overlend. Second, within developing countries, poorly regulated domestic banks—with deposit insurance and privileged access to their central bank—are more likely to overborrow internationally. By gambling at the government's expense through accepting dollar deposits to finance domestic loans, the banks can expose the whole economy to undue foreign exchange risk.

While their opinions seem to be in conflict with one another, both Meltzer and Hausmann are of course "right". They should be thanked for sharpening the terms of the debate. Nevertheless, a serious philosophical impasse remains: how should the IMF and the United States cope with currency crises in developing economies? We need better guidelines for when IMF or American interventions are warranted, and on how to minimize moral hazard in future official lending. Secretary O'Neill also needs to be reassured that American taxpayers' money won't be wasted in far away places. But in order to resolve the current philosophical impasse, let us first consider the special role of the U.S. dollar in international finance.

Definitive and Provisional Monies in International Exchange

Europe and the euro aside, the world is on a dollar standard. International trade and capital flows in Asia, Africa, the Americas, and Australasia are mainly invoiced in

dollars, governments hold their official foreign exchange reserves in dollars, and private foreign exchange markets are organized using the dollar as the vehicle currency. Thus, in order to preserve the purchasing power and international attractiveness of their domestic monies while minimizing foreign exchange risk, developing countries try (not always very successfully as in Latin America currently) to smooth fluctuations in their dollar exchange rates. The resulting currency asymmetry, a strong dollar as “definitive” money at the center and a fragile periphery, unbalances the world’s monetary system.

On the crisis-prone periphery, developing countries which are debtors live on sufferance: their domestic monies are only “provisional”. Apart from debts to international agencies such as the IMF and World Bank, their foreign debts are very short term and largely dollar denominated. Any economic or political disturbance at home provokes the suspicion that these foreign debts may not be repayable, and that the domestic currency will depreciate against the dollar. The resulting run into dollars then forces an increase in domestic interest rates: both on internal domestic-currency debt to slow the run, and, because of default risk, on dollar-denominated debt held both externally and internally.

As in Argentina and Brazil in the past year, such an increase in interest rates throws the public finances into deficit for two reasons: economic growth falls and so reduces current tax collections, and the interest costs of carrying public sector debt increase almost immediately because the debt is so short term. This fiscal double whammy further undermines confidence in the provisional domestic money: capital flight intensifies and normal bank lending to domestic industry dries up. In the worst case, as in Argentina, output falls sharply and the economy collapses.

But what about the biggest international debtor of all? After running trade deficits for more than 20 years, the United States is a net debtor: its liabilities exceed its claims on the rest of the world by about \$3 trillion. At about 25 percent of US GNP, America’s net international indebtedness is higher than that of any other industrialized country—and higher than, say, Brazil’s which is only 12 percent of Brazilian GNP. Yet, unlike Latin American currencies today, and unlike East Asian currencies in the great crisis of 1997-98, the dollar is not threatened by a loss of confidence. As long as its purchasing power is seen to be stable, i.e., as long as the Federal Reserve Bank keeps ongoing price inflation very low, the dollar cannot be attacked in the usual sense. Why?

In the 21st century, the dollar is definitive money—much like gold was in the 19th century. When frightened by events at home, foreigners have no more fundamental monetary asset into which they want to fly. In this sense, the dollar standard now is stronger than it was during the Bretton Woods period of the 1950s and ‘60s with fixed exchange rates. While other countries (outside the communist bloc) had fixed dollar parities, the United States still had a residual commitment to convert dollars into gold at \$35 per ounce. Although the foreign exchanges then as now were organized around the dollar as the vehicle currency, gold was the more fundamental asset. The dollar could be attacked (and was on occasion) as foreigners, speculating that the dollar price of gold might increase, rushed to convert their official dollar holdings into gold. However, this

gold convertibility commitment has long since lapsed, and the dollar today is not only the world's vehicle and reserve currency but also its most fundamental monetary asset.

