
Conclusion

The reference rate proposal was one of the first ideas to be developed for disciplining the intervention policies that countries pursue in a world of floating exchange rates. A hint of the idea appeared in the Interim Guidelines for Floating, which the IMF developed in 1974,¹ but then the idea got submerged in the more laissez-faire version of floating that the IMF adopted after the Second Amendment of the Articles took effect in 1978. When the Institute for International Economics developed ideas for a more structured international monetary system in the 1980s, we focused on ideas for target zones for exchange rates, rather than guidelines for floating. However, it has now become clear that most large countries value the freedom that floating offers and are unwilling to accept the constraints on their freedom of action implied by a target zone system. That is why this study has asked whether some of the substantive advantages in a target zone system could still be reaped with a system that preserves the lack of obligation

1. Guideline 3 read: "(a) If a member with a floating rate should desire . . . to bring its exchange rate within, or closer to, some target zone of rates, it should consult with the Fund about this target and its adaptation to changing circumstances. If the Fund considers the target to be within the range of reasonable estimates of the norm for the exchange rate in question, the member would be free . . . to act aggressively to move its rate toward the target zone. . . . (b) If the exchange rate of a member with a floating rate has moved outside what the Fund considers to be the range of reasonable estimates of the medium-term norm for that exchange rate to an extent that the Fund considers to be likely to be harmful to the interests of members, the Fund will consult with the member, and . . . may encourage the member . . . (i) not to act to moderate movements toward this range, and (ii) to take action to moderate further divergence from the range. A member would not be asked to hold any particular rate against strong market pressure" (De Vries 1985, 488–89).

to hold the line at a particular exchange rate (which means with a floating exchange rate).

The study has argued that a reference rate system could indeed still give assurance against aggressive intervention and could still provide a framework in which countries could work together to avoid dangerous payments outcomes. These benefits would be attainable without endangering the other important recent trend in macroeconomic policy: the adoption of inflation targeting as providing a nominal anchor. One can debate how large the effects would be, but in most cases it is difficult to see that such effects as exist would be other than beneficial. That is not for a moment to claim that they would solve all problems: The hypothetical histories presented above make that very clear. In some cases reference rates would have been unlikely to make much difference, and there are even a couple of cases (Japan in the 1990s and Argentina after its crisis) when it was clearly helpful to the national authorities to have been able to generate large foreign demand by holding rates that would have been prohibited by a reference rate system. But these are the exceptions and not the rule. If the world wants a system where the presumption is for national actions to be internationally consistent, then the most promising is a reference rate system.

In particular, a system of reference rates offers more than would be possible by giving substance to the existing rule prohibiting exchange rate “manipulation.” This system requires development of a clear view of equilibrium rates, and cannot authorize intervention that would have the effect of impeding market rates’ movement toward those equilibria. It offers the chance to anchor private expectations.

Reference rates seem unlikely to be adopted in the near future, if only because they would quite unambiguously prevent China and other East Asian countries from pursuing their current economic strategy, which involves running large current account surpluses.² There are, however, at least two circumstances under which one could envisage the world adopting a reference rate system.

By far the most likely is adoption in reaction to a crisis. Every major international monetary change in history has come about this way. In 1944 nations gathered together at Bretton Woods to design an international monetary system that would avoid repeating the disaster of the 1930s. In 1973 countries adopted the regime of generalized floating because they saw no other way of exiting the crisis of the Bretton Woods regime. The

2. This strategy is often described as “export-led growth.” However, I prefer to use that term in its original sense, in which the distinguishing feature is that export growth rather than import substitution is looked to as the main mechanism for avoiding a balance-of-payments constraint. In practice export expansion often made the countries involved attractive recipients of capital inflows, which enabled the countries practicing export-led growth to run current account deficits (as several of the East Asian countries did before 1997).

present growth in global imbalances threatens to end up inducing a collapse of the dollar, which could in turn produce a severe recession in the rest of the world, since income and substitution effects would reinforce one another to depress income. (In contrast, the substitution effect would be expansionary in the United States.) It is conceivable that this crisis could induce countries to say “never again” and to search for a system that would give the promise of avoiding similar disasters in the future. There is a much better chance that the search will end with a successful outcome if thought has been given in advance to the sort of system that might fit the bill. That is why the merits of a reference rate system need to be discussed now even if one is not optimistic about the chances of its imminent adoption.

By far the most desirable possibility would be the adoption of a reference rate system with the intention of heading off such a crisis. If there were widespread agreement that such a crisis might occur, and if world leaders showed a high order of statesmanship, then some group like the G-20 might agree on the desirability of such a move and order the negotiation of the necessary changes in the IMF. At the moment there is a lack of both wide agreement on the diagnosis and many world leaders with the requisite sense of statesmanship, which is why I am not optimistic about imminent adoption. But, to repeat, that should not exclude discussion and analysis.

