would have been addressed through liquidity support (well-known IMF facilities such as the SDR and the General Agreement to Borrow were developed in fact to provide such balance of payments support during the Bretton Woods era) or through an IMF-approved devaluation insofar as the balance of payments situation was viewed as reflecting an erosion of competitiveness, e.g., due to accumulated higher inflation in domestic costs and prices). Such a devaluation—for example that which was undertaken by pound sterling in 1968—would be spread uniformly over all trading partners, meaning that bilateral parities and price relationships between all other pairs of countries would be undisturbed.

By contrast, post-Bretton Woods, the brunt of adjustment to a balance of payments problem—whether the problem reflected an erosion of competitiveness or a domestic savings-investment imbalance stemming from policy choices—would be borne by the exchange rate. As well, the degree of exchange rate adjustment would be potentially much greater, since it could and routinely did involve overshooting for example. And thirdly, the devaluation would be asymmetrically spread over other currencies. By the same token, it would be larger for the limited number of currencies that shouldered the burden. And because of the differential movement against other currencies, the bilateral parities between other pairs of countries would also be affected. Insofar as countries that experienced disproportionate revaluations resorted to protectionist measures, the potential amplitude of exchange rate movement would be further expanded; and insofar as such countries were destabilized, there would be secondary shock waves emanating from an original disturbance.

The case for floating exchange rates is that they shelter countries from terms of trade shocks etc., facilitate adjustment of external imbalances, and in principle prevent the accumulation of inflation differentials that could subsequently lead to a disruptive exchange rate crisis.

Allowing that floating exchange rates actually fulfil these objectives for an individual country, how do they work for the system as a whole? After all, if one country adjusts to the impact of a terms of trade shock by devaluing, other countries face