Exchange Rates - Domestic Societal Approach

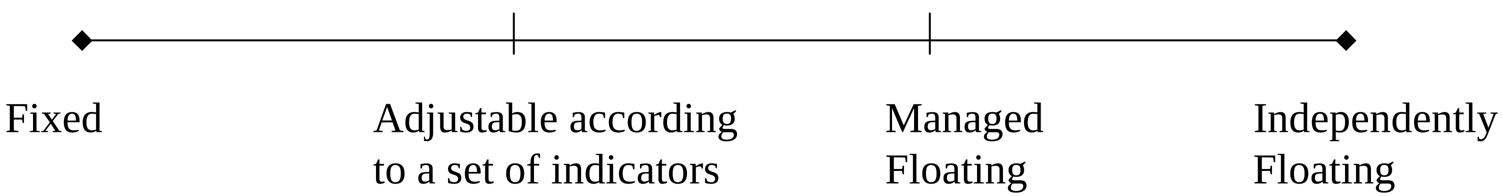
- **Who wants what?**
  - Examine domestic distributional aspects of exchange rate policy (just as we did with trade).
    - Predict winners, losers, and coalition patterns. Draw on Economics to determine how exchange rates affect the incomes of various groups
    - This ties national policy choices 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.



- 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

Preferred degree of exchange rate flexibility/ national monetary independence		***Preferred Level of the Exchange Rate*** 1. High	2. Low
	1. Low	11 International traders and investors	12 Export-competing traded goods producers
	2. High	21 Non-tradables producers	22 Import-competing traded goods producers

Source: Jeffry A. Frieden, "Exchange Rate Politics: Contemporary Lessons from American History." *Review of International Political Economy* 1, 1 (Spring 1994):85.

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.