

The Relationship Between The Appropriate Exchange Rate Regime And The Economic Development: An Analytical Approach

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ABSTRACT

Interest in experimental and theoretical studies on the choice of the exchange rate regime in developing countries began following the currency crises that shook the economies of Mexico (1994), South-East Asia (1997), Russia (1998) and Brazil (1999). In the face of free movement of capital and other shocks, and immediately after these crises, a growing consensus emerged among developing economies that were closely integrated into the international trading and financial system on the need to either float or move to seamless binding. Less attention had been paid to the arrangements for linking the arbitrator by the Argentine crisis, and then, it has become the prevailing view now that the increased flexibility in the exchange rate management would help to address external shocks, and reduce the risk of banking crises, and to contribute to the achievement of financial stability.

Theoretical studies provide for the choice of an exchange rate system capable of improving the level of gross domestic product and adapting to external shocks. The nature and magnitude of shocks likely to be experienced by the economy, as well as the structural characteristics of the commodity and labor market and the financial market of the country, are important considerations in the choice of an appropriate exchange rate regime for the economy.

Introduction

Economic growth in broad terms reflects the increase in production and goods produced by the economy during the period studied. It is by this aspect expresses the amount of an increase over a period or several long periods in the volume of production. Additionally, the economic growth has been featured by the fact that the country's economy is constantly in an augmentation in production for a long time, and in the short term, the volume increase reflects a period of a recovery. In its narrow sense, economic growth means an increase in the basic product of the economy, i.e. it is not directly measured as reflecting the improvement of the social and economic status of the society. This concept is called economic development. Economic growth is an economic indicator measured by the level of gross domestic product represented by the added value of various active institutions in the economy.

The theory of economic growth was developed in the 1950s in reliance with econometrics as compared to other branches of economic analysis, resulted in many economic growth models beginning with the classic model of economic growth, and the neoclassic model of Solow-Swan (1956), and the internal growth model. All these models are for the same purpose of searching for the interpretation of economic growth and its relation to the product, the factors of production and the productivity of these factors.

Many theoretical and applied studies have talked about the determinants of economic growth, especially the Solow model (1956). In this model, growth can only be the result of economic liberalization as external variables while the internal ones denote the inflation, human and material capital.

1. ECONOMIC OPPENESS AND ECONOMIC GROWTH:

Economic openness means the abolition of restrictions on commercial transactions and capital movements. Theoretical and applied studies have witnessed a major development in the study of the relationship between openness and economic growth. In theory, two concepts of growth model, In relation to the models of neoclassical growth by Solow-Swan (1956), Diamond (1965), Römer et Weil et Mankiw (1992), the production function assumes that the marginal

productivity of the factors of production is decreasing, namely labor and physical capital as well as the financial one. In this model, economic openness is a long-term economic growth, because growth in this case responds to the degree of technological development in the outside world. In the short term, economic growth is caused by the liberalization of foreign trade and by exploiting the advantages of foreign trade. This scenario allows the economy to specialize more in activities in which it has a comparative advantage and as consequence, the economic openness encourages and accelerates the economic growth.

The economic growth model, headed by Römer (1986) and Lucas (1988), states that long-term economic growth is not achieved through technological development abroad, but rather by internal factors. The study also confirms that the results obtained before the newclassic models are temporary and that the progress they have sought is due to the evolution of the outside world. The productivity of the productive machinery has also improved because of the imposed competition, which has contributed to the reduction of production unit costs, owing to the expansion of markets and trade liberalization considered as the basic factors conducive to sustained growth.

The testimony of many international institutions proved that there is a positive impact between economic openness and economic growth, in a study by Dolls (1992) concluded that economic openness affects the level of the prices, and in turn, it affects positively the level of economic growth. In addition to this, Sachs et Werner (1997) study of 117 countries in which they measure the expected effects of economic openness on economic growth using the following indicators: tariff barriers, exchange rate in the parallel market, the degree of monopoly of the main export-oriented products, the status of the economy (whether socialist or not). The study concludes that the relationship is positive between the openness and the economic growth which exceeds 2% compared to growth rates in the less open economies. On the same vein, Greenaway, Morgan *et* Wright (1998) noted in their study of 73 countries that there is a positive correlation between economic openness and economic growth.

2. EXPORTS AND ECONOMIC GROWTH:

In the study of the relationship between the external sector and economic growth, Michaley (1977), Balassa (1978), Tyler (1981) and Teder (1983) investigated the causality between the economic growth and export performance in developing countries. The importance of this issue comes from the fact the exportation is an explanatory variable that plays an important role in bringing about PIB increase and proving a positive relationship between export growth and increase in production. Therefore, a sample of 41 low- and middle-income developing countries was taken to estimate the relation between per capita GDP and share of exports in GDP. The results of the study indicate a strong positive correlation between these variables. On the other hand, the sample was divided into two parts, the first consisting of 23 countries with average in terms of per capita income values, and the second from 18 countries with low per capita income. The results of study suggest a positive and significant relationship between the two variables in the average per capita income, while for low-income countries there was no correlation between the two variables. As a conclusion to Michaley, the country must have a minimum level of development so that its export performance is affected. As Krueger (1978) concluded, two basic assumptions are envisaged: more liberalization generates high growth rates and if the exchange sector is free, the positive economic growth will be the result accordingly.

