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INTERNATIONAL MONETARY SYSTEM: THE CHOICE OF EXCHANGE RATE REGIME

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Abstract
International monetary systems comprises sets of agreed rules by nations, conventions and supporting institutions, that facilitate global trade, cross border investments and relocation of capital between countries. It provide means of payment acceptable buyers and sellers of different nationality, including deferred payment. To operate successfully, they need to inspire confidence, to provide sufficient liquidity for fluctuating levels of trade and to provide means by which global imbalances can be corrected. The systems can grow organically as the collective result of numerous individual agreements between international economic factors spread over several decades. Alternatively, they can arise from a single architectural vision as happened at Bretton Woods in 1944. This paper traces the history of International Monetary System and establishes its relevance or irrelevance in a world getting increasingly dominated by digitization and its outcome in the shape of Bitcoins, Crypto currencies, Bloackchain, Crowd funding and many other new products where no control can be excersied for all practical purpose.

Keywords: International Monetary System, Convertibility, Bretton Woods, Hybrid Exchange Rate System, Brexit, Eu.

Introduction

International financial markets are characterized by high risk and complex variables. These factors make the gamut of international finance highly volatile and limit the steady growth of trade across nations. In order to lessen the uncertainties and make the world more suitable for the global trade, International Monetary System (IMS) evolved over a period of years. This system decides on role of governments and institutions, affects sources and types of financing available, influences free flow of international trade and exchange rate.

The International Monetary System consists of laws, rules, Institutions, transfer instruments, procedure for transfer of money across countries and others. These elements in turn affect international trade, foreign exchange rates, capital flows, balance of payments position of countries, prices of goods in foreign markets, foreign loans, and many others variables. The international monetary system therefore plays a very vital role in the financial management of companies, individuals, banks and countries.

Why International Monetary System?

Since most of the international trade are settled on the cash basis (not barter)- lack of financing causes liquidity problems. This may ultimately affect volume of international trade. International monetary system provides liquidity to the market and makes funds available for conducting foreign trade. It helps in facilitating maximum sustainable international trade and flow of funds across countries. The international monetary system tries to make financing available for bridging the gap between demand and supply for currencies.

Thus, even if Indian rupee is not acceptable for settling foreign debts of India, the present monetary system enables India to make international payments in number of ways. For all those countries whose currencies are not widely acceptable for settling international payments, or do not have adequate foreign exchange reserves, the existing monetary system provides different mechanisms for overcoming liquidity problems. Whatever approaches one adopts for international payments, agreements among participative countries do help evolve strong and smooth presence of the international monetary system.

A successful exchange system is one of the pre-conditions for stable balance of payments for countries. To be successful, an exchange system should meet the following three conditions.

1. First, it should be able to avoid prolonged payment deficits or surpluses.
2. Secondly, effective exchange system should be able to correct imbalances in the balance of payment position without causing high inflation or restricting trade.
3. And finally, it should be able to encourage international trade and other economic activities.

However, sometimes imbalances on the balance of payments may develop due to factors such as crop failure, lower exporting ability of the country, etc. These factors cause disequilibrium in the international balance between supply and demand of various currencies. These imbalances may be of a short term nature. Any reversal of imbalance in the near future makes financing available for repaying funds borrowed earlier to adjust the earlier disequilibrium.

Even though different governments have different preferences about settling payment imbalances, any choice for bridging the gap depends on the cooperation of other countries. For example, to increase international borrowing, a country needs some other country to lend it. To depreciate the external value of currency, the other country's currency must appreciate. To reduce imports, the other country's export and income must reduce. In other words, unilateral adjustments in international markets are impossible and at times suicidal too.

It is said that one of the reasons for great depression and economic self destruction of nations in the thirties was the unilateral move by several countries to follow "beggar, thy neighbor policy". For example, pressed with high rate of unemployment, Great Britain in 1931 devalued its currency by over 25 percent to boost export. This caused severe debt crisis among under-developed countries and sharp decline in the international trade. Subsequently, several nations also devalued their currencies thus neutralizing the impact of devaluation in pound.

