

in international trade, in handling matters relating to policies on domestic and foreign economic activities, therefore without a correct knowledge and a method of handling it appropriately, disastrous consequences will be inevitable.

To pose the problem in such a manner doesn't mean that I want to uphold this economic category of great importance, but I want us to realize the role of the exchange rate and thereby understanding it correctly. Misunderstanding it or understanding it incorrectly, and then making errors in handling the exchange rate will make us pay the penalty for it.

lar, Japanese yen, German DM, etc.) has recently aroused a lot of controversy. In general, many people think that the present exchange rate applied in Vietnam tended to appreciate the VND against other currencies leading to an unfavorable balance of payments. The other opinion maintains that the current exchange rate was appropriate to present conditions but in future a floating exchange rate would have to be adopted. Both opinions were based on the comparison of purchasing power of domestic currency with those of foreign currencies and considered this relation as the main and

TO KNOW AND MANIPULATE THE EXCHANGE RATE

by Prof. Dr. LÊ VĂN TÈ

I. INFORMATION ABOUT EXCHANGE RATE

Exchange rate is an economic category relating many other ones and acts as an instrument for affecting foreign trade, and at the same time, as a factor of great importance to monetary policy of a nation. That is why the task of learning and applying the exchange rate, a special kind of price, becomes a measure of managerial skill and ability to control the national monetary policy, and affects-directly or indirectly, favorably or unfavorably-the economic growth and stability, and the stability and purchasing power of the domestic currency.

For centuries, the humankind has faced this important matter and has tried to approach it in order to master it and introduce an appropriate exchange rate and use it as a positive instrument for regulating the economy, but results achieved didn't always come up to their expecta-



tions.

This phenomenon resulted from the fact that, as economists put it, the exchange rate is a "price of prices". It is affected by made factors and hard to understand because of its abstraction. However, the exchange rate is what people have to think of every day, every hour, and use it

In recent years, international forums and conferences have witnessed the presentation of many different, or even contradictory, opinions about the exchange rate. But each opinion has its own theoretical and practical bases. In Vietnam, the exchange rate between the VND and other currencies (US dol-

only factor in determining the exchange rate.

To form a general and exact view on the exchange rate, we had better review systems of exchange rate and bases for determining the exchange rate.

As we know, many exchange rates have come and gone: the multiple rate, fixed exchange rate based on the sterling, and after 1947, on the US dollar. The fixed exchange rate system came to an end after the US dollar was devaluated two times and it was replaced by the floating exchange rate system. Under a free float system, exchange rates between currencies are determined by many factors (the purchasing power of a given currency is one of them only). The main factor is the balance of payments of the nation in question, and more importantly, the supply of and demand for a certain currency. The demand for and supply of the currency concerned, in their turn, are affected by the interplay of

market forces (real demand, speculation, preference for certain currencies, etc.)

But when we consider the supply and demand relation as the decisive factor, we should answer the question: What determines the supply and demand relations? To find an answer, many economists returned to the balance of payments of the nation concerned, that is, examined the balance of trade for values of visible imports and exports; the transaction of services for international service supply; the capital account of the balance of payments for movements of investments; and transaction of aid and immigrant remittances for unilateral transfer of currency, etc. Finally, they affirmed that there was no unique factor determining the exchange rate. Recently, a study carried out by IMF to order placed by APEC Ministers of Finance into changes in exchange rates and influence of these changes on trade and investment in OPEC countries has introduced the Big-Mark exchange rate based on the purchasing power parity theory, and this exchange rate was re-fixed right away.

These data show that the task of fixing the exchange rate is very complicated. Since the day the fixed exchange rate system was replaced by the floating exchange rate system, the world has undergone an experiment with more failure than success. The failure came from the wrong realization of the exchange rate and the placing too much emphasis on market forces, or in other words, from the blind cult of the invisible hand in determining the exchange rate. That is why only a short time after the floating exchange rate system was adopted (from March 1973 to June 1976) many countries came to the Jamaica Conference and issued a joint communiqué advising governments

adopting a managed exchange rate. The transition from the fixed exchange rate to the managed floating exchange rate is a landmark in the process of realizing and controlling the exchange rate, the recognition of the strength of the public hand, or the government intervention in fixing and handling the exchange rate. From these data, we can draw two conclusions:

Firstly, we shouldn't base the exchange rate on the purchasing power of the currency as the only factor.

