

MILTON FRIEDMAN'S 1971 FEASIBILITY PAPER

Leo Melamed

The story is fairly well known. In 1971, as chairman of the Chicago Mercantile Exchange, I had an idea: a futures market in foreign currency. It may sound so obvious today, but at the time the idea was revolutionary. I was acutely aware that futures markets until then were primarily the province of agriculture and—as many claimed—might not be applicable to instruments of finance. Not being an economist, the idea was in need of validation. There was only one person in the world that could satisfy this requisite for me. We went to Milton Friedman. We met for breakfast at the Waldorf Astoria in New York. By then he was already a living legend and I was quite nervous. I asked the great man not to laugh and to tell me whether the idea was “off the wall.” Upon hearing him emphatically respond that the idea was “wonderful,” I had the temerity to ask that he put his answer in writing. He agreed to write a feasibility paper on “The Need for Futures Markets in Currencies,” for the modest stipend of \$7,500. It turned out to be a helluva trade.

In celebrating Milton Friedman's centennial in 2012, it is instructive to marvel at his legendary prescience by again reading his 1971 paper. Keying off on President Nixon's closing of the gold window on August 15, something that he had urged the president to do, Friedman asserted that the system of fixed exchange rates “is now dead.” It was! Today, the financial world is predominantly based on floating rates and could not possibly function without flexibility in foreign exchange—a system we continuously recommend to our

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Chinese friends. Most notably, Friedman's paper stated, "Whatever else happens in international financial arrangements," there will be "a major need for a broad, widely based, active, and resilient futures market." The phenomenal growth and expansion of financial futures of every form into every corner of the globe is irrefutable evidence of the verity of this assertion.

Would we have proceeded without Friedman's affirmative response? There is no way to know. What I do know is that Friedman's paper gave us the courage and foundation upon which to face down an army of naysayers and launch the International Monetary Market (IMM), the first futures exchange for the express purpose of trading in financial instruments. The rest is history. The Chicago Mercantile Exchange (CME Group) is today a publicly listed company valued at near 20 billion dollars whose trading volume is composed of 93 percent financial and other nonagricultural products. Today, financial futures markets represent a broad, widely based, active, and resilient global industry whose instruments provide risk management capabilities for nearly every facet of finance and beyond. Just as Milton Friedman asserted.