CRISIS OF ECONOMIC THEORY BASIC CAUSE OF CURRENCY TURMOIL

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When Keynes rediscovered the role of money, with his well-known warn: *the gold-standard system is a barbarous relic,* he recognized the cause of cyclic economic crisis was deflation made by the principle of currency circulation based on the gold reserve. His economic theory helped the capitalist economy escape the world economic crisis (called Great Depression to distinguish from current cyclic recessions) since 1933. In the other hand, countries rapidly recovered their economics after the World War II thanks to Keynesian theory. It can be said no other theory is successful in reality. Until 1970s, the theory identifying inflation with price hike misunderstood price hike due to materials crisis, oil crisis as inflation and used a new illness - stagflation to blame Keynesian theory for causing the global hyperinflation. Due to the US government's trust, this theory used its influence to make a conclusion on the end of the Keynesian theory and like a school criticizing another, put an obstacle to the economics' progress while in other sciences latecomers applied earlier achievements to attain higher theories.

The East Asian currency turmoil with steady and sharp devaluation revealed clearly the crisis of economic theory when currency no longer boosted the economy, but devastated the most vital economies of some East Asian countries. The economic theory lost its role in guiding economists to manage the economy properly, detect hiding dangers and forward remedies to correct the discovered mistakes. Currency is the weakest field in the economic theory. The International Monetary Fund's past operations show more failures than successes. Its biggest shortcoming is not to adjust the effects of American inflation on other countries because IMF members have to issue local money to maintain the fixed exchange rate minus and plus one percent. The IMF was at a standstill so long in rectifying this fixed exchange rate that European countries had to remove this fixed exchange rate system by selling US dollars to raise their currency value which dropped by fourteen times. This caused outstanding gold fevers in which the gold price rocketed to US$800 per troy ounce in early 1981.

The special drawing rights (SDRs) regime relacing the role of US dollar was overthrown when the Bretton Woods currency system collapsed. It was given birth by the IMF but was useless for stabilizing the exchange rate, a core of stabilizing the world currencies. No countries used SDRs to equalize their payment balance, so when it faced currency crisis, it had to depend on loans in US dollar. The IMF was not capable of explaining its suggestions scientifically. In 1996, when forcing our monetary authorities to use credit line to manage the credit volume, the IMF weakened Vietnam's banking system because they had to freeze 50% of their bank deposits. Fortunately, when joint stock banks rejected, credit line was invalidated by being granted more credits if lacking. When asked which economic theory the IMF applied to make the policy on stabilizing the world's currencies, IMF officials gave differing answers. One said it was based on the monetarism, another the liberalism. The weakest point was the IMF did not prove the rights or wrongs of the monetary theory they used in their policies. Therefore, they did not satisfy the questions of the countries' monetary authorities and scientists when they wondered which theory the IMF's suggestions depended on. To prove this remark, I put forward some questions. The IMF can deny this remark by answering the following questions:

1. Why does the IMF suggest to use M_1 and M_2 which are different kinds of money supply to manage money when there is a unique formula about money demand: $Md = PQ/V$.

2. The IMF advised countries to issue more money in line with the GNP growth rate. Did the IMF depend upon a theory to change $MV = PQ$ into $MV = GNP$? So how does the IMF prove $PQ = GNP$ while they are two obviously different conceptions and volumes? Regarding developing countries, they are advised to issue an additional 20% per year. In 1989, Vietnam issued an additional 262%, but its inflation soared to 570%, in 1988 its issue dropped to 34%. Thanks to large issue of money, money (MV) and commodities (PQ) was balanced while the volume of commodities increased by many times since the markets were flooded with commodities and their prices had to fall. If Vietnam did not issue money as such, it can hardly became the third biggest rice exporters from a rice importer.

If an international monetary organization pays no attention to the theory it has to depend upon to make and execute the policy on global currency stabilization, it will look like the blind seeking his way in the dark. As a result, the IMF did not forecast and hedge currency crises, it is like a meterorological station which cannot forecast the storm to prevent it. There is an old Vietnamese saying: *the best way is to foresee the danger to hedge, the good one to see it when it has just happened and stop it on time and the bad one to let it proceed and overcome it later.* In the currency crisis, especially in East Asian nations, the IMF did not use the good way when speculators sparked off the currency crisis in Thailand in May 1997. So for the moment it uses classic medicine lacking firm theoretical base, in favor of curbing inflation and causes doubts to everyone because they do not see the IMF use the money medicine to bring these countries out of crises. The conditions which are so tightened to secure the repayment of loans cause doubts that the IMF only acts as a credit broker for loaning countries.