Secondly, the exchange rate should be controlled by the government and the government intervention is necessary when there is an unfavorable change.

However in the market economy the government intervention must be different from what were done in the centrally planned economy. In the market economy, the intervention must come from demand of the market. The government, and its central bank, must change itself into a part of the market acting as a buyer, or a seller, in order to affect supply and demand forces, make them meet at a intersection which could create the most favorable condition for the economy and the stabilization of domestic currency, because no economic stability and development could be obtained without stabilizing and raising the purchasing power of domestic currency.

I hope that the above-mentioned analyses are enough to refute the opinion considering the purchasing power of two currencies concerned as the only basis for fixing the exchange rate between them. This opinion goes against the theoretical basis and against the nature of the exchange rate as well. If this opinion is approved and applied to the economy, disastrous consequences will be inevitable.

II. SOME OPINION ABOUT

THE WAY WE HANDLE THE EXCHANGE RATE

To handle the exchange rate at present and in the future, we should consider it against a background of international economic relations, of the interplay of various factors, and particularly, we should consider it as an important part of the national monetary policy. Based on these requirements we should orient our thinking towards the following directions:

1. It's necessary to understand that the exchange rate is a kind of price, and as a price, it requires us to recognize and handle it in a manner appropriate to its nature. However, it has a wide-ranging effect, that is, when changes in exchange rate become greater than an admitted extent, it will affect prices in all markets (commodity market, credit market, foreign exchange market, etc.). Moreover, the exchange rate, in general, is one of variables in the economy (these variables have effects on each other). So in many countries and in Vietnam as well, the task of controlling the economy has faced the contradiction between the stability and the rationality of exchange rate. Realities show that the stability and rationality could be suited to each other, but in long position, they hardly harmonize well with each other, even in developed countries. A report made by IMF in 1977 said: "Since 1973, fluctuation in exchange rates tended to balance inflation rates in great developed countries, but it was only a tendency. In the long term, hardly the prices and exchange rate change at the same degree but changes in exchange rate are usually greater, or smaller, than changes in price levels".

So we must make a choice and the priority is usually given to the stability. As for the irrationality of the exchange rate, different measures will be taken to improve it. Of these

measures, we must pay attention to the way to control inflation rate in order to raise the purchasing power of domestic currency. The Jamaica Joint Communiqué is also based on this argument when it advises governments to take measures to maintain the relative stability of the exchange rate. Therefore, stabilizing the exchange rate must be the target in the long term and the inevitable tendency of the task of handling the exchange rate of the world and of Vietnam as well.

2. To achieve this target, emphasis should be put on the role of the government, or on the central bank to be precise, because the central bank is considered as the body carrying out the monetary policy, including the task of controlling the exchange rate. Experience we obtained in the past shows that the control over exchange rate must originate from the market, and the central bank, as a participant in the market, must possess not only abilities to intervene if need be, but also methods of directing and managing, so it can intervene at right time as required. To realize this task, in my opinion, the following principles must be observed:

a. We should regard the exchange rate as one of other prices because of its nature. So it's necessary to watch changes in both foreign and domestic markets, and then to use different instruments to intervene in the market with a view to achieving intended results. However, the intervention of the central bank is conditional upon the fact that these changes originate from the supply and demand relation as stated above.

If these changes come from the inflation, we must find out causes of inflation in order to prevent and control them. To use foreign exchange reserves to stabilize the exchange rate when inflation occurs is a suicidal policy because it

exhausts the foreign exchange reserve when the fall in value of the domestic currency is caused by the inflation.

b. In regulating the exchange rate, we shouldn't deal with the purchasing power only, because thinking through to adjust the exchange rate by decreasing the value of domestic currency when its purchasing power is on the decrease can lead to nothing but economic shocks, and more importantly, the vicious spiral of increasing inflation and decreasing exchange rate. In such cases, it's necessary to separate relatively these two variables from each other, and find out causes of inflation in order to curb it or reduce it effectively. After this was done, we can obtain a stable monetary system with an exchange rate which has been stabilized before. Any adjustment of the exchange rate based only on the purchasing power is nothing but a passive, temporary and unacceptable measure, because it goes against the nature of the exchange rate, and particularly, denies all other factors affecting the exchange rate in the market economy.

