

Econ 340

Lecture 16 Fixed versus Floating Exchange Rates

Outline: Fixed versus Floating Exchange Rates

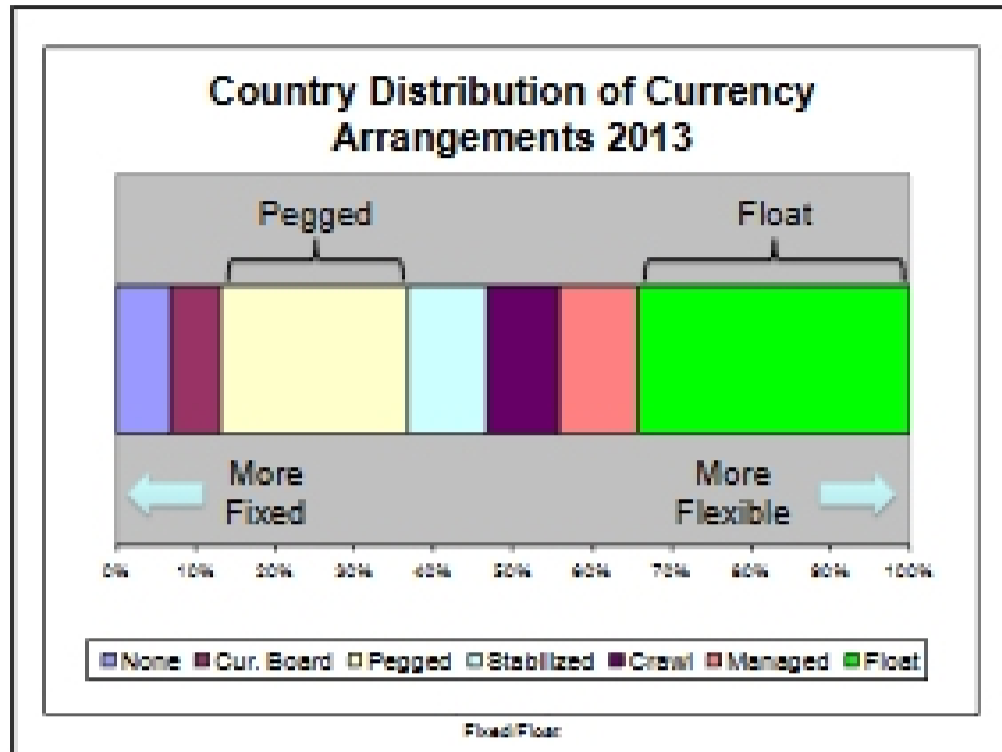
- Both Systems Are Used
- What the "Experts" Recommend
- Pros and Cons of Floating
 - Disruption When Rates Move
 - Automatic Adjustment
- Pros and Cons of Pegging
 - Stability
 - Instability
- Alternatives
 - Crawling Peg
 - Monetary Unification
- The Problem of Undervalued Currencies

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Who Uses Fixed and Float

- Lessons from the list of exchange arrangements (below)
 - Floating rates are used by many countries
 - Rich & poor
 - Large & small
 - All over the world
 - Pegged rates are used today mostly by small countries
 - Many countries are between fixed and floating
- (Source of table below: IMF, "Annual Report on Exchange Arrangements and Exchange Restrictions 2008")

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- ### Outline: Fixed versus Floating Exchange Rates
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- ### What "Experts" Recommend
- Some favor freely floating rates
 - Let exchange rate adjust to fix imbalances
 - "Let the market work"
 - Others favor perfectly fixed rates
 - Define currency rigidly in terms of something you can't control
 - Gold
 - Foreign currency ("Currency Board")
 - AND give up control of the money supply
 - Let flows of money fix imbalances
 - i.e., do not sterilize!
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