Consequently, the US *alone* can go deeply into debt to the rest of the world in its *own currency*. Private foreigners happily build up their dollar deposits in American banks—Latin Americans particularly like Florida banks!—and purchase dollar-denominated industrial bonds and equities. Foreign central banks have accumulated, and continue to acquire, huge stocks of U.S. Treasury bonds. Indeed, almost half of those outstanding outside of U.S. government agencies are in official foreign exchange reserves. If the dollar depreciates, say 10 to 20 percent against the euro or the yen, the creditworthiness of American banks is not impaired because their assets and liabilities are both denominated in the same currency, i.e., dollars. And the US Treasury's capability of servicing its foreign dollar debts remains unchanged. Thus the dollar can fluctuate more or less randomly against the currencies of other industrial economies—as it has since 1971—without provoking a banking or currency crisis.

In contrast, when developing countries—such Argentina or Brazil—allow their domestic currencies to depreciate, the value of their banks' peso-denominated assets falls relative to their dollar-denominated international liabilities, which are generally very short term. Thus, when exchange rates fluctuate, peripheral countries are more vulnerable to bank runs than is the center country. Similarly, a depreciation of the peso impairs the ability of the government of Argentina, whose tax revenues are in pesos, to service its dollar debts.

Thus it is not surprising that developing countries the world over exhibit “fear of floating”, as neatly shown by Calvo and Reinhart [2002]. In noncrisis periods, they peg “softly” to the dollar. Even though most no longer have official dollar parities, they remain anxious to smooth fluctuations in their dollar exchange rates.

The United States as Lender of Last Resort?

Because of this financial asymmetry, the United States is the natural lender of last resort to debtor economies in Asia, Latin America, and elsewhere on the dollar's periphery. Only the United States has the power to create “international base money” and is itself invulnerable to an attack on its currency. Consequently, financial crises the world over potentially land on America's doorstep. True, the IMF remains the immediate crisis manager—the world's crisis lender of first resort. The Fund's own dollar-based resources are sufficient to deal with smaller crises. But really big rescue operations such as for Mexico in early January 1995 and for Brazil in August 2002 require supplemental funds from the American Exchange Stabilization Fund or, at the very least, American acquiescence before the program can go through. Indeed, officials from the U.S. Treasury often accompany, or closely follow, IMF missions to financially stricken developing countries—as in the East Asian crisis of 1997-98.

Although this asymmetry between the dollar and the currencies of developing countries is just an accident of post World War II history, it is neither widely understood

or accepted. Indeed, political correctness in international treaty organizations—including in the IMF itself—requires that all members be treated pro forma as equals. In order not to appear to be in thrall to the United States, the majority of developing countries which peg to the dollar to some degree or other tend to classify themselves as “managed floaters” or “freely floating” if only to placate the IMF.

But the country most in denial of how the world dollar standard works is the United States itself. Apart from an isolationist fringe, mainstream American politicians and economists (except specialists in international finance of course!) see the United States as a very large economy by world standards, but they do not see it as one with special monetary characteristics. Instead, the US is simply seen as having the most successful form of market capitalism. This common view has it that the U.S. can easily attract capital from the rest of the world sufficient to cover its ongoing trade deficits because investment opportunities within the American economy are so much better than elsewhere. Insofar as a currency crisis in a developing country results in capital flight to the United States, Americans see this mainly as a fault within the country in question.

From this mainstream perspective, it is not surprising that incoming presidents continually vow “no more bailouts”, as with George W. Bush and the Meltzer report. Yet when some great crisis on the periphery occurs, as with Mexico in late 1994 or Brazil this August, a reluctant America is finally dragged in to make emergency loans—perhaps too little and too late. Meanwhile, many financially fragile developing economies in Latin America and elsewhere are becoming even more fragile.

My contrarian view holds that it is America’s central monetary position that permits it to attract such immense amounts of capital from the rest of the world at very low interest rates. Foreigners demand international dollar liquidity—whether it be individuals holding dollar bank accounts or foreign governments holding US Treasury bonds. Over the last 20 years, the United States has chosen to use its privileged access to foreign capital to run very large trade deficits. (In the 1950s and 1960s, the US ran trade surpluses while still providing the rest of the world with the monetary liquidity it demanded.) The upshot is that America’s unique capacity to attract capital from the rest of the world makes it the natural lender of last resort to other countries not so favorably situated. Much of this lending would simply recycle the capital flying into dollars from recurrent financial crises in the peripheral countries.

