

## Macroeconomics

### INTRODUCTION

The impact of globalization is tangible all over the world. Sometimes the effect of globalization can be dramatic, sometimes it can be barely noticed. While globalization can be very difficult to track and study, there are tools that can help an economist to get an idea of what is happening when it comes to international trade. One of such tools is the so-called *exchange rate*, which is linked to currency exchange. While every nation has its own currency, the value of the latter changes every single moment. Comparing the value of one's currency to another is called the exchange rate. In a free market, the *exchange rate* is determined by the interaction of buyers and sellers. However, in 1990s, the unregulated market created a major problem for Asian currencies, which led to the Asian financial crisis. As a result, many are calling for creating exchange rate control. Though there are sufficient grounds to demand exchange rate control for the Asian countries, one has to remember that a capitalistic market is characterised by freedom and not government interference.

### MACROECONOMICS

Globalization is the reason why economists and investors should consider macroeconomics. Although the impact of globalization was already tangible even before the turn of the 20<sup>th</sup> century, in recent decades the forces of globalization were intensified due to radical improvements in technology, both in communication and in transportation. While globalization can be also understood as good businesses seeking to expand overseas, the effect of globalization can be extremely complicated and very difficult to quantify. According to the example offered by Kroon (2007), "...globalization has forced us to incorporate multinational ownership and location of production – an acquired

comparative advantage not based on natural resources” (p. 217). In the past, the geopolitical analysis of a certain nation could provide one with an easy assess to the country’s military and economic might.

Not so long ago, an analyst would simply consider the location of a particular government, the natural resources within the country’s control and manpower to have a fairly accurate assessment of the nation’s ability to wage war and defend itself from external attacks. In the Age of Industrialisation, the same scheme of assessment can be applied to corporations. An analyst could go to its headquarters and study natural resources together with the country’s human resources to have a fair assessment of the state’s power and influence. Today, a casual observation is not enough because a company’s headquarters can be located, for instance, in Arkansas and yet have business establishments exploiting human and non-human resources in countries like China, Vietnam, Philippines and India. The only way to keep on top of the global economic situation is the expert use of exchange control.

#### EXCHANGE CONTROL

Since currency exchange can create subtle, as well as sudden shifts in the national economy, any country needs exchange control badly. In order to clearly illustrate the necessity of exchange control, the aspect of the national currency must be considered thoroughly. First, there would be cheaper imports as a result. Consequently, UK businessmen and UK residents will be able to purchase goods at a much lower rate. When they travel overseas, they will experience more purchasing power, since the pound is higher there (Riley, 2006). In terms of the given country, the producer who imports raw materials as well as component parts will also benefit from the stability of the pound. The same also proves true for the UK companies that import technology.

A strong exchange rate will also result in lower inflation. Since it is cheaper to import than to offer the produced goods to the home clientele, residents and businessmen can trade alternative products overseas, thus, enhancing international trade. Forcing local manufacturers to face stiff competition in the international market, such strategy will help to lower the prices of goods and, hence, lower the inflation rate. The next consequence that will come because of lower inflation is lower interest rates. This means that people will have access to cheaper money, which will result in higher consumer and capital spending (Riley, 2006). The reverse will be true if exchange rate is weaker.

Currency exchange and exchange rates are very important especially after World War II when the gold standard was no longer used as a tool to regulate trade between two countries (Krugman & Obstfeld, 2003). An increase in exchange rate can be beneficial or not, depending on the perspective of the one doing business. Exporters would like the real exchange rate to decrease, while the importer would like the exchange rate to rise. The changes in the exchange rate, however, are predetermined by demand and supply as well as the interaction of buyers and sellers (Kroon, 2007). The absence of government interference is, thus, is the essence of a free market. However, in the 1990s the Asian financial crisis came like a Tsunami causing great havoc in the financing sector and causing the financial collapse of numerous corporations.

#### THE ASIAN FINANCIAL CRISIS

Many economists render the idea of exchange controls with considerable disdain. This is especially true for those who are die-hard advocates of the free market. To be honest, though, it must be admitted that there are more examples of economies destroyed

because of government intervention than the examples of free markets operating in highly industrialised countries. However, if exchange control is being considered, there is only one justification for the deplorable state of the market economics. Schumpeter *et al.* (1986) were able to put it succinctly by saying that exchange control is the weapon used in economic warfare. The total victory will be to create a number of advantages where none existed. From the perspective of national leaders and their finance ministers creating exchange control was a tempting offer, but mostly not a standard practice. However, everything changed after the Asian financial crisis.

