EDITOR'S NOTE

This issue of the *Cato Journal* features articles that were first presented at the Cato Institute's 25th Annual Monetary Conference, November 14, 2007. The theme of that conference—**Monetary Arrangements in the 21st Century**—raises important questions about the types of monetary regimes that best protect the value and stability of money while promoting economic freedom.

The hyperinflation in Zimbabwe reminds us of the chaos that government fiat money can create when state-run central banks misuse their discretionary powers. Milton Friedman and Anna Schwartz were right when they wrote in their monumental *Monetary History of the United States*, "Inflation is always and everywhere a monetary phenomenon." Yet the idea seems to persist that a little monetary stimulus can be good for economic growth.

The world's preeminent central bank, the U.S. Federal Reserve Bank, still has a *dual mandate*: to achieve maximum employment and price stability—even though it is evident that the Fed, or any central bank, cannot control the real variables that determine long-run growth, such as the quality of institutions and technology. But the Fed can destroy growth by monetary mismanagement, as we learned from the "Great Contraction" of the 1930s and the stagflation of the 1970s.

In the lead article, Federal Reserve Chairman Ben Bernanke argues that greater transparency in communicating with the public is beneficial for meeting the Fed's dual mandate. At the conference, he made an important announcement that the Federal Open Market Committee would henceforth expand and extend its forecasts to better inform the public. He details those changes in his article and also reminds us of the limits of monetary policy: "In contrast to inflation, which in the long run is determined by monetary policy, the rates of economic growth and unemployment that can be sustained in the long run are determined by many factors outside the control of central banks."

One country that is trying to develop its monetary institutions and that will become ever more prominent in global capital markets is China. Yi Gang, assistant governor of the People's Bank of China, gives a detailed view of the evolution of China's exchange rate regime and argues that real reform takes time, so the West should be patient. The articles by Eddie Yue and Dong He, John Greenwood, and Fred Hu discuss the future of the renminbi, including the problem of conducting monetary policy when the PBC tries to control both the exchange rate and inflation, the costs of sterilization (i.e., draining excess liquidity stemming from the purchase of foreign exchange to peg the renminbi at an undervalued rate), and the impact of the renminbi on the Hong Kong dollar and the global economy.

Arnold Harberger provides important insights from a review of the fundamentals of monetary and real exchange rate economics while Miranda Xafa considers what we have learned from experience with alternative exchange rate regimes and with capital controls. She holds that capital account liberalization is an important policy objective that does *not* require flexible exchange rates but does require financial sector reform. Marvin Goodfriend makes the case for price stability and flexible exchange rates within the now widely adopted "new neoclassical synthesis" model. His analysis sheds light on the difficulty faced by central banks that simultaneously try to peg the exchange rate and use the interest rate as an instrument to achieve price stability.

The articles by Anna Schwartz, Antonio Martino, Steve Hanke, George Selgin, and Richard Timberlake all deal with aspects of Milton Friedman's monetary economics—from the legacy of Friedman to his view of the euro, his perspective on when to float and when to fix, his position on currency competition, and his devastating critique of the Fed's failure to prevent the Great Contraction (1929–33).

In the final article, Surjit Bhalla presents new evidence to support a link between an undervalued real exchange rate and economic growth. He concludes, "The pattern of investments and economic growth can in large part be explained by the level, and change, of currency undervaluation." Moreover, he finds that "the real exchange rate is policy determined," implying that policymakers can deliberately spur growth by undervaluing the exchange rate. Such behavior, however, is likely to cause distortions, and the question remains whether the impact on growth is sustainable.

I thank Cato's Founder and President Ed Crane for his support of the Annual Monetary Conference over the last quarter century, and the contributors to this volume for their diligence in preparing their conference papers for publication.

—J. A. Dorn