Fragility on the Periphery

In contrast to the United States, why are peripheral countries so much more financially fragile? And whose fault is it? True, many have completely inadequate domestic fiscal processes: they are incapable of raising taxes and resort to the printing press to finance fiscal deficits. But, in my contrarian view, even responsible countries are victimized by the “system”. International currency asymmetry makes even well conceived economic policies much more difficult to implement on the periphery than at the center. Because their monies are only provisional and not definitive (see page 2), developing countries usually run with risk premia in their interest rates (making them

higher than on dollar assets) and so strain their government budgets. In addition, within trade connected regions—such as East Asia or Latin America—a currency attack and devaluation in any one country upsets the fragile financial equilibria of the others. In short, being minister of finance in Argentina, Brazil, Thailand, or Indonesia, is much more difficult than being the US Secretary of the Treasury!

New Rules for the Dollar Standard Game

Suppose that the American government finally recognizes its central position in the world monetary system and the “unfair” asymmetry in current financial arrangements. It also becomes determined to reduce financial fragility on the American periphery—looking at the periphery as being a *collectivity* of developing countries whose regional fortunes interact. The IMF as lender of first resort would stay as crisis manager, but the US itself would formally agree to be the residual source of finance—the lender of last resort. The combined IMF-U.S. entity would have sufficient resources to act sooner and more assuredly to limit financial crises on the periphery.

What then would be appropriate rules for this new relationship between the United States and developing countries on its periphery? What is the appropriate conditionality on which crisis lending should be based? Recognizing the underlying currency asymmetry, consider first a set of rules for the developing countries. Then follow with complementary rules governing the position of the United States itself.

In the accompanying Box, rules 1 through 4 apply to the developing countries. These rules are intended to be guidelines for policy makers there and for professional advice-giving financial-support organizations such as the IMF or World Bank—or even the U.S. Treasury.

Rules 5 through 8 in the Box apply to the center country. Besides identifying the role of the United States as lender of last resort, these rules restrain American behavior. Their success depends mainly on the United States’s understanding the underlying currency asymmetry in the world economy, and then of its own volition doing something about it. International agencies have very little leverage over American behavior.

These eight rules are hardly all encompassing. Yet they go some distance to resolve the philosophical impasse over the dangers of moral hazard in international rescue operations versus the need to take collective action to prevent a financial breakdown in one country from spreading to neighboring ones.

New Rules for the Dollar Standard Game

Developing Countries

- Rule 1.* Recognize that the greater fragility of financial systems on the periphery requires prudential financial regulations more stringent than those appropriate within the industrial economies. To supplement domestic regulatory restraints on foreign exchange exposure by banks, capital controls may be needed.
- Rule 2.* Recognize that “soft” pegging to the dollar helps reduce risk in peripheral countries whose domestic financial markets are incomplete—and becomes absolutely necessary in the presence of capital controls or severe limits on net foreign exchange exposure by banks. Desist from advising them to float their exchange rates against the world’s dominant money, and against their neighbors.
- Rule 3.* Aim for mutual exchange rate stability within natural economic regions such as South America or East Asia. Lend collectively through regional stabilization funds as well as to individual distressed economies. Using the dollar as the anchor currency, set long-term exchange-rate objectives for the group to limit contagion from beggar-thy-neighbor devaluations.
- Rule 4.* Restrict short-term private borrowing by countries under IMF or World Bank programs. Private and sovereign debt contracts must provide for the deferral of repayment should that country be declared in crisis.

United States

- Rule 5.* Conduct an independent monetary policy to limit inflation and stabilize the purchasing power of the dollar. Provide a stable nominal anchor for the price levels of developing countries.
- Rule 6.* Supplement the resources of the IMF in major crises and, if necessary, act as lender of last resort—subject to the conditionality laid out in Rules 1 through 4.
- Rule 7.* In noncrisis periods, remain passive in the foreign exchanges without exchange rate targets. Allow foreigners to transact freely in dollars. No capital controls for the center country.
- Rule 8.* Do not force developing countries to open their financial markets—and cease pushing the entry of American banks and other financial institutions into their domestic economies.

