Preface

This book is a substantial expansion of the two Ohlin Memorial Lectures that I gave at the Stockholm School of Economics in September 2000. I gave the lectures from notes that mostly contained the ideas of chapters 3 and 4 of this book, and some of the content of chapters 10–13. It was a great honor to be invited to speak in such a distinguished lecture series, in memory of one of the greatest figures in international economics this century. I would particularly like to thank Mats Lundahl for the invitation.

Among economists world-wide Bertil Ohlin is famous both for his pioneering contributions to trade theory and for his development of the theory of the transfer problem in 1929, when, it must be said, he won a debate with John Maynard Keynes in *The Economic Journal*. In Sweden he was best known at first for his many articles in newspapers and journals on current economic issues, and later his major political role as leader of the Liberal Party. But, was he ever concerned with the particular issue that was the subject of my two lectures, and now of this book, namely the choice of exchange rate regimes? The answer is: yes, he was.

With the German financial crisis in 1931 capital inflow into Sweden suddenly ceased. Swedish reserves declined, and the

Swedish central bank (the Riksbank) tried to maintain convertibility into gold by obtaining foreign loans. But negotiations collapsed when Britain went off gold in 1932. At the same time France and the rest of the gold bloc stayed on gold at the original parity. Eventually Sweden had to suspend convertibility so that the krona was allowed to float, though the intention initially was to return (peg) to gold.

With the British (pound sterling) devaluation, there were three alternatives for Sweden: return to gold at a devalued rate, peg to sterling, and allow the rate to float while using monetary policy to target the price level. Here was a classic "choice of exchange rate" decision to be made. Sweden wisely chose floating and price level targeting, which led to gradual inflation until the price level was restored to the pre-depression level. In response to the 1932 financial crisis the Riksbank was able to act as lender of last resort to the banking system. The exchange rate decision enabled Swedish policy to be flexible and thus quite expansionary in the circumstances. I owe this account to Eichengreen (1995).

The main point here is that Bertil Ohlin, while in his early 1930s, played a role in the discussion of exchange rate policies. He and the other main Swedish economists at the time, Wicksell and Cassell, favored the price stability approach. They had long emphasized the importance of price stability as a precondition for prosperity, no doubt heavily influenced by the experience of German hyperinflation. In 1932 Ohlin published an article on Swedish monetary policy, and, later another, entitled "Can the gold bloc learn from the sterling bloc's experiences?" (Ohlin 1936). He concluded: "It is obvious that currency depreciation has been an essential condition of economic improvement in the sterling countries."

My own interest in the subject of this book is long standing. It began with the proposals in the early 1970s for European monetary integration, which stimulated my 1971 Graham lecture at Princeton University on monetary integration (Corden 1972). Chapter 9 of this book builds directly on this earlier work. Later I became interested in the macroeconomic policies of developing countries as the result of a World Bank-sponsored project that led me into in-depth case studies of the experiences of many developing countries, published as Little et al. 1993. My ideas on exchange rate policy—especially the distinction between the nominal anchor approach and the real targets approach to the choice of exchange rate regime—were expounded in Corden 1991.

In the current book my primary aim is to clarify issues, as well as draw some lessons from country experiences. In general I do not advocate simple solutions to problems, especially when they do not exist other than in the minds of advocates! But I do have some conclusions in the last chapter, and my policy views are scattered throughout the book. Chapters 3–9 consist primarily of verbal theory helped with a few diagrams; chapters 10–13 consist of case studies. In each case study I have sought to derive some lessons on the central issues raised in the earlier chapters. My method could be described as "story telling informed by theory." I do not claim that the country cases are selected on any scientific basis. I have tended to select countries where there have been crises, or where interesting issues are highlighted.

The length of chapter 12 indicates my particular familiarity with Asian countries and with the Asian crisis that began in 1997. I have devoted a whole chapter to Argentina not because that country is particularly important in the world but because it currently is a major laboratory experiment of the much-advocated currency board regime. I do not discuss at any length the many proposals for reform of the exchange rate relationships among the major currencies—the dollar, the yen, and the Euro. There is a vast literature on this once-popular subject (referring of course to the dollar, the yen, and the Deutschmark), and I have given my skeptical views in Corden 1994.

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