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TOPIC :- MERITS OF FIXED AND FLEXIBLE EXCHANGE RATE

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Merits of Fixed Exchange Rate System:

Following are the merits of fixed exchange rate system:-

(I) It encourages development of international trade.

(II) It ensures a regular flow of foreign capital and supports progressive planning efforts.

(III) It facilitates long-term international investments.

(IV) It rules out speculative activities in foreign exchange.

(V) It gives an added incentive to the country to adjust its domestic affairs in order to maintain a fixed exchange rate.

(VI) It is desirable if multilateral trade transactions and agreements are to be encouraged through regional economic co-operation of different countries.

(VII) It systematises the world's monetary system. Hence, the IMF has adopted fixed or pegged exchange rate system.

(VIII) It assists in internal economic stabilisation

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Since the merits of the system of fixed exchange rates mentioned above are substantial and carry much weight, the IMF aimed at maintaining stable or pegged exchange rates for its members.

Merits of Flexible Exchange Rate System:-

Following are the merits of flexible exchange rate system:-

(I) It automatically deals with the problem of balance of payments.

(II) It permits the country to adopt an independent monetary policy to maintain its domestic economic affairs.

(III) It eases the liquidity problem, since there is no need to maintain large-scale reserves under the system.

(IV) It permits foreign exchange rates to be determined in its natural course.

(V) The system of flexible rates facilitates continuous adjustment, so that the adverse effect of a prolonged period of disequilibrium is avoided.

(VI) It permits the continued existence of free trade and convertible currencies.

(VII) It eliminates the need for official foreign exchange reserves.

Presently, however, International Monetary Fund favours a fixed exchange rate system with some relaxation. Floating of exchange rate is permitted under certain circumstances.

Against the two extremes of rigidity fixed and freely flexible exchange rates a system of controlled or managed flexibility is suggested on practical consideration into the exchange rate regime. The focus on intermediate regime between fixed and floating exchange rate is desirable for a tendency to eliminate the drawbacks and capture the merits of both extreme systems.