The financial crisis that hit Asia was predetermined by many factors, yet the most critical is the fact that some currencies were overvalued. An overvalued currency has its advantages, but if speculators and other investors get hold of the idea that this particular currency is overvalued, they can initiate an “attack”, putting at risk the currency with high interest rates, the currency exchange will collapse (Montiel, 2003). There are two countries in Asia that were able to weather the storm, namely, Singapore and China. However, before going further it would be better to reconsider the economic state of the countries that were badly hit by the above-mentioned crisis.

According to experts in economics, Japan experienced considerable economic hardships when in May of 1997 it was going to raise interest rates to defend the yen (Nanto, 1998). Investors and speculators smelled blood and began to unload Southeast Asian currencies (Nanto, 1998). Apparently, speculators decided that, since the more established Japanese market was in trouble, weaker economies would fall shortly. It can be argued, though, that in many instances the economic collapse was an obvious fact meaning that their negative perception fuelled their fears and hasten the fall of many Asian currencies.

The three Asian economies that were damaged the most because of the crisis were Indonesia, Korea, and Thailand (Asian Development Bank, 1999). The primary reason according to experts was the "...shortage of foreign exchange that has caused the value of currencies and equities in Thailand, Indonesia, South Korea and other Asian countries to fall dramatically" (Nanto, 1998). Therefore, it was obvious that the reason of the economical collapse was overvaluation of the economical prospects. It must be admitted that there was a time when the above-mentioned countries' economies were perceived as robust, though. However, investors and speculators learned shortly that this is not the case. Yet, even if the alleged economic rise with help of the exchange control was true, no one could have predicted that the Asian financial crisis would turn out that disastrous, affecting not only the region but also the United States of America (Nanto, 1998). The collapse could have been prevented if these countries had found the way to depreciate their currency (Montiel, 2003). The IMF was expected to create stability in the region, but its policies and interventions fell short. For each government, the next necessary step should have been an increase in the interest rate in order to stop the money haemorrhaging. If these steps had been followed, negative impact of the Asian financial crisis would have been mitigated, but this was not the case.

In order to understand the Asian financial crisis from the point of view of policymakers, it is important to study two survivors – Singapore and China. In the case of Singapore, the authorities recognised early the fact that there was going to be a recession and did everything possible to reduce its impact on the society. Knowing that Singaporean officials are well aware of the true state of their economy, the government made deliberate steps to slowly depreciate its Singapore dollars against the US dollar to maintain its competitiveness (Jin, 2000). This move was brilliant from the perspective of

later analysts because Singapore was able to communicate to the outside world that their currency was not overvalued.

While many will consider this a brilliant move by Singapore officials, this is merely a small part of the entire story. The government of Singapore decided to reach complete excellence by initiating financial reforms as well as cost-cutting measures to increase their competitiveness (Jin, 2000). Some of its Asian neighbours were contented to seek help from the IMF. For instance, the IMF was more than willing to provide \$3.9 billion as part of the support package for Thailand. Meanwhile, Indonesia had no choice but to ask for help. The IMF responded by announcing the availability of a \$40 billion stabilization package for Indonesia (Nanto, 1998). Therefore, it was clear why Indonesia, Thailand and South Korea were forced to ask for help. However, the countries should have considered the long-term effect of their actions, since it was easy to see that investors were highly confident when it came to Singapore, and were rather doubtful when it came to other Asian countries. In the aftermath of the unreasonable decisions of the above-mentioned countries, it is still hard for them to establish economic relationships with the rest of the world.

Aside from Singapore, China was also able to weather the storm, which was achieved by using *exchange control*. Using stringent policies China's currency, the RMB was not capable of capital account transactions (Sharma, 2003). Due to the partial convertibility of the RMB made it extremely difficult for speculators to take any short position against the RMB and this has spared the Chinese economy in the financial crisis of the 1990s (Sharma, 2003). If only other Asian countries were more than willing to use the exchange control demonstrated by the Chinese and the prudence demonstrated by the Singaporeans, they could significantly reduce the impact of the Asian financial crisis.

## CONCLUSION

It can be argued that there are many ways to combat the Asian financial crisis aside from using exchange control. Singapore was able to show that timely adjustments in their policies as well as implementing cost-cutting measures allowed them to remain competitive. If other Asian countries had been aware of the reasonable decisions made by Singaporean leaders and considered them in the light of the deliberate moves made by the Chinese to prevent the outflow of money, the herd mentality of speculators could have been neutralised and its devastating effects would have been minimised.

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