Moral Hazard

Rules 1 and 4 deal with both sides of the moral hazard problem. Because banks in developing countries have some type of deposit insurance (often informal) and face higher interest rates on accepting deposits in the domestic currency, Rule 1 curbs their instincts to gamble and *overborrow* by accepting lower cost dollar deposits from foreigners to finance domestic loans. Then Rule 4 reduces moral hazard to *overlend* by international banks and other short-term creditors. Should there be a general attack on the domestic money, suddenly they would become long-term lenders. (Something like Rule 4 has been mooted by the IMF for restructuring sovereign debt, but Rule 4 would cover private foreign debts as well.) Rules 1 and 4 would nudge peripheral countries away from short-term borrowing in favor of longer-term sources of finance.

Beggar-thy Neighbor Devaluations

Rules 2 and 3 address the pressing need to achieve exchange rate security on the periphery. After the breakdown of the original Bretton Woods system of fixed dollar parities in 1971-73, prevailing doctrine in the industrial countries swung in favor of floating exchange rates. In 1976, Article IV of the IMF charter was amended to eliminate any obligation of member countries to maintain official exchange rate parities. For industrial countries with complete domestic financial markets, floating is tolerable and was even desirable in the great inflation of the 1970s. In contrast, developing countries where domestic financial markets are incomplete and their domestic monies are only provisional, find that the risk of a free float is too great. The resulting “fear of floating”, where they try to key on a major currency usually the dollar to smooth fluctuations in their exchange rates, has been well documented by Calvo and Reinhart [2002].

In good times, this informal keying on the dollar is sufficient to maintain mutual exchange stability, as in East Asia before the crisis of 1997-98. In bad times, however, we now know that this informality in exchange rates is insufficient to prevent currency contagion and a round of inadvertent beggar-thy-neighbor over devaluations. Before spreading throughout the region, the East Asian crisis began with an attack on, and over devaluation of, the Thai baht.

In South America, mutually destabilizing devaluations go on continually—rather than being so obviously bunched as in East Asia in 1997-98. In 1991 in a much praised experiment, Argentina successfully stabilized the peso against the dollar as the anchor for ending near hyperinflation. After 1997, Argentina’s international competitiveness was undermined by currency depreciations in Brazil, Chile, and Uruguay. Even more distant neighbors such as Australia and Russia, which produce competing primary products, also managed to get themselves undervalued in the late 1990s. The result was the attack on the “overvalued” peso and a collapse in Argentina’s economy in late 2001.

But the story is not yet finished. In 2002 Brazil itself is in trouble—in part because of Argentina’s example and also from the steep depreciation of the Argentine peso. Chile is the one country that seems relatively unscathed from the turmoil in the

Southern Cone. However, it only managed this by allowing the dollar value of the Chilean peso to drift downward by about 40 percent from mid 1999 to mid 2001—thus increasing the pressure on its neighbors. Because of these negative spillover effects, Latin America seems to be entering a new “lost decade” paralleling that of the 1980s.

Recapturing the Spirit of Bretton Woods?

It was not supposed to be this way. After all, the IMF was set up in 1945 with all countries adhering to formal exchange rate parities. The idea was to prevent beggar-thy-neighbor depreciations of the kind that wracked the industrial countries under the international gold standard in the 1920s and 1930s. The chain probably began with the Poincaré devaluation and then stabilization of the French franc in 1926 that made France “too” competitive and drained gold from the beleaguered British. The 1931 British devaluation then worsened the competitive positions of the United States and Germany—and so quickened the onslaught of the great depression in these two countries. After the United States devalued and left the gold standard in 1933, the pressure returned full circle to haunt France who was now uncompetitive and finally forced off the gold standard with a devaluation in 1936.

So, in the IMF Articles of Agreement of 1945, formal exchange rate parities that could not be changed without the IMF’s permission were seen as bulwarks against untoward changes in exchange rates. “Never again” would adverse cross-country spillover effects rule the roost. However, to recapture the spirit of the 1945 Bretton Woods Agreement today, one must first recognize the major institutional changes that have occurred.

