Mint Parity Theory (MPT)

Meaning

- The value at which a country's currency can be exchanged for a unit of another country's currency, in term of gold standard.
- It's the fixed exchange rate between currencies.
- Historically, many currencies were tied to the value of gold, where the exchange rate was fixed and currencies could be converted at a specified rate.
- However, most countries have moved away from the gold standard, allowing their currencies to float against each other.

Example

- For example, under the gold standard, one gram gold cost \$78 in USA.
- one gram gold cost INR 6000 in India
- So what is the exchange rate according to mint parity theory

\$1 = Gold cost in India / Gold cost in USA =

if it is INR 1 = Gold cost in USA / Gold cost in India =

Fluctuation in exchange rate in Mint Parity Theory (MPT)

- The exchange rates between currencies were essentially fixed or pegged to specific amounts of gold.
- This fixed exchange rate system meant that currencies' values were directly linked to the value of gold.
- However, the exchange rates were not perfectly stable, and fluctuations could occur due to various factors:

1. **Trade Imbalances:** If a country had a trade deficit, meaning it imported more than it exported, it might have insufficient gold reserves to maintain the fixed exchange rate. This could lead to pressure on the currency's value, potentially resulting in a devaluation.

2. **Gold Supply and Demand:** Fluctuations in the supply and demand for gold could impact exchange rates. For example, discoveries of new gold deposits or changes in gold production could influence the stability of the fixed exchange rate.

3. **Speculation:** Market speculators or traders could also affect exchange rates by buying or selling a currency in anticipation of future movements or changes in the gold standard.

4. **Government Policies:** Monetary or fiscal policies of a country could also influence exchange rates. For instance, decisions related to increasing or decreasing gold reserves, interest rates, or changes in economic policies might impact the exchange rate under the gold standard.

Determination of exchange rate in MPT

- Suppose the official price of gold in Britain was £20 per ounce and in the United States it was $80 per ounce,these were the mint prices of gold in the two countries.
- The rate of exchange between these two currencies would be determined as £20 = $80 or £1 = $4.
- Under the gold standard, the balance of payments adjustments were made through the free international flows of gold.
- The export and import of gold involved costs of packing, freight, insurance, interest etc.
- Consequently, the actual rate of exchange between two currencies could vary above and below the mint parity by the extent of cost of gold export.

Graphical Explanation

- The cost of exporting gold including freight, insurance, packing, interest etc. of gold worth $4 is 0.04 dollar.
- the exchange rate between dollar and pound at the maximum can be £1 = $4.04 and lower can be £1 = $3.96

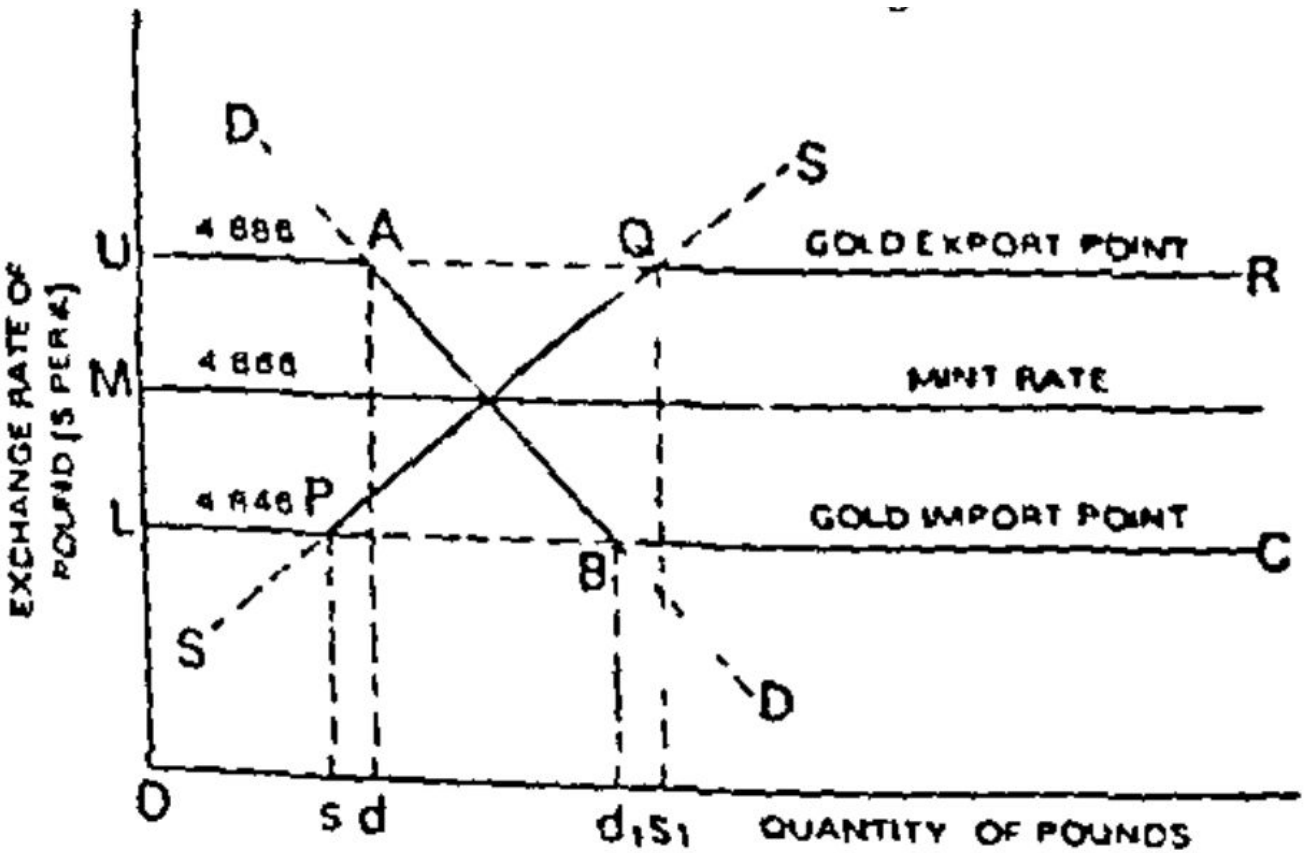

Fig 2

Relevance of the MPT

1. The actual rate of exchange can differ from the equilibrium rate of exchange.
2. Under gold standard, there are specified limits beyond which the fluctuations in the rate of exchange cannot take place.

Criticism

1. The international gold standard has been completely abandoned since its breakdown under the weightof depression of 1930'sthe theory presupposed the free international gold movements.
2. The modern governments do not permit the free buying and selling of gold internationally. In these circumstances, the mint parity theory ofexchange rate has little relevance.
3. Most of the countries at present are having inconvertible paper currencies. In such a system, the mint parity theory cannot at all determine the rate of exchange

Conclusion

- While the term "Mint Parity Theory" is not a conventional or widely used term in modern economic theory, fluctuations within fixed exchange rate systems, like those under the gold standard, were influenced by these and other factors, leading to occasional deviations from the established pegged rates.