Adolfo Canitrot. 1993. The exchange rate as an instrument of trade policy. UNCTAD discussion paper 71 (October).

There is a tension between the two conflictive roles of the exchange rate, namely: that of serving as a stabilisation instrument (through adjusting money supply and demand and external trade, assets and capital balances), and that of serving as an instrument of trade policy (through increasing incentives to export, the competitiveness of domestic production and help domestic firms to acquire capital and intermediate goods and foreign technology in favourable terms).

How does the exchange rate perform with respect to particular aspects that influence investment and trade policy?

- *selective promotion of investment:* the exchange rate is a general instrument, that operates mostly through making the wage rate to fall. Direct subsidies are more specific and more to the point for the vast majority of the firms, and have significantly less worsening effects on income distribution;
- *acquisition of capital and intermediate goods and foreign technology:* the exchange rate can be used to cheapen and thus improve the access of domestic firms to capital and intermediate goods and foreign technology, but this would reduce the competitiveness of production for exports and would not necessarily discriminate between acquisition of productive capacity and imports of final, consumer goods. Subsidies play the same role and can be made specific to sectors, firms, technologies and markets and be made conditional to performance;
- *level of economic activity:* depreciation of the exchange rate may increase savings as the profit share of income increases, but the same process reduces consumption. If the reduction in domestic consumption exceeds the increase in exports that is associated with depreciation-led increase in competitiveness, the level of economic activity falls leading to further reductions in employment and consumption, and eventually in the level of savings. Thus, to increase exports it is preferable to use other means – like facilitating the process of upgrading productive capacities;
- *fiscal accounts balance:* if the exchange rate depreciates, it may also affect negatively the fiscal balance. On one hand, recession (or a reduction in the level of economic activity) may reduce fiscal revenues. On the other hand, the government's attempt to compensate for the fall in economic activity and the increase in the costs of debt repayments increase fiscal expenditure. Therefore, the fiscal balance worsens.

It is, therefore, very difficult to attain a balanced exchange rate policy that serves both objectives, stabilisation and export promotion. Additionally, non-marginal export growth cannot be achieved purely through exchange rate policy.

Export grow is the most important development connecting on a sound basis the present stage of stabilisation policies with future long-term growth.