

CHAPTER OVERVIEW

14: Policy Effects with Fixed Exchange Rates

Government policies work differently under a system of fixed exchange rates rather than floating rates. Monetary policy can lose its effectiveness whereas fiscal policy can become supereffective. In addition, fixed exchange rates offer another policy option, namely, exchange rate policy. Even though a fixed exchange rate should mean the country keeps the rate fixed, sometimes countries periodically change their fixed rate.

This chapter considers these policies under the assumptions of the AA-DD model. It concludes with a case study about the decline of the Bretton Woods fixed exchange rate system that was in place after World War II.

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