The pre-Bretton Woods period (1821-1931)
The pre-1914 Gold Standard
Long ago when barter system existed, commodities were used as medium of exchange. However, barter was a time consuming process. Eventually, metals came to predominate as money. Gold and silver became widely acceptable medium of exchange all over the world. The use of gold as money goes back to a very old time, perhaps even before the written history.

In the pre-1914 era, most of the major trading nations accepted and participated in an international monetary system called the Gold Standard. Gold became the ultimate choice for being the medium of exchange since it has many attributes to enhance its attractiveness. Gold is durable since it does not wear out easily. It is homogenous since one unit of gold is practically identical with another unit of gold. It is costly and hence has a high value-to-weight ratio. Its low-weight, high-cost quality makes gold easily transportable with low storage cost. Gold is easily divisible in smaller quantities. Its scarcity and high cost of mining ensures that supply of gold does not change frequently. This means if prices are pegged to supply of gold, they are likely to be more stable. And so gold became a metal money.

For as long as gold was considered to be the medium of exchange, stable exchange rate prevailed. For instance, purchase of an aircraft from the United States or United Kingdom simply required payment in gold at a price expressed in ounces of gold. However, the gold standard suffered from some practical difficulties. The purity and precise weight of gold bars became difficult to be determined. In gold standard, a nation's monetary unit was defined as a certain weight of gold. The money in circulation in this period was "full-bodied coins" - the monetary value of which equals the value of metals it contained. Even though sovereign minted the money, counterfeiting of coins was frequently undertaken by mixing silver or other metals in gold. Sometimes, even sovereign reduced gold or silver content of full-bodied coins for "debasement" - another form of devaluation. Debasement of full-bodied coins ultimately resulted in Gresam's Law of "bad money drives out good money", taking place.

Since both coins looked identical and were similarly stamped and anybody with both coins preferred using debased coins for transactions, and thus retaining full bodied money for better store of value. Similar situation took place in the UK in 1542. This resulted in severe inflation since debased coins did not have intrinsic value.

Over the last several hundred years, most nations supplemented gold's exchangeability role with paper monies - note issuing and bank deposits. Since it was easier to make and transfer paper monies, government issued paper certificates as money. Initially many were doubtful of the value of paper monies since its excessive and reckless printing might lead to rise the commodity price level. To gain acceptance of the paper monies, governments had to agree for free convertibility of paper monies into gold at a fixed rate. This constrained monetary authorities to print notes excessively. Eventually when constraints on monetary authorities became too severe since imports were more than exports for some countries, gold was driven out of the domestic monetary system. This forced central banks of those nations disallowing conversion of domestic monies into gold.

The Bretton Woods System (1946-1971)
Towards the end of the World War II (1939-45) victory for allied nations became almost sure. It was then eminent economists, civil servants and politicians of allied nations, especially President Roosevelt of the USA, assigned high priority to evolve a purposeful international monetary system in the post-war period. As a result of the war, economy of most of the European nations was devastated. Japan too was one of the worst sufferers. A strong need for fresh monetary cooperation was felt once again. Eventually in 1944, an international conference in the rural surroundings of Bretton Woods, New Hamshire, USA, was held to consider a new international financial order for substituting the failed gold standard. The

conference was attended by the representatives of forty-four nations. They expressed concern over restrictions practices of nations in 1930s, general rise in the unemployment and hyperinflation in certain countries. The foundation of the post World War II international monetary system was laid down in this conference.

The sordid state of world economy towards the end of the Second World War was felt very strongly by many countries. Almost all nations wanted to have greater and more effective monetary cooperation than what existed so far. It is because of this, the Bretton Woods conference gave birth to a new international monetary system that worked very well for nearly 25 years. The architecture for today's international monetary and financial system has actually evolved around the Bretton Wood institutions.

The Bretton Woods Conference emphasized the stability of exchange rates by adopting the concept of fixed but adjustable exchange rates. It proposed establishment of International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD) also known as the World Bank and the International Trade Organization (ITO).

