

competitors. More deeply, taking into account general equilibrium effects, they affect to some extent the relative prices of all other prices in the global economy. If these three currencies are mutually persistently far from equilibrium, by inference so is the global structure of prices.

The theory of multiple equilibria has been developed to explain what appear to be sudden, unwarranted speculative attacks on currencies that have been performing quite well. It essentially holds that financial markets accurately anticipate a change in the policies that have supported the currency to date. In other words, if an inflationary future is implicit in the economic and political context facing a country, then financial markets precipitate the shift to the exchange rate to which that inflationary future would inexorably lead. Since the attack validates itself in the form a "self-fulfilling prophecy", for the theory to hold, the government whose currency is attacked must indeed follow through and adopt the inflationary policies, the anticipation of which led to the attack in the first place. The trouble with this theory is that governments of the attacked countries have not generally behaved as the theory requires—their policies have not become more inflationist. The result is that the exchange rate shifts tend to be real and to cause significant discontinuous changes in the relative competitive position of the country that is attacked and of course on its trading partners and competitors. At the same time, the currency risk attached to emerging market currencies has become so great that the effective cost of capital to borrowers in these countries has risen, affecting the relative prices of capital and labour.

The third puzzling aspect of exchange rate behaviour, persistence of divergence from purchasing power parity, also has implications for the information content of international prices. Insofar as they are large enough to create serious cost advantages/disadvantages that last long enough to affect producer decisions about how to organize production of goods and services in a context where cross-border fragmentation of the production process is eminently possible, such divergences can distort the international division of labour.