3. THE PHYSICAL AND HUMAN CAPITAL:

Technological progress is a key factor in economic growth, but many neoclassical economists have argued that an important additional factor which is the human capital must play an important role in generating domestic economic growth. As a representation for this, more than 70% of their children have attended school, and nearly 40% of them are integrated into the secondary education system. These efforts cover special needs and are an effective investment that will contribute to raising the level of education. Productivity, and therefore the education are the result of an efficient correlation between:

- Dissemination of knowledge.
- More social movement.
- Acquisition of qualifications and experience.

The experimental evidence presented by both Barro (1990) and Lee et Barro (1993), conducted in 129 countries during the period 1960-1985, has concluded that educational attainment rates for the adult population have had direct positive effects on the GDP growth rate, the same as Benhabib et Spiegel (1994) who argues that human capital affects economic growth through two channels:

- Human capital directly affects local technological innovations.
- Human capital affects the speed of economic development of the country that adopted and imported technological technologies from a developed country.

4. THE FINANCIAL SECTOR, INFLATION AND ECONOMIC GROWTH:

This research arena of the about the impact of the financial systems on the economic growth, had been richly advocated by the pioneering work of Gold Smith (1969), Mac-Kinnon (1973), Shaw (1973). However, the problem is that the results of growth were measured after the implementation of the fiscal policies imposed in conditions that were afflicted by crises hitting the global economy in the past 30 years. The result of these studies is that the financial sector plays an important role in accelerating economic growth and activating economic performance by facilitating the movement of capital to productive sectors. For Mac-Kinnon, the expansion of financial markets and the depth of financial intermediation contribute to economic development by giving investors an opportunity to finance their own needs. The good governance

of the economic policy contributes to the enhancement of financial depth and the development of intermediate activities, as Amabe et Châtelain (1995) has pointed out: Suppression or financial restraint means low interest rates, credit programs by institutions, or more comprehensively all state interventions to limit the freedom of activity of the financial sector, do not give a lower rate of economic growth. On the contrary, lead to a reduction in savings at the expense of private investment, while fiscal liberalization should lead to higher savings and more efficient use of the resources available for investment.

As for inflation, Fisher (1993) and Gregorio (1993) conclude that there is an inverse relationship between inflation and economic growth. On the other hand, the study of Vieilieu et Rajhi (1993) found that inflation is not considered as a relevant variable in the interpretation of the economic growth, but it is due to the speed of price volatility, contrarily to Borro (1997) who concluded in his study that low inflation is in fact an instrumental variable to access the good performance of economic growth in the long run.

5. THE CONVERGENCE OF THE ECONOMIC PERFORMANCE OF TRADE PARTNERS AND ECONOMIC GROWTH:

In this context, two scenarios should be distinguished: the first is about the equal level of per capita income at the global level, and the second, the adjustment of the level of economic growth in all countries of the world. At this level of analysis, Solow (1956) shows that the absolute convergence of per capita income is similar in all countries with the aspiration to catch up the global development.

6. THE FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH:

The financial institutions played an important role in raising the level of sustainable economic growth. On the other hand, many economists whose research focused on the relationship between financial development and economic growth concluded that there is a positive relationship between financial development and economic growth, and that financial liberalization affects the level of financial development, which in turn affects economic growth. In this context, King et Levine (1992) examined the effectiveness of financial depth, i.e., the relationship between economic growth and financial development during the period 1960-1985, through an econometric investigation between basic income level, secondary enrollment rates, openness rates and public expenditure. The study concluded that the financial development can affect the economic growth via three channels:

- Financial development allows the allocation of funds more efficiently and improving the marginal productivity of capital, as it affects the economic growth positively.
- Financial development works to channel part of the savings into investments, leading to a positive impact on economic growth.
- Development of capital markets that encourages households to diversify their portfolios due to the improved conditions for obtaining consumer loans by lower costs and reducing incentives to encourage savings.

In this context, Levine (1997) revealed in his study that five characteristics of the relationship between financial development and economic growth have been found. This is due to the accumulation of capital, creativity and technology in order to achieve real economic growth, and the purpose of access to a sophisticated financial system must be embodied: protection against risks, optimal allocation of resources, good control of corporate officials by shareholders, mobilization of domestic savings, and improved management of trade in goods and services.

Moreover, these empirical studies have shown that financial development and financial liberalization contribute to the diversification of financial products, as well as to attract foreign capital instead of domestic capital flight. It also reduces the role of informal financial markets. In addition to this, the financial development enhances the financial institutions specializing in multiple jobs bringing considerable value added to the economy.

