Does exchange rate policy matter for growth?

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Previous studies on whether the nature of the exchange rate regime influences a country’s medium-term growth performance have been based on a tripartite classification scheme that distinguishes between pegged, intermediate, and flexible exchange rate regimes. This classification scheme, however, leads to a situation where two of the categories (intermediate and flexible) characterize solely the exchange rate regime, whereas the third (pegged) characterizes both the exchange rate regime and the monetary policy framework. We believe that the failure to account for this discrepancy may result in an inaccurate assessment of the effects of alternative exchange rate regimes on economic growth. Our study refines this classification scheme by accounting for different monetary policy frameworks. We estimate the impact of exchange rate arrangements on growth in a panel-data set of 60 countries over the period from 1973 to 1998 using a dynamic generalized method of moments estimation technique. We find evidence that exchange rate regimes characterized by a monetary policy anchor, whether they are pegged, intermediate, or flexible, exert a positive influence on economic growth. We also find evidence that intermediate/flexible regimes without an anchor are detrimental for growth. Our results thus suggest that it is the presence of a strong monetary policy framework, rather than the type of exchange rate regime per se, that is important for economic growth. Furthermore, our work emphasizes the importance of considering the monetary policy framework that accompanies the exchange rate arrangement when assessing the macroeconomic performance of alternative exchange rate regimes.

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