The primary objectives for the establishment of IMF were to promote international monetary corporation to achieve exchange rate stability, eliminate exchange controls of nations and to finance short-term payment deficits. Founders of the IMF realized that if international trade is to be optimized, it is necessary to have a multilateral international payment system. This means if a country has only pound sterling as foreign exchange, it need not import goods and services for UK only. Under a multilateral payment system, foreign exchange held in any currency can be used for import from any country. This is possible due to free convertibility that was encouraged by the IMF. Though the Bretton Woods negotiation ended in 1944, the IMF began its operation in 1946 only.

Par Value or Pegged Exchange Rate System
The International Monetary System that existed from 1947 to 1971 is generally known as the par value or pegged exchange rate system. A pegged currency requires a peg - a reference point in terms of which the value of currency is stated. This system was conceived at Bretton Woods and each member country of the IMF was statutorily required to define the value of its currency in terms of gold or the US dollar. They were also obliged to maintain (to peg) the market value of their currency within + 1% of the defined (par) value. The value of US dollar was set to US $ 35 per ounce of gold. The US government promised that all dollars in the hands of other central banks would be redeemed in gold upon demand at the fixed price of $ 35 per ounce. Every other nation then defined its currency in terms of the dollar or gold.

At the end of World War II, the US held over 74% of the world's monetary gold stocks and accounted for about half of the world's real GNP. Eventually, the US dollar became international money. In the early post-war period, European countries were happy to accumulate dollar balances whenever they could by running balance of payment surpluses with the US. The dollar was not merely as good as gold, it was better than gold. This is because the dollar deposits earned interest, while gold did not.

History for us $35 an ounce of gold as the parity

This choice of $35 as the parity for the dollar in January 1934 was an historical accident. It could have been US $ 30 or US $ 40. American Economists convinced President Roosevelt that the only way to move out US economy from depression was by increasing gold price. This would result in more production of gold and more sale of gold to U.S monetary authorities, leading to an increase in money supply. As a result, commodity prices would go up and firms would no longer incur losses. To increase the dollar price of gold, a subsidiary of the government owned "Reconstruction Finance Corporation" bought gold in New York. The price of gold in the US increased than its prices in the London at the prevailing exchange rate. Arbitragers had an incentive to buy gold in the UK and sell in the US. For this they had to buy the sterling first. This caused the price of pound to go up against dollar and many other currencies, weakening the competitive position of British firms in the world market. The British objected. The US authorities stabilized the dollar price for gold when it was near $35. Had the British objection been delayed until the free market price was $40, the US gold parity would have been $40.

Source:"The International Money Games" by Aliber Z Robert.

Breakdown of Bretton Woods: Emergence of Managed Floating
For many in later years, Bretton Woods's agreement remained fixed exchange system in name only. By mid 1971 out of 21 major industrial countries, except USA and Japan, devalued their currencies by over 30 percent against US dollar. Four had revalued and four were floating their currencies when Bretton Woods's system collapsed in 1971. The inevitable collapse of the Bretton Woods arrangement was identified by an American economist, Robert Triffin in 1960s only when the IMF

administered fixed exchange rate system started showing signs of strains from different directions. According to Triffin Paradox, the increase in world trade is bound to result in the increase of world's stock of dollars. This means provider of dollars, the USA, must run balance of payment deficits which other nations can accumulate by having surpluses. This raised doubt regarding United States government to convert dollars into gold at the fixed rate and vice versa. By 1960, external liabilities of the US exceeded its reserves of gold stock.

Until 1971, nations kept reserves not only in gold but also in the dollar. And since a major part of the gold reserve and dollars came from the US, growth of international liquidity could come only from an outflow of gold and the US dollar from America. And a lot of dollars in the initial periods of Bretton Woods did come out of the USA from its deficits, Marshall Plan of 1948 for European recovery, US defense expenditure and others.

Even small deficits of the US in 1950 were widely welcomed because they increased international liquidity. It seemed the key factor in guaranteeing the workability of Bretton Woods system depended on the acceptability of the US dollar. If anything were to happen to the USA and dollar that would shake the confidence, it would lead to a collapse of the system.

