The Fallacy of the “Currency War” under the Flexible Rates

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Each Country can undo the Negative Spill-over

• Sachs (with Eichengreen), Cooper in 1984
• Historically as well as theoretically the Beggar-Thy-Neighbor Doctrine is false.
• Monetary approach to exchange rates combined with strategic (game theoretic) approach will prove in a classical setting that
• Laissez faire monetary policy by each country will achieve the Pareto-optimum configuration. (Hamada-Okada, 2007)
Naive Currency War
Target: Nominal Exchange Rate

Japan Monetary Policy

US Monetary Policy

Results: World Inflation

¥/$=110
¥/$=100
The Fallacy of the Currency War Under Flexible Rates Targets: Price Levels (Unemployment rate) (Reality)

Results: Harmony: Laissez-Faire leads to a Pareto Optimum. Each country can undo the negative effect of its neighbor.

The Meltdown of the World Currency System
Targets: The price level of the neighbor country

Japan aiming Brazil’s price level
Brazil aiming Japan’s price level