Until now, how to find solutions to halt the future money crises is out of the IMF's mind. The principal causing currency crises is short sale speculation which is not identified for elimination but defended against accusations. Mr. Camdessus, the IMF's managing director made a report on international money dealing in a conference of 14 Asian nations on Dec 1, 1997, but that report has not yet publicized so that everyone knows what is the IMF's attitude towards this principal. Since Feb 2, 1998, currency speculators have rushed into sales of US dollar, amounting to US$500-600 million. This causes fluctuations in exchange rate. (see the following charts)

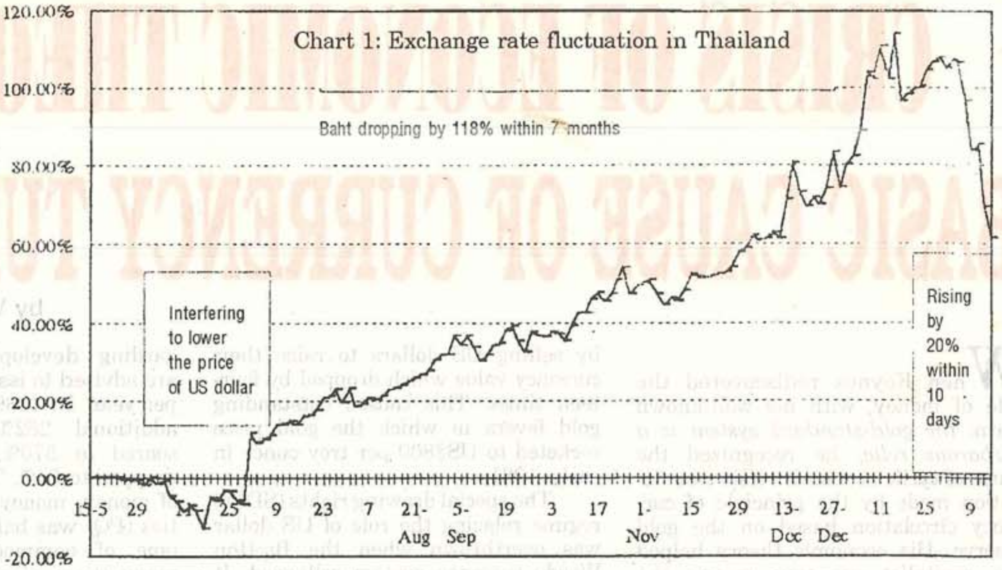

Chart 1: Exchange rate fluctuation in Thailand

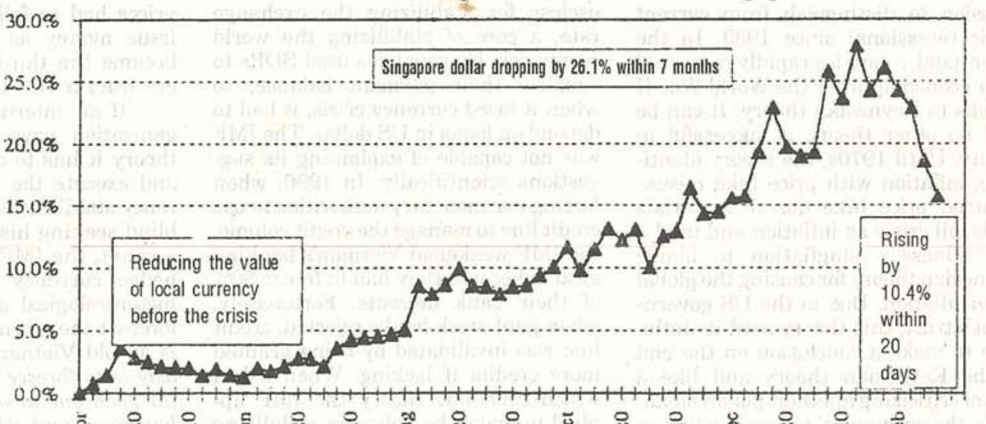

Chart 2: Exchange rate fluctuation in Singapore

As such, had the IMF offered loans to help equalize Thailand's payment balance just from May 1997, the crisis might not have happened. Singapore has taken initiative in raising the value of US dollar since April 1997, so it suffered fewer losses in the currency crisis. In fact, the IMF's settlement is not better than that of Singapore.

Malaysia and Philippines have the same fluctuations which show that the principal of the crisis currency is international currency speculators. They themselves worsen the currency crisis when manipulating and raising the market price higher than real price. If they are defended against accusations in the currency crisis, then the above-mentioned countries have magic to overcome their shortcomings in economic management for a very short time, 10 days and 20 days as seen in the above charts.

These above charts shows the large margin of devaluation and revaluation, briefed in the following table:

	Dropping in 7 months	Rising	Within
Thailand	118%	20%	10 days
Singapore	26.1%	10.4%	20 days
Philippines	66%	22.6%	11 days
Malaysia	84.3%	35%	20 days

The above charts and figures prove the IMF does not see that the international stock market should be reformed by abolishing the manipulation of US dollar for speculation while this is permitted in many nations' securities laws. The IMF's trustworthiness lost in the East Asian currency crisis can be restored only when it improves its knowledge about scientific theories in the monetary economy, eradicates scientifically doubtful theories to escape the crisis of economic theory. Speculation in currency must be eliminated as the stockbrokers' speculation after the Great Depression in the period 1929-1931. That is the only right way for the IMF to fulfill its task of stabilizing currencies to develop the world economy■

Chart 3: Exchange rate fluctuation in Malaysia and Philippines