7. THE FOREIGN EXCHANGE IMPACT ON THE ECONOMIC GROWTH:

The variables that are considered basic in formulating the appropriate economic policy to reach the development goals are: the rational management of the exchange rate, the need to avoid frequent adjustments in the exchange rate policy, which has undesirable effects on the economy and the value of the national currency. This package should be taken cautiously in an attempt to achieve sustainable economic growth and economic development at the lowest cost which is considered as a key macroeconomic objective in the medium and long term for developing countries.

7.1. THE RELATIONSHIP BETWEEN THE FOREIGN EXCHANGE AND ECONOMIC GROWTH:

The methodology of this context respects these two scenarios: the relationship of economic growth to the level and volatility of the foreign exchange rate, then the comparison of growth and the exchange rate system in the

The empirical studies have shown that there is a very negative correlation between exchange rate fluctuations and economic growth (Bosworth, Collins et Chen, 1995). The study also suggests that there may be long-term consequences that exceed the short-term effects on the competitiveness of institutions of the country under study.

The study by Collins et Razin (1997) has shown that the overvaluation of the national currency causes a slowdown in the economic growth rates and that large changes in the real exchange rate are linked to a lack of knowledge of the relative position of prices and in turn lead to greater risks and poor investment prospects. This result contributes in rising costs of adaptation to this situation: a decline in production, a shift in the structure of economic activity from tradable to non-tradable sectors, and an increase in interest rate volatility leading to financial instability. The exchange rate imbalance has negative effects on the main activities of the economy, such as the study by Edwards (1988), cottani, cavallo et khan (1990), ghura et grennes (1993) andsekkat et varoudakis (1998) By focusing on the study of economic performance and its relation

to foreign exchange rate changes. The researchers concluded that this could lead to a decrease in the efficiency of the misallocation of economic resources and the flight of capital as well as the weakening of the profitability of institutions. This phenomenon, therefore, receives particular attention as an important source of macroeconomic imbalance and is seen as a prerequisite for improving economic performance and ensuring macroeconomic stability. In this context, the causality is pro-cyclical in the sense that the policies aimed at stabilizing the real exchange rate at a certain level have at the same time efficiency in promoting growth. Economic theory did not define the proper exchange rate system for economic growth, but developed channels that could be exploited to influence economic growth without compromising the quality of the adopted expenditure system. Some argue that flotation can encourage growth for an economy that is resilient to prices and wages and able to absorb and adapt to economic shocks easily through currency fluctuations, giving the country the possibility of adopting an independent monetary policy, which gives it the potential to absorb shocks.

It is the economy with the potential to absorb shocks easily that can achieve high growth rates, and the floating exchange rate is by nature exposed to sustainable fluctuations and imbalances (Flood et Rose (1995), Baxter et Stockman (1989)). Additionally, the exchange rate shocks floating can result in an imbalance in resource allocation decisions. For economies with a backward or weak financial system, it is difficult to cope with exchange rate fluctuations. Previous studies show that economic growth rates vary from one expenditure system to another, but these rates are slow in the fixed exchange system. In this context, the idea of the exchange rate flexibility on economic performance remains ambiguous.

According to Collins (1996), the choice of an appropriate exchange rate system remains an internal matter for the state, and low-growth countries are highly likely to follow a fixed-exchange system, and it is certain that if this country wants to improve its growth rate. Many researchers also believe that the stability of the real exchange rate accelerates economic growth rates at a time when monetary authorities are shifting to currency exchange flexibility. Bailliu and Lafrance et Perrault (2002) consider that the exchange system does not affect the equilibrium values of variables but can affect the adjustment process because, whatever the nature of the system, in the long run the real exchange rate recovers its balance after any economic shock. On the contrary, it is time for adjustment having an impact on economic growth and, as a consequence the exchange rate system affects economic growth for its effect on adaptation and adjustment.

7.2. FOREIGN EXCHANGE DETERMINANTS AND ECONOMIC GROWTH:

The effect of variables related to the foreign exchange rate on the economic growth rates of a country can be more obvious or less, and vary from one variable to another. In this context, Römer (1989) tackled the economic openness and its relation to economic growth. In addition, more open economies are more able to integrate with technological progress and benefit from market expansion (Barro et Sala i Martin et al. 1995), and that the price decrease in real exchange rate contributes to the increase of exports through the impact of competition. This openness also allows for the importation of locally produced capital, which promotes economic growth. Conversely, the high real exchange rate encourages the traditional sector. In addition, in reducing the excesses of domestic exporters, the exchange rate affects economic growth as a result of openness to capital movement that can positively affect weak projects.

The response of economic growth to economic openness appears to be better in more open countries. It is widely believed that capital flows have positive effects on economic growth under a flexible exchange system, since the rigid exchange system increases speculation. Dooley (1996), in a study, confirmed that the flows observed in emerging markets during the 1990s were encouraged by the application of fixed or semi-permanent exchange rate systems, but both Corsetti and Pesenti et Roubini (1999, Krugman (1998) which took place in the 1990s to the role played by local banks by directing capital flows to the more productive sectors. Rizzo (1999) highlighted the relationship between the system of exchange and economic growth and the uncertainties raised by economic theories and concluded that the impact on economic growth depