Exchange rate stability

I am an avid reader of *Finance & Development* and I generally applaud its policy recommendations and economic analysis. I was dismayed, however, at "The Case Against Benign Neglect of Exchange Rate Stability" (*Finance & Development*, September 1999) by Benoît Coeuré and Jean Pisani-Ferry. Their analysis of exchange rate regimes is plagued by the same form of Keynesianism that has brought stagnation to most of Europe.

While the authors' advocacy of coordinated responses to macroeconomic shocks is right on target (especially as it applies to Russia), the theoretical underpinnings of their exchange rate analysis are troubling (as is their preternatural fear of "instability"). Foremost, their assertion that exchange rates are "public goods for the world economy" troubles me greatly. Exchange rates are not goods per se, they are prices, conduits of information that translate millions of bits of data into simple form for investors. Saddling larger countries with the white man's burden of maintaining exchange rates as a public good will inevitably cause distortions and misalignments, as prices are kept either artificially high or low.

In fact, it is this other lever of government action, fiscal policy, that Messrs. Coeuré and Pisani-Ferry neglect. While "wide swings" in currency exchange rates may have a destabilizing effect for some countries, the market signals that rate fluctuations send often point to other nefarious goings-on. Meddling in monetary policy is usually symptomatic of government failure in fiscal policy (witness Malaysia's troubles over the past two years); without a concerted attempt to rectify fiscal profligacy, tinkering with exchange rates will only perpetuate misalignments and cause distortions elsewhere in the economy.

How can any government have ALL the knowledge available to set an appropriate rate (or even band) for its currency? It's impossible: the only way this knowledge is imparted is through the market, as with floating rates. While there is no denying the presence of politics in exchange rate policies, the more Pareto-optimal solution is pressing for market-responsive and open exchange rate regimes, rather than sustaining the Keynesian belief in ability to control the system.

Christopher A. Hartwell
Reason Public Policy Institute
Los Angeles, CA