Comment

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The three chapters in part II of this book address important questions about exchange rate adjustments, particularly that of the US dollar, in light of the present disequilibria. What all the authors implicitly conclude is that adjustments are warranted, especially in the US dollar value, because the United States has an unsustainable current account deficit. That there appears to be a consensus on that conclusion is undeniable.

In that vein, John Williamson's approach to the "problem" in chapter 2 should surely be the envy of both engineers and international economists. I liken his approach to the Wizard of Oz behind the curtain—it only needs the pull and push of a few levers to achieve the desired outcome. Never mind that several key macroeconomic policy developments may stand in the way of the behavior required to generate the rebalancing that is outlined in his chapter. The allocation of the reduction in the US current account deficit, as he points out, could be done in any number of ways. His logical approach, summarized in table 2.1, distributes the burden of adjustment among several countries, with Japan and the euro area accounting for nearly 60 percent of the proposed change in the US current account balance.

The conclusion of Williamson's chapter is that the adjustment can be accommodated "rather comfortably by the rest of the world, with the possible exception of Japan." Further research on this subject to augment this conclusion should focus on whether the policy mix—particularly in the euro area and Japan—is conducive to such adjustment in the near term. Furthermore, policies to induce this adjustment, especially in the United

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States, are not at all self-evident. As for Japan, its aggressive exchange rate policy in the form of currency intervention likely delayed the process of adjustment, with costs borne by US producers (lost production) and consumers (jobs) relative to what would have been most likely if Japan had faced its restructuring head-on without resorting to currency manipulation.

Other policies to induce the adjustment are not very attractive. For example, it is unlikely that any economist would wish for a productivity slump, inflation acceleration, or inappropriate monetary policy to induce a dollar adjustment of 20 percent. Nevertheless, Williamson's chapter is very helpful in advancing discussion on the likely options as the dollar realignment emerges in the years ahead.

The vexing questions remain, for both policymakers and those in the private sector: How long can a US current account deficit of the present size be sustained? And what are the factors supporting the view that the present deficit in the United States is unsustainable? These questions were outside the scope of Williamson's research agenda for his chapter; however, they are questions that require answers before policy proposals are made. In light of strong productivity growth and other positive features of US fundamentals, what level of the US current account deficit is sustainable? As good essays do, Williamson's places on our radar important further questions to consider.

The modeling prowess of Simon Wren-Lewis and Agnès Bénassy-Quéré and her colleagues in chapters 3 and 4, respectively, is welcome in a book dedicated to the discussion of exchange rate adjustments. Both of these efforts give ample backbone to the discussion. Wren-Lewis's chapter includes some intriguing results pertaining to two major uncertainties in the United States—a fiscal shock and a technology shock. That both shocks, in his simulations, increase the level of the US current account deficit is an important result. This raises the important question of whether the United States could sustain a deficit larger than the present consensus of 2 to 3 percent. Though Wren-Lewis likely did not intend to infer this, the fiscal expansion shock that thereby induces a larger medium-run deficit may well imply abrupt and likely painful adjustment in the decade following 2010. This will also be the period during which the United States will experience the first major wave of baby boomer retirements. A fiscal expansion shock would be a recipe for crisis beyond 2010, for the federal government cannot afford to be ill prepared for the consequences of the unfunded liabilities associated with the Medicare program. This particular shock scenario is worthy of further investigation because of the likely policy backdrop that will confront global investors in the 2010–20 period.

Finally, I offer a few comments on the chapter by Bénassy-Quéré and her colleagues—another solid contribution to this volume. Of particular note are the renminbi results. In light of data reliability and capital controls in China, estimates of renminbi misalignment are very difficult to obtain, as may be illustrated by the big difference between the results from the two

approaches used in the chapter. The renminbi range of undervaluation is somewhere from 4.7 percent to upward of 28 or 30 percent. The chapter appropriately concludes that the patient (the dollar) is overvalued and the "diagnosis of bilateral misalignments [is] robust for most currencies." The large undervaluation of China's and other Asian countries' currencies relative to the dollar is the culprit. Oddly, Japan is not significantly out of line according to their calculations, at least as of 2001 (when the nominal yen-dollar value averaged nearly 125 for the year).

I took away from this chapter a reinforced conclusion that exchange rate misalignments are evident and fairly large, especially in US-Asian bilateral rates. I drew less comfort on how these misalignments will be resolved in the near term.