And, the Bretton Woods did collapse in 1971 because of a huge accumulation of the dollar abroad on which US government had neither command nor control. The balance of payment situation for the US changed from a surplus of $4 billion in 1947 to a deficit of $29 billion in 1971. Another reason for the collapse of the Bretton Woods system was the rigidity imposed by the fixed exchange rate system. This resulted in delayed changes in the exchange rates to reflect changes in the economic fundamentals for a country. While such rigidities helped nations having persistent surplus, they became intolerable for countries suffering from recurring deficit on the current account. The phenomenal success in export for countries like West Germany and Japan came mainly because of undervaluation of their currencies. Despite having a strong tendency for appreciation, these currencies were not allowed to find new levels due to several exchange rigidities.

Although the US deficit did increase international liquidity, it also triggered off a "crisis of confidence" in the USA. By 1971, the US total liability rose to about $50 billion and in 1971, the Central Bank of Germany alone had held enough dollars to exhaust the entire gold stock of the US at $35 an ounce.

In early 1971, foreign exchange market became very hectic. Speculators, MNCs and banks became eager to unload the dollar to acquire other currencies since they felt dollar would soon be worthless. Many central banks with the stronger currencies started buying massive amount of dollars to maintain the exchange rates at the official par value. They even closed foreign exchange markets for brief periods. The international monetary system then faced two problems - there was a tremendous desire to sell dollars, on the other hand, traditional buyers, (like banks) were no longer willing to purchase them. The eventual outcome was the collapse of the Bretton Woods System. The par value system emphasized by IMF officially ended on August 15, 1971. On this day, President Nixon in a famous speech, designed to deal with US inflation and unemployment withdrew US commitment to buy and sell gold at $35 an ounce and thus suspending conversion of dollars into gold. He also imposed a 10 percent surcharge on most imports to the US. The US also let the price of gold be determined by market forces only. Although the suspension of US gold sales was inevitable, the 10 percent surcharge was not because it was levied in a period when most countries were in recession. All these steps were taken without prior consultation with the International Monetary Fund.

On the whole Bretton Woods’s agreement faced “Triffin Paradox", whereby the growing role of the US dollar in solving world's liquidity by incurring liabilities to foreigners resulted in dwindling US government gold reserves. In 1957, against foreign liability of approximately $7 billion, the US had gold reserves of $22 billion. The scenario, however, reversed drastically when in 1971 for a total liability of approximately $58 billion, US government had gold reserve of just over $9 billion. As mentioned earlier, almost ten years before the collapse of Bretton Woods, Robert Triffin warned that a system based on one or two currencies is normally very fragile. This is because any attempt to augment the supply of international liquidity by increasing their supply could impair confidence in them.

Fixed rates with wider bands (December 1971 - 1973)
The Smithsonian Agreement and its Aftermath

After the breakdown of Bretton Woods agreement, from August to December 1971, most major currencies were permitted to fluctuate. Failures of Bretton Wood's system were most apparent in the form of recurring crisis in the exchange markets. To resolve this situation, ten leading trading countries of the world, also known as the "Group of Ten" - agreed on December 18, 1971, to a new set of parity rates and new conditions. Finance ministers of the ten participating countries met at Smithsonian Institute in Washington, D.C. which also happened to be the repository for America's artifacts. It was also, in the words of then president of USA, Nixon, a place where "The greatest Monetary Agreement in the History" took place. As a result of this agreement, currencies were allowed to fluctuate over a wider band 2.25 percent on either side of the central

rate without any government intervention. Even the United States raised the official price of gold from US $35 to US $38 an ounce and thus devaluing dollar by 8.57 percent. Consequently Japanese Yen was revalued by 17 percent, German Mark by 14 percent and other European currencies by 10 percent. Overall, the dollar depreciation was an average of approximately 12 percent. Since the convertibility of dollar into gold was not restored, the agreement also resulted in the introduction of Special Drawing Rights (see appendix). The US authorities did not find even $38 parity compatible with convertibility.

