12 Concluding Session: Panel Discussion

The conference ended with a panel discussion under the title ‘Future Prospects for the Crawling Peg’, in which five participants were asked to consider, in the light of the conference, whether they thought the crawling peg might have a wider role in the future (a) for other semi-industrial countries, and (b) for the industrial countries at the centre of the international monetary system.

I JOHN WILLIAMSON

These remarks are principally directed to describing the impact that the papers and discussions at the conference have had on the views I expressed in my background paper (Chapter 1 above).

However, I wish to mention in passing some of the interesting themes that emerged during the conference which are excluded by thus restricting my topic: the problem of how to manage a small economy in the present international monetary environment, the role of the IMF in stabilisation programmes, and the phenomenon — apparently far more widespread than I had realised before — of currency substitution. Furthermore, it is necessary to deal only cursorily with certain topics that indeed fall within my self-imposed terms of reference if I am to avoid monopolising this session. Let me mention three such issues.

(1) The problem of which price indices to use in interpreting the concept of the ‘real exchange rate’ — which to me means ‘the relative price of two national outputs’, i.e. exactly what Michael Mussa told us four years ago was not meant by the nominal exchange rate. Genberg’s paper set out most of the issues, but we have not reached a solution.

(2) The question of expectations. There seemed to me to be remarkably wide agreement that McKinnon’s story of stable regressive expectations was a wildly inaccurate description of experience during the current float even among the industrial countries, and certainly for the disastrous experiments with floating on the part of semi-industrial countries of which we have heard (Israel, Mexico, Peru).

(3) The analysis of how different systems react to, or can accommodate, various types of shock. At the formal level, at least, this is a rather new approach to the problem of choosing between alternative systems. I have no doubt that
it is destined to play a central role in aiding rational choice. But I find it impossible to summarise briefly: consider only the bewildering variety of shocks distinguished by Genberg (temporary vs permanent, government vs private, monetary vs real, domestic vs foreign) or Urrutia’s catalogue of the shocks that have buffeted the Colombian economy in recent years (Brazilian frosts, civil wars in other coffee-producing countries, the boom in the US market for drugs). My own impression is that the crawling peg has not come out badly from this type of comparison: let me just instance the Colombian experience in confronting, temporarily, the ‘Kuwait Problem’, and avoiding the annihilation of non-traditional exports. What other exchange rate regime would have allowed this? But that is an impressionistic judgement and the analysis obviously needs systematising, including evaluation of the empirical importance of different types of shocks— in which Black’s Table 3.2 (p. 75) must surely be considered a pioneering effort.

For all the importance that I am sure should be attached to the analysis of the impact of various types of shocks in alternative systems, I doubt whether differences of view about the origin of shocks underlie our continuing differences of opinion about the desirability of a PPP-guided crawling peg. Paradoxically, the paper that did most to reinforce my prior thoughts on this issue was that of McKinnon, precisely because it revealed to me the fundamental point on which we differ: our theory of inflation. McKinnon’s theory of inflation, for countries other than the ‘financially repressed’ like Colombia, may be expressed:

\[ \hat{p} = \hat{e} + \hat{p}^* \]  

(1)

where \( p \) is the country’s price level, \( e \) the exchange rate (in units of national money per unit of foreign exchange), \( p^* \) the foreign price level, and a hat denotes a proportional rate of change. If prices are determined directly by arbitrage as implied in (1), then it is clear that a PPP-guided crawling peg, which involves setting

\[ \hat{e} = \hat{p} - \hat{p}^* , \]

would indeed involve indeterminacy of the price level and thus be a self-evidently crazy policy. Furthermore, given (1), Swoboda is absolutely correct in saying (p. 35) that there is a fundamental difference between freezing rents and freezing the nominal exchange rate, in that the former involves freezing a relative price while the latter involves freezing the absolute price level.

Consider at the other extreme the model of inflation presented in Aghevli’s appendix, which is:

\[ \hat{p} = g \]  

(2)

where \( g \) is a constant. With this model, freezing the exchange rate distorts relative prices and no more stabilises the general price level than does a rent freeze while, as