QUESTIONs - CHAPTER 23 EXCHANGE RATE REGIMES

Question 23.1

23.1A A nation might try to achieve three main policy objectives, namely monetary policy independence, a fixed exchange rate, and international capital mobility. What are the merits of each of these objectives? Why are they desirable?

23.1B Since the year 2000, US policymakers have grown concerned about the exchange rate between the US dollar and the Chinese yuan. Effectively, the yuan was fixed to the dollar at a rate they considered to be inappropriate. Moreover, China was able to maintain some monetary independence. What does this imply for capital mobility?

23.1C The buoyant growth of the Chinese economy in the 21st century has attracted a lot of capital towards China. Given that capital restrictions are hard to enforce perfectly, Chinese money growth has been rapid. What does this imply for monetary policy independence?

23.1D As the Chinese economy integrates ever more tightly into the global economic system, capital restrictions will become ever harder to enforce. What policy options do the Chinese monetary authorities have in light of this development?

Question 23.2

23.2A At the end of the 19th century many industrialized nations moved to a gold standard. Several drawbacks to this standard are discussed in the text. One is that the rate of inflation is influenced by the discovery of gold supplies. Explain why this is so.

23.2B The IMF has various classifications for different exchange rate regimes. How would you classify the gold standard? Explain.

23.2C The First World War effectively ended the gold standard era. Can you explain, with the help of the policy trilemma, why the start of the First World War caused policymakers to change their monetary arrangements?

23.2D When the Great Depression hit in 1929 countries often engaged in beggar-thy-neighbour policies. Can you explain how this works?

23.2E The Bretton Woods Agreement sought to enact a new and stable international monetary order. This order eventually broke down due to diverging economic policy interests. Explain with the policy trinity (for the United States, Germany, and Japan) how this came about.
23.2F The Bretton Woods Agreement was brought down by the n-1 problem. Is the n-1 problem typical for all exchange rate regimes?

Question 23.3
23.3A In the past decades a significant number of Latin American countries have moved towards dollarization. What is dollarization and how would you classify this arrangement?
23.3B What motivations could these governments have to dollarize? Why didn’t they yenize, or rupeeize?
23.3C Some economic analysts have argued that only corner solutions for exchange rate regimes are sustainable in the long run. They believe that only a fully floating currency or a very solid fixed arrangement (currency board or separate legal tender) is durable. Explain why this might be so.
23.3D Do we observe the corner solutions argument in practice?
23.3E Of the rich industrialized economies (US, Japan, euro area), none have a fixed exchange rate regime. Explain why this is so using the policy trilemma.

Question 23.4
The openness and transparency of the Fund has increased significantly in the past decade, particularly in response to external criticism of its conduct. On the IMF website, you can find some frequently asked questions to the fund, of which many relate to these criticisms. Moreover, you can find a factsheet on economic crises and the Fund.
23.4A How does the IMF help to resolve economic crises?
23.4B What is the moral hazard problem associated with IMF lending?
23.4C Does the Fund impose austerity on countries in difficulties?
23.4D Graph the development of IMF credit outstanding through time. What picture emerges? Which countries are currently the biggest lenders of the Fund?

The governance structure of the IMF is under pressure due to the rising economic importance of Asian countries.
23.4E Find out whether the same holds true for the World Bank by visiting its website and investigate the voting power of member states. What is your conclusion?

Question 23.5
In its Economic Issues No. 13, the IMF discusses the merits of fixed or flexible exchange rates. The title of the paper is: Fixed or Flexible? Getting the Exchange Rate Right in the 1990s. You can find this paper on the IMF website.

23.5A Which exchange rate regime (fixed, flexible) is considered superior in terms of economic performance (growth, inflation rate)?

23.5B Which regime is more crisis prone in practice?

23.5C Why should small and open economies adopt fixed exchange rates?

23.5D What is the trade-off between credibility and flexibility and how is it related to exchange rate regimes?

23.5E Which considerations determine the type of exchange rate peg a country might choose?

23.5F Why does sterilization only work in the short run?

23.5G What is the importance of banking systems for exchange rate regimes?

Question 23.6

The Excel file for question 23.6 has data on foreign exchange reserves for a group of countries. One of the current policy issues is the build-up of foreign exchange reserves by central banks in developing countries.

23.6A When did this build-up start in earnest for the Asian countries? And when for Saudi Arabia? Can you explain why?

These huge foreign exchange reserves are mostly held in US dollars, and thus represent claims on US production.

23.6B What would happen to the value of the dollar if central banks stopped purchasing these dollars?

23.6C What would happen to the value of their reserve holdings?

23.6D What interest does the IMF have in this issue? Why is it worried about this development?

23.6E Some economists have described the current financial system as a “new Bretton-Woods”. Can you explain why?