This agreement and dollar devaluation was expected to reduce the adjustment problem of nations and provide stability to the system. But even this agreement did not last long when dollar came under heavy selling pressure by the end of 1973. Continued inflation in the US due to the Vietnam War kept causing financial problems for Americans. In February 1973, President Nixon announced further devaluation of dollar by 10 percent from $38 to $42.22 an ounce of gold. By mid March 1973, repeated exchange crisis forced most major countries to abandon fixed exchange rates. Thus even the Smithsonian Monetary Agreement - so called most important agreement in the history too failed to replace the Bretton Woods System. While it was agreed that a new monetary system was needed, there were no agreement on what such a system should look like.

Fixed rates among few and floating rates among the others

By mid-March 1973, six leading European nations of the Eastern European Community (EEC) (West Germany, France, Belgium, the Netherlands, Luxembourg and Switzerland) decided to replace the Smithsonian agreement by a new system called " Snake in the Tunnel". However widening of the margin of fluctuation either side of par to 2.25 per cent at the Smithsonian Conference posed a threat to EC plan for limited exchange rate fluctuation amongst member currencies. With this, if one currency rose from its floor to its ceiling against the dollar and other fell from ceiling to floor, there would be a 9 percent change in the relative values of the two currencies. Accordingly “Snake in the tunnel" scheme was devised as a way of restricting EC exchange rate fluctuation. The basic idea was that members agreed to maintain no more than 2.4 percent band around all their respective currencies to limit fluctuation. At the same time all EC currencies would move together as a block within the 4.50 percent Smithsonian band of fluctuation against dollar.

In this system they agreed to keep their currencies fluctuating against one another within a narrower band. The snake was the narrower band for exchange fluctuation among EEC countries, but it was allowed to move freely outside the tunnel or with other countries. According to the agreement, exchange rate of EEC currencies was to be maintained within a 2.25 percent range of their target rates. In addition they were to jointly vary with the US dollar by no more than 4.5 percent.

Furthermore, the currencies of Netherlands and Belgium were to maintain an exchange rate no more than 1 percent from the target rate, a system known as “the worm within the snakes within the tunnel". Even this system however did not last for long. Owing to the oil price shock of 1973 that led to higher inflation differentials and current account imbalances in the European countries, several EC countries withdrew from the snake. Italy left the snake in February 1973, France in January 1974 and UK remained outside the scheme after 1972. Consequently the snake survived but the tunnel disappeared.

Monetary Integration of Europe

The debate over monetary integration in Europe remained clouded because of four quite distinct issues which were sometimes incorrectly linked. They were: the Exchange Rate Mechanism (ERM) and how to develop further European Monetary System and the question of establishing and developing a "parallel" currency such as European Currency Unit (ECU) or a single unit of account for all EEC countries which do not replace national currencies. The other two were the establishment of a European Central Banks and the much bigger issue of monetary union in the EEC and the creation of a common currency.

It was not the first time that the idea of an EEC monetary union surfaced. Arguments in favor of European Monetary Integration have a long history and surfaced from time to time in a cyclical manner. The most explicit and unambiguous proposal was contained in Warner Report of October 1970 which envisaged that the EEC would move into stages to full monetary union (EMU) by 1980. As preclude to the first stage European central banks were invited to restrict fluctuation in their currencies around the existing par values. Under the then prevailing adjustable peg arrangement (during the period of Bretton Woods), any one currency could fluctuate within a band (or tunnel') of one percent either side of the dollar value. This meant if one EC currency moved from its floor to its ceiling and also other moved from its ceiling to its floor, there would be a 4 percent relative fluctuation in the value of these two currencies. During the 1970s, however, nothing of this ambition emerged, other than various exchange rate mechanisms and institutions designed to induce an element of coordination in monetary policy.

The sharp fall of the US dollar in 1970 further bolstered the desire for exchange stability even among nations who tried to maintain stability between 1973-1978. In other words, there were many moves by few countries to bring parity and fixed rates among nations.

As a result of continuous pressure in the foreign exchange market, EEC countries established European Monetary System (EMS) in March 1979. One of the most important features of EMS was the regulation of exchange rates by the Exchange Rate Mechanism (ERM) and also establishment of the European Currencies Unit (ECU), a weighted average of the member nation's currencies.