The robust dollar standard of the new millennium differs from the dying gold standard of the 1920 and 1930s in many ways. In the earlier era, the world’s gold monetary base had become much too small to prevent deflation. In contrast, Alan Greenspan and company now have control over the American (dollar) monetary base, and have been willing to expand it vigorously if need be. So, unlike the 1930s, forced deflation in the industrial world is not a problem. There is now no need to introduce an international clearing currency such as bancor, which Keynes wanted to prop up aggregate demand in the world economy. As per Rule 5, it is sufficient for the United States to act independently to stabilize its own price level.

The current situation is also different because the industrial economies have adapted to floating exchange rates. With developed long-term bond markets, any industrial country can opt to float its exchange rate. If the euro/dollar rate moves up or down by 10 to 15 percent, this does not precipitate any domestic financial crisis—although it is of great concern to Airbus and Boeing! Therefore, one can tolerate fluctuations between the US dollar and sterling, the Swiss franc, the euro, and the Canadian dollar, and the currencies of other industrial countries¹.

¹ The yen is a different matter and we have argued elsewhere [Goyal and McKinnon, forthcoming] that Japan’s low interest liquidity trap can be attributed to fluctuations in the yen/dollar exchange rate.

Instead, the IMF's main focus should be on the need for mutual exchange rate stability in the financially fragile periphery. Largely inadvertent beggar-thy-neighbor devaluations have been, and are, a highly upsetting influence. But what form should new parity obligations among peripheral countries's currencies take?

Long-term Exchange Parities (Rule 3)

Take the easy case first. Consider a group of countries without ongoing fiscal imbalances or recurrent out-of-control inflation. The East Asian countries before 1997 pretty well satisfied this criterion—and with the recovery seem to be satisfying it once more. (The major exception is Indonesia.) Except for Japan, they have a history of softly pegging to the dollar and now three important countries are more or less formally pegged to the dollar—China at 8.3 yuan, Hong Kong at 7.8 HK dollars, and Malaysia at 3.8 ringgits. With these three forming a nucleus of stable exchange rates, other major players in the region—such as Korea, Singapore, Taiwan, and Thailand—can more easily secure their exchange rates: both the baht and won have recovered most of their dollar value since the overshooting depreciations of the 1997-98.

What should the initial dollar parities be? As long as today's exchange rates are approximately right in the sense of purchasing power parity (PPP), then mutual pegging to the dollar at today's rates is feasible and highly desirable for the exchange rate security for the group. But the normal riposte is "suppose the fundamentals change" and today's exchange rate turns out not to be the equilibrium rate in the future. Wouldn't it then be a mistake to have fixed the exchange rate? In response to this common criticism, I would make two points:

- (1) The only "fundamental" that is important for the exchange rate is domestic monetary policy. One can show [McKinnon 2002] that so-called real shocks are better dealt with in a common monetary area where exchange rates don't change.
- (2) As long as the starting nominal exchange rate is not far from true PPP, the economy will grow into it over time.

China neatly illustrates (2). After consolidating the official exchange rate with informal regional swap rates in 1994, a unified exchange rate was set more or less accidentally at 8.3. China then proceeded to grow into it, having experienced internal inflation in 1994-95 and externally imposed deflation in 1997-98 from the Asian crisis. Luckily for the other smaller economies in the region, China did not also devalue and has kept the rate constant to the present day.

In what sense should this proposed new parity regime be long run? Unlike China with its capital controls, foreign capital flows frequently surge in countries like Korea. Of course the first best-solution is to restrict such hot money flows as per Rule 1. But failing this, what can the Korean authorities do? Suppose they announce their long-term parity rate to be 1,600 won per dollar—which, on that day, corresponds to the actual market

rate. In noncrisis circumstances, the Bank of Korea (BOK) agrees to keep the rate within an informal “soft” band around 1,600 won per dollar.

But suppose Korea experiences a massive new capital inflow that puts upward pressure on the won. The BOK cannot contain it by purchasing dollars for won without losing control of its monetary base—thus threatening future domestic inflation. Then the optimal strategy for the BOK is to announce a *temporary* suspension of the official parity of 1,600 won per dollar. Simultaneously, the BOK also announces that it intends to nudge the rate, now say 1,500, back toward 1,600 within a few months—as soon as practicable. If credible, the big advantage of this strategy is that it sets up regressive expectations in the foreign exchanges. The apparent yield to foreigners of investing in short-term won assets is reduced because of expected depreciation of the won over the next few months. Thus the capital inflow will slow and perhaps even be reversed. But for this containment policy to succeed, everybody must believe that the government (with IMF support and encouragement) is serious about maintaining its parity of 1,600 won per dollar into the indefinite future.

