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COMMENTARY

The Greenback in Boca

By RICHARD H. CLARIDA

On Feb. 6 and 7, the Group of Seven finance ministers will converge on Boca Raton, Fla., for their first meeting since September in Dubai. There will, I suspect, be plenty of pow-wow about the exchange rates (when is there not?), especially about the adjustment of the dollar against the other G-7 currencies that has occurred over the past two years and, in particular, since Dubai.

There, the G-7 agreed to a communique that stated that exchange rates should reflect economic fundamentals, and that more flexibility in exchange rates is desirable for major countries to promote smooth adjustments -- based on market mechanisms -- in the international financial system. While some vestiges of "strong dollar" rhetoric are still heard from U.S. officials, Treasury Secretary John Snow is always careful to remind questioners that the U.S. desires a strong dollar whose value is determined in the currency markets.

The markets correctly interpreted the language in the September communique as part of an effort to put pressure on Japan to scale back its massive intervention efforts aimed at slowing the appreciation of the yen. The communique also helped to support the U.S. case, made by Mr. Snow during his September visit to Beijing, that China move with all deliberate speed away from its rigid peg to the dollar.

Since Dubai, the other G-7 currencies have continued to advance against the dollar (although Japan has continued to try to slow the advance of the yen) and the adjustment has, for the most part, continued in an orderly fashion. U.S. interest rates remain low, the U.S. stock market is up substantially, and -- as Alan Greenspan has emphasized in recent speeches -- the U.S. continues to finance its current-account adjustment in a way that is not impinging on the favorable prospects of growth and inflation which most forecasters now expect.

I believe that the U.S. position going in to Boca will be that the G-7 should continue to honor the "spirit of Dubai" and that the communique on exchange rates should reflect as much as possible the "letter of Dubai." However, the U.S. is likely to meet opposition to a position that seeks to adhere to the status quo on exchange-rate policy. Based upon the public comments by officials from other G-7 countries, there may well be at Boca an effort from other countries to push for a statement that elevates the importance of exchange-rate stability as a G-7 policy goal, and that explicitly calls for countries to intervene -- perhaps even in tandem -- to achieve exchange-rate stability. This would not be unprecedented. Indeed, almost exactly 17 years ago, in February 1987 in Paris at the Louvre, the G-7 reached an agreement that emphasized the importance of exchange-rate stability, that argued that over the preceding two years the dollar had fallen far enough, and that resulted in substantial interventions to keep the dollar within range of its February 1987 levels.

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The Louvre Accord was a mistake: The dollar should have been allowed in 1987 to find its own level, reflecting the monetary and fiscal policies that were being pursued at the time and the global economic recovery that was then under way. Others believe that Louvre was a successful example of international policy coordination. However, regardless of the merits of the case for the Louvre Accord in 1987, I believe that under present circumstances, the U.S. should vigorously resist an effort at Boca to make exchange-rate stability a pre-eminent G-7 goal. My reasons are as follows:

- First: The adjustment in the dollar has been orderly and will, over time, contribute -- along with a rebound in global growth and a narrowing of imbalances between saving and investment -- to the reduction in the U.S. current-account deficit that many are calling for.
- Second: Much of the widely criticized volatility and instability in exchange rates that has been observed in recent weeks is itself due to the many and varied -- and frequently contradictory -- efforts at "jawboning" by some officials in other countries, efforts that have been undertaken in an attempt to limit currency appreciation against the dollar.
- Third: The Dubai communique already included the statement that the G-7 "continue[s] to monitor exchange markets closely and cooperate as appropriate," wording -- a feature in G-7 statements since at least 1997 -- that is more than sufficient to cover truly exceptional circumstances. In sum, by sticking to the sound Dubai language on exchange rates, the G-7 meeting will contribute to exchange-rate stability.

Why change?

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