The ECU, like the special drawing rights, was a basket of the EC member countries currencies. The weights given to different currencies reflected the proportion of the country's GNP in the EC gross product, and its share of the intra-community trade. The EMS arrangements provided for a quinquennial review of the composition of the ECU basket. (It course ensured that the change in composition would not affect the value of an ECU).

While all the EC currencies were represented in the composition of the ECU, not all participated in the exchange rate mechanism. The ERM established a parity grid with a band for the permissible movement of exchange rates between each pair of currencies. The band was +/- 2.25 percent for most currencies, few EC countries decided to have a wider band of +/- 8.0 percent. If an exchange rate between ERM participating currencies reached either limit, both the central banks were obliged to buy (and sell) the two currencies for unlimited amounts to prevent over-stepping the band.

The Post- 1973 Dirty Floating System

The collapse of Smithsonian agreement resulted in a "floating exchange rate system". However monetary authorities still did not allow their currencies to be determined solely by demand and supply. In order to keep the exchange rates within desired limits, they kept intervening from time to time. This system is therefore known by various names. Some call it "managed float",” free float" or “partial float". Yet some describe it as the "dirty float" since managed float for them cannot be a "clean" float. This system provides the advantages of floating rates and avoids the disadvantage of sharply fluctuating rates.

It was not until January 1976, at a meeting in Jamaica, the "managed or freely float" system that began to emerge was formally approved. However it was only after a protracted negotiation of two years, in April 1978, framework for the current international monetary system was decided to ratify floating exchange rate system. Two major features of the amendment were: termination of par value system based on gold and legalization of floating exchange rate and freedom for each country to peg or let float the value of its currency. Although monetary system envisaged by the Jamaica Agreement still holds, several modifications have been made as a result of certain crisis that emerged over the years.

Euro: The Trans-European Currency

Since January 1, 1999, the world has witnessed one of the most profound and far reaching economic events of the modern history. On that day, the European Union (EU) launched the final stage of Economic & Monetary Union (EMU), thereby creating a new trans- European currency, the Euro. This monetary revolution has created second largest economic bloc in the world, thus offering a direct challenge to the supremacy of US dollar. The Euro has therefore affected almost every one in the world- from businessmen to politicians. The Euro became an official currency for eleven European nations: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain.

Core economic advantages of Euro

Exchange rate risk: In the international business environment, decision made are often adversely affected by future shifts in exchange rates. For example, if Germany’s BMW invests $ 100 mn in France, its profitability is likely to be suffer badly if French Franc sharply depreciates after the investment. Hence, the more unpredictable exchange rates, the risky are foreign investments and the less likely are the companies to pursue growth in foreign markets. The euro, by virtue of replacing national currencies among European nations completely eliminates exchange rate risk between participating countries and thus offering a great boon to investments in euro land.

Transactions costs: Tourists planning European excursions before the euro encumbered themselves with the hassle and cost of many currencies. The euro eliminates these costs and hassles.

Price transparency: A single currency makes price differences between goods, services and wages in different countries more evident, thus enhancing competition across markets. Euro prices provide a simple and consistent for comparison, spurring households and businesses across the continent to compare prices abroad.

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Deep financial markets: Before the euro efforts to match the immediate financial needs of consumers with the investment requirements of savers were plagued by the psychological and economic costs of 11 national currencies. Every financial instrument then was listed in different national denominations, thus fracturing the size of the financial markets. The euro revolutionizes this situation. The German banks now offer a single financial product, euro loans, to companies not just in Germany but through the European Union. All these have resulted in creating phenomenal depth in the financial market.

Mounting Pressure for return to Bretton Woods

Almost seventy years after the historic Bretton Woods conference established a new monetary order at the end of World War II, calls are once again growing to turn the clock back to golden age of stable exchange rates. Appalled by the daily gyrations in the trillion-dollar market, some monetary experts are arguing for reform of the world finance system and "target zones" to limit fluctuations of currencies like the US dollar.

