Exchange Rates - Domestic Societal Approach

• Who wants what?
  – Examine domestic distributional aspects of exchange rate policy (just as we did with trade).

• Predict winners, losers, and coalition patterns. Draw on Economics to determine how exchange rates affect the incomes of various groups.
• This ties national policy choices to the interests of particular social groups.
• Then reintroduce Politics (i.e., constraints of collective action and structure of policymaking institutions).
Dimensions of Exchange Rate Policy

• Two dimensions of exchange rate policy:

  1. STABILITY (fixed vs. floating regime).
  2. LEVEL (strong vs. weak $US currency).

• STABILITY: Winners and Losers
  – Policy issue: which exchange rate regime to adopt?
  – Many regimes possible (IMF lists 9 types).
  – Continuum runs from fixed to floating regimes.

    Fixed  Adjustable according to a set of indicators  Managed Floating  Independently Floating
For now, consider a dichotomous choice: Fix or Float? Fixing involves a trade-off - “Unholy Trinity” (Cohen). Fixing promotes int’l trade and investment but, with internationally mobile capital, renders domestic monetary policy impotent.

How are interest groups affected by trade-off (Frieden)?

“Winners” of fixing are actors with overseas economic ties:
- International investors (MNCs)
- Exporters of traded goods (autos, aircraft, high-tech, agriculture).
- Internationally-oriented merchants and shippers (import-export businesses and shipping lines).

“Losers” are groups tied to the domestic economy.
- Import-competing producers (textiles, apparel, sugar, etc.)
- Nontradables producers (construction, prepared food, services).
LEVEL: Winners and Losers

• Policy issue: what level to target for the exchange rate. A distinct coalition pattern for the level as opposed to stability.

• Supporters of depreciation:
  – Export-competing producers of traded goods.
  – Import-competing producers of traded goods.
    (Note that the traded goods sector is united on level but divided on stability)

• Supporters of appreciation:
  – Nontradables producers. Appreciation helps nontradables producers because it raises the price of their output relative to the price of the tradable goods they consume or have to buy as inputs.
  – International investors (MNCs)
  – Consumers (they do not lobby – See Mancur Olson).
  – Foreign producers (prevented by law from lobbying).
### Figure 1: Exchange-Rate Politics

<table>
<thead>
<tr>
<th>Preferred degree of exchange rate flexibility/ national monetary independence</th>
<th>Preferred Level of the Exchange Rate</th>
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<tbody>
<tr>
<td>1. Low</td>
<td>1. High</td>
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<td>International traders and investors</td>
<td>11</td>
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<td>Export-competing traded goods producers</td>
<td>12</td>
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<tr>
<td>2. High</td>
<td>2. Low</td>
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<tr>
<td>Non-tradables producers</td>
<td>21</td>
</tr>
<tr>
<td>Import-competing traded goods producers</td>
<td>22</td>
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Collective Action

• **Comparison with Trade:** Unlike trade policy, the exchange rate is a high-cost collective action issue with few opportunities for excluding free-riders.

• For both LEVEL and STABILITY lobbying is a public good for literally millions of individual firms.

• Large group setting implies limited lobbying due to small per-capita stakes, negligible impact of individual contributions, costs of organizing everyone, bargaining over terms, enforcing agreements.

• But privileged groups are possible – Caterpillar Tractors in the 1980s.

• Nevertheless, exchange rate only rarely subject to interest group pressures (exceptions: 1890s, 1930s, 1980s).
Policymaking Institutions

- Institutional barriers to interest group activity
  - Policymaking institutions very insulated from societal pressures (contrast with trade policy).
  - More true of the junior partner (Federal Reserve) than with Treasury (ESF).
  - Greater institutional insularity implies additional barriers to collective action on the part of social actors.