macroeconomic policy coordination.[24] There are at least three problems with the policy coordination solution. First, depending on the degree of coordination, there could be a surrendering of national sovereignty that proves more costly in terms of domestic economic performance than the original exchange rate volatility, especially when it is far from clear whether volatility is in fact a legitimate concern, at least with respect to international trade. Moreover, it is uncertain (and quite possibly doubtful) whether the surrender of this amount of national economic sovereignty would be politically palatable.

Another problem with macroeconomic policy coordination solutions is that they are frequently based on setting and maintaining exchange rate target bands. Although maintaining bands is a key goal of coordinating policy, this Commentary points out that the estimation of equilibrium exchange rates, around which target bands would be set, is not well understood.[25] For the same reasons that exchange rate misalignments are problematic, so too are more managed exchange rates that are not close to their equilibrium values. It is also important to recognize that a system of target bands can lead to an increase instead of a decrease in exchange rate volatility.[26] Thus, ironically, exchange rate bands can actually exacerbate the very problems that they are meant to alleviate.

A third problem is that, if policy coordination is meant to maintain rigid exchange rate relationships, as is suggested by the Bretton Woods Commission, it could imply, for example, that economies should be kept at the same stage of the business cycle, and that fiscal and monetary policies should be synchronized across

[24] See, for example, Bretton Woods Commission, *Bretton Woods: Looking to the Future*, Washington DC, July 1994, p. 4; and J. Williamson and C.R. Henning, "Managing the Monetary System", in *Managing the World Economy Fifty Years After Bretton Woods,* Institute for International Economics, Washington DC, September 1994, pp 90-3. Both favour coordinated macroeconomic policies along with, and as a necessary complement to, a system of exchange rate bands.

[25] Williamson and Henning, for example, who themselves propose the adoption of exchange rate bands, state that estimates of equilibrium nominal exchange rates, " ... are unlikely to be wrong by more than 10 per cent". That does not inspire much confidence in their ability to delineate bands within which equilibrium exchange rates are contained. See Williamson and Henning, *op. cit.*, p. 87.

[26] The ERM turmoil in 1992 and 1993 is a case in point. Despite the best efforts of various monetary authorities, intense market pressures pushed several currencies outside their prescribed bands. In a discussion of the ERM crises, the Bank for International Settlements suggests that exchange rate stability might best be achieved in a less constraining, formal exchange rate arrangement. See BIS, *64th Annual Report,* BIS, Basle Switzerland, June 1994, p. 170.