Although critics feel that calls are little more than nostalgia for era that cannot be recreated, a period of unprecedented world growth and prosperity under a regime that held sway from 1944 until it was blown apart by the Vietnam War in the early 1970s. However, reformers argue that collapse of the Bretton Woods and the introduction of freely floating exchange rates, wild swings in the dollar, mark, and yen have slowed world growth, driven up unemployment and fostered protectionism. A wish to go back to the Bretton Woods became all the more important when recently, the Exchange Rate Mechanism (ERM) was rocked by crises in the 1990s.

The Bretton Woods Commission, an ad-hoc body of experts set up in 2013 s expected to propose that top industrial nations adopt a system of "flexible exchange rate bands", although it is not yet clear how wide they would be. The idea of target zones has been long advocated by academics, with key work carried out in the 1980s by economists John Williamson and Marcus Miller. On October 13, 2008, British Prime Minister once again suggested that the world leaders must agree to a new economic system and a new Bretton Woods to build the international financial architecture.

Brexit - Withdrawal of United Kingdom from the European Union.

On 23 June 2016, In a referendum wherein 51.9% of the participating UK electorate voted to leave the EU. On 29 March 2017, the UK government invoked Article 50 of the Treaty on the European Union. The UK is thus due to leave the EU on 29 March 2019. UK Prime Minister Theresa May announced that the UK would not seek permanent membership of the single market or the customs union after leaving the EU and promised to repeal the European Communities Act of 1972 and incorporate existing European Union law into UK domestic law. A new government department, the Department for Exiting the European Union (DExEU), was created in July 2016, with Eurosceptic David Davis appointed its first Secretary of State. Negotiations with the EU officially started in June 2017.

The UK joined the European Communities (EC) in 1973, with membership confirmed by a referendum in 1975. In the 1970s and 1980s, withdrawal from the EC was advocated mainly by Labour Party members and trade union figures. From the 1990s, the main advocates of withdrawal were the newly founded UK Independence Party (UKIP) and an increasing number of Eurosceptic Conservative Party members.

There is strong agreement among economists and a broad consensus in existing economic research that Brexit is likely to reduce UK's real per-capita income in the medium- and long-term. Studies on effects that have already materialized since the referendum show annual losses of £404 for the average British household and a loss of 1.3% of UK GDP. Brexit is likely to reduce immigration from European Economic Area (EEA) countries to the UK, and poses challenges for UK higher education and academic research. The size of the "divorce bill" (the sum of money demanded by the EU from the UK for the departure), future of Scottish secession, Britain's international agreements, relations with the Republic of Ireland, and the borders with France and between Gibraltar and Spain are uncertain. The precise impact on the UK depends on whether it would be a "hard" Brexit (whereby the UK leaves the EU and does not join EFTA or the EEA) or a "soft" Brexit (whereby the UK joins EFTA, the EEA, or enters into a special agreement with the EU that retains significant access to the EU's single market).

Selecting an Exchange Market Policy

Exchange market policy (free or floating) can affect nation's ability to achieve economic objectives such as infrastructure development, efficient use of productive capacity, stabilization of economic activities and others. However, relative importance of economic objectives differs from country to country. For example, for a developing country - issues of development and income distribution are important, whereas for developed nations - income stabilization and full employment issues are vital. Even structure of the economy has a vital impact of exchange market policy on the ability to

attain economic objectives. For example, a country with little foreign trade will perhaps find it quite difficult to follow freely floating exchange rate system.

In their studies, Tower and Willett, gave few more important characteristics that influence the choice between fixed flexible rates.

1. **Openness of a Nation's Economy to International Trade:** Countries with large proportion of their income through foreign trade can experience disturbance in the income due to exchange rate fluctuations. They may therefore, prefer fixed exchange rate system over floating rate system.
2. **Pattern of Foreign Trade:** Even pattern of the existing foreign trade can affect choice between fixed and floating exchange rate. A country with trade in number of goods can always sustain exchange rate fluctuations.
3. **Development of Domestic Financial Market :** Any poorly developed financial market can discourage adoption of flexible exchange rates since it can lead to highly variable and unpredictable exchange rates behavior.
4. **Inflation with regard to trading partners:** Large inflation differential with major trading partners can also affect exchange rate policy for a nation. This is because under fixed system, frequent parity adjustment due to interest differential may ultimately make the exchange rate system of the concerned country look like floating rate system.