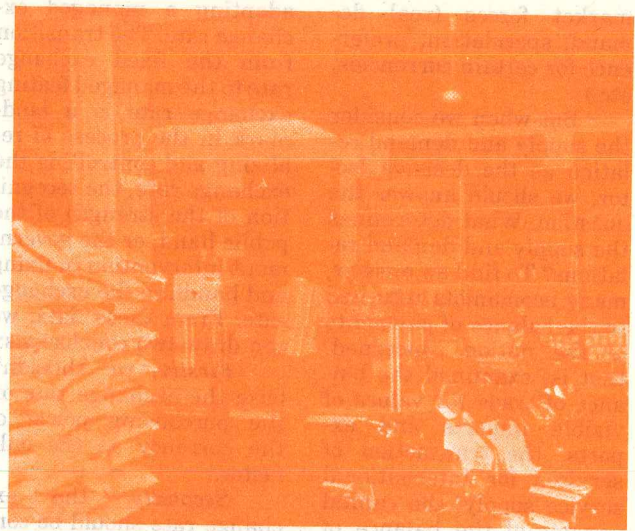
c. After adjusting the exchange rate, it's necessary to take measures to keep it stable and create favorable conditions for the foreign trade. The method of using exchange rate to encourage importation or exportation, as we must understand it, is very relative and limited, because, thinking through, there is no economic activity having an one-way meaning. The exportation, finally, aims at importation, therefore if an exchange rate favors exportation, it also discourages exporters when they want to import something. This relation must be sustained and set against a background of national monetary and finance policies.

The above-mentioned principles reflect main measures to stabilize the

exchange rate in long position and make adjustments to it in short position. This means that, the stability of the exchange rate becomes a red thread running through the process of manipulating monetary and finance policies as effectual instruments for achieving economic objectives.

Because the exchange rate has wide-ranging effects and great importance to the economy, all signs of simplification and subjectivity in handling and controlling the exchange rate will certainly lead to bad results. Human experience accumulated by taking part in international trade, especially in the market economy in the world and in Vietnam as well could provide us with a lot of examples of success and failure in dealing with the exchange rate. Fortunately, although Vietnam has just made a transition from the centrally planned economy to the market economy, but the way of handling and controlling the exchange rate in recent years has reflected abilities of monetary authorities to manipulate such an important instrument as the exchange rate and help to realize the national monetary policy.

However, facing such a complicated and abstract category as the exchange rate, nobody dare think that one has mastered and manipulated the exchange rate very well. The exchange rate as J.M. Keynes puts it, has two-sided effects: it is an effectual instrument for stabilizing the monetary system and the economy as a whole, but if we handle it incorrectly, it will become an obstacle to the economic stability. I think that this opinion is worth thinking about when we have to deal with the exchange rate every day. I hope that my above-mentioned opinions will help to find out the right way to approach this difficult and complicated economic category ■



INFLATION OR DEFLATION - CAUSE AND HOW TO SETTLE

by Dr. NGUYỄN ĐẮC HƯNG

In August 1996, although natural calamity causes serious losses to the northern provinces but the prices of food, foodstuff saw no considerable change, the country's price index dropped by 0.4%. This is the third successive month from June until now with the fall in price index. So, the price index in the first eight months is only up by 2.2%, lower than ever and out of expectation. The prices proceeded like that and what is the inflation?

There can be different opinions on how to access the inflation rate, but in the past our inflation rate was regarded as consumer price index in the market. When I met Mr Micheal Bell, permanent representative of the International Monetary

Fund (IMF) in Vietnam, I asked him whether the way to figure out the inflation rate in Vietnam is different from the international practice or not. Although he said there was no difference in general, but he thought some prices were not included and our calculation is still different to some extent from regional countries. But anyway, the price fluctuation, or recent inflation trend caused the public anxiety, and different solutions to this problem as well, of which the solution of credit and foreign exchange rate is stressed.

In theory, there are causes of inflation, they are excessive money supply, demand pull and cost - push. Similarly, deflation is the shortage of money in circulation, production, and the