Negatives in the Australian and New Zealand Policy of Floating (Wildly Fluctuating) Exchange Rates - a seminar presentation by Robin Pope

Tuesday 16 October 2012 | 12.30pm - 1.30pm
Rutherford House Lecture Theatre Three
All welcome - no RSVP required

Since commodity prices in Australia and New Zealand fluctuate wildly, old guard IMFers like Ken Rogoff find it praiseworthy that their central banks foster wild exchange rate swings. Such praise overlooks this policy's costs in the form of: 1) exchange rate risk premia raising interest rates four to ten times above those in other developed countries; 2) elimination of these countries' import-competing sectors, and planning hurdles for their high-tech innovating manufacturing exporters, that inefficiently distorts output to the low-skill, capital intensive, volatile commodities sector; 3) firm bankruptcies; 4) frequent arbitrary redistributions of wealth to overseas based lenders; and 5) frequent arbitrary windfall profits to commodities producers despite the fact that the long gestation lags in this multinational sector guarantee that these windfall profits have virtually zero aggregate demand benefits in either the short or medium term. Any long term benefit is more than questionable in light of the utter unpredictability of exchange rates inside any policy relevant frame, and hence the inefficiency of enticing production based on unpredictable price relativities.

Wiser policy requires a fresh framework. The paper presents a new contradiction-free framework that can allow for these omitted effects.

Dr Robin Pope is an Australian citizen located at Bonn University, engaged in a range of research projects in economics, finance, botany, zoology, physics, psychology and mental health that apply the SKAT (Stages of Knowledge Ahead Theory) framework that she has developed for decision making under risk and uncertainty. Previously, while at the University of New South Wales, she developed a new exchange rate framework focused on dominant (but neglected) cost and demand transmission channels, which showed that, contrary to what was previously assumed in Australia, services are the main beneficiaries of depreciations and local manufacturing is harmed. Her sectoral exchange rate models are suitable for countries that share Australia's characteristics of a mainly import competing manufacturing sector and a commodities oriented export sector, and provide evidence of the deleterious impact of exchange rate uncertainty.

Her experimental work with Renhard Selten has yielded insights into both the evaluation stage of decision making – how central bankers, wage setters and firms actually evaluate alternatives as distinct from how economists too often assume that they evaluate them - and on the later decision stages after changes in knowledge ahead. Experimental results indicate the costs of complexity and uncertainty in having floating exchange rates that impair macroeconomic management, costs that cannot be discerned via normal econometric methods.

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