The argument is symmetrical. If Korea suddenly experienced a sufficiently sharp capital outflow such that the BOK could not prevent a depreciation without undue contraction of its monetary base, again it would announce a temporary suspension of the 1,600 parity rate. But the BOK’s stated intention would be nudge the won back up when the dust settles. This expected future appreciation of the won would then curb the capital outflow while limiting the extent of the initial depreciation, and also limit the necessary increase in short-term interest rates. If, as in the 1997-98 crisis, Korea’s official exchange reserves are inadequate to make a credible commitment to nudge the won back up, the IMF or a suitable regional stabilization fund could then step in with the necessary loan.

From the broader point of view of stability in the whole East Asian region, long-term parity commitments have the advantage of limiting contagion in the presence of volatile hot money flows. Although others in the region would see the Korean authorities suspend their 1,600 rate as a response to the sharp capital outflow, they would not fear for their competitive positions if they saw that the moderate depreciation of the won was temporary.

Finally, collective action by East Asian countries to announce that each was establishing a long-term exchange rate parity would make such a policy more credible for any one of them. Put the matter the other way around, if only one East Asian country by itself announced a long-term dollar parity, it would be less credible because of the possibility of exchange rate shocks from other countries. But if they all declare parities, credibility all around would be high. And East Asia is fortunate that three countries already have fixed dollar exchange rates.

Although such a system of generalized dollar parities could work without Japan, fluctuations in the yen/dollar exchange rate are a disturbing influence—and indeed create a synchronized business cycle in the smaller East Asian economies [McKinnon and

Schnabl 2002]. So it would be much better if Japan, necessarily assisted by the United States, implemented a long-term parity for the yen/dollar rate. And because a credible long-term yen/dollar parity is the key to escaping from the liquidity trap, Japan itself would be the biggest beneficiary [Goyal and McKinnon, forthcoming].

Long-term nominal exchange parities for inflation-prone Latin American countries are a different story—and, unlike East Asia, are not generally feasible in the near future. In Latin America, stabilizing “real” (inflation adjusted) rather than nominal exchange rates is more relevant—and a much trickier calculation to make. However, some principles from our East Asian paradigm could still hold. Should any Latin American country experience a crisis and an uncontrolled devaluation of its currency, then establishing regressive expectations by nudging it back up is all important for that country (to prevent real interest rates from increasing) and of course for its neighbors. So the economic consequences for Argentina of sharp devaluations by Brazil in 1999-2001 could have been ameliorated by such a policy. Moreover, the IMF should monitor and then flag countries who, consciously or unconsciously, let their currencies get undervalued—as with Chile’s downward float of almost 40 percent between mid-1999 and mid 2001.

Conclusion

An important reason for the great financial instability in developing countries is the doctrinal failure to come to grips with international currency asymmetry. Most of the world is on a dollar standard with a strong central money where one set of rules is appropriate, and a periphery of more fragile monies where a somewhat different set of rules and modes of operation are necessary (see Box).

One manifestation of this doctrinal failure has been the advice commonly given to developing countries “float your exchange rate and open up your domestic capital to foreign capital flows and foreign banks”. Here, I have tried to show that such advice is misplaced for most developing countries, which need to cosset their financial systems until they become industrialized and their long-term bond markets are developed. Even more serious is the failure of such advice to consider cross-country spillover effects from changes in exchange rates. On the periphery, exchange rate policy should be a collective endeavor within economic regions whose economies are linked in trade and finance.

In contrast, the capital markets for the center country, the United States, must remain open so that foreigners can freely transact in, and hold, dollar assets at all terms to maturity. Otherwise the world’s payment mechanism would be seriously impaired. So too should the United States generally remain passive in the foreign exchange markets except in major crises where its unique access to capital makes it the natural lender of last resort. Finally, the United States should not use leverage from its central position the international monetary system (which, after all, is just an accident of history) to push the commercial interests of American commercial and investment banks in foreign markets.

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