Besides these factors, there are several other variables which may ultimately affect the exchange rate policy followed by a country.

Exchange rate regimes in today's international monetary and financial system

The exchange rate regimes adopted by countries in today's international monetary and financial system, and the system itself, are profoundly different from those envisaged at the 1944 meeting at Bretton Woods establishing the IMF and the World Bank. In the Bretton Woods system:

1. Exchange rates were fixed but adjustable. This system aimed both to avoid the undue volatility thought to characterize floating exchange rates and to prevent competitive depreciation, while permitting enough flexibility to adjust to fundamental disequilibrium under international supervision;
2. private capital flows were expected to play only a limited role in financing payments imbalances, and widespread use of controls would prevent instability in such flows;
3. Temporary official financing of payments imbalances, mainly through the IMF, would smooth the adjustment process and avoid unduly sharp correction of current account imbalances, with their repercussions on trade flows, output, and employment.

In the current system, exchange rates among the major currencies (principally the U.S. dollar, the euro, and Japanese yen) fluctuate in response to market forces, with short-run volatility and occasional large medium-run swings. Some medium-sized industrial countries also have market-determined floating rate regimes, while others have adopted harder pegs, including some European countries outside the euro area. Developing and transition economies have a wide variety of exchange rate arrangements, with a tendency for many but by no means all countries to move toward increased exchange rate flexibility.

This Variety of Exchange Rate Regimes Exists In An Environment With The Following Characteristics:

1. partly for efficiency reasons, and also because of the limited effectiveness of capital controls, industrial countries have generally abandoned such controls and emerging market economies have gradually moved away from them. The growth of international capital flows and globalization of financial markets has also been spurred by the revolution in telecommunications and information technology, which has dramatically lowered transaction costs in financial markets and further promoted the liberalization and deregulation of international financial transactions;
2. international private capital flows finance substantial current account imbalances, but the changes in these flows appear also sometimes to be a cause of macroeconomic disturbances or an important channel through which they are transmitted to the international system;
3. Developing and transition countries have been increasingly drawn into the integrating world economy, in terms of both their trade in goods and services and of financial transactions.

Lessons from the recent crises in emerging markets are that for such countries with important linkages to global capital markets, the requirements for sustaining pegged exchange rate regimes have become more demanding as a result of the increased mobility of capital. Therefore, regimes that allow substantial exchange rate flexibility are probably desirable unless

the exchange rate is firmly fixed through a currency board, unification with another currency, or the adoption of another currency as the domestic currency (dollarization).

Conclusion

For a long time, commodity and metals continued to serve as the medium of exchange for settling domestic and international obligations. Although this system had an in built advantage of stability in the exchange rates, it also suffered from some great limitations. As the world became more and more complex, both politically and economically, well established systems of old days started becoming meaningless one after another.

The definite breakdown of Bretton Woods's regime in March 1973 represented fundamental shift from a system of adjustable pegs to one of wider flexibility in the management of exchange rates. The changes in International monetary agreements were officially sanctioned in 1978 when IMF formalized exchange rate flexibility that had already become a fact of life half a decade before. The amended articles allowed a large degree of freedom to countries in choosing their exchange rate regimes. Currencies could float or be pegged to dollar; Special Drawing Rights (SDRs) or any basket of currencies.

The present regime, as it has worked since 1973, can be described as being a hybrid system, although its free-for-all nature has led some to refer as being a non-system. And perhaps the best illustration of the hybrid character of the present international monetary and the existence of monetary unions and common currency areas has important implications for the stability of the monetary system. While such unions reduce transaction costs, they also encourage economic discipline, larger financial markets and a considerably stable economic environment.

A major structural change is likely to take place in the coming days in the international monetary system as members proceed with their economic and monetary union. At the Maastricht summit in December 2016, the heads of the state and government of the European community agreed on far-reaching proposals for the transition to a single currency, the ECU, and the establishment of a European System of Central Banks. The monetary union will be reached in three stages, as envisaged in the report of the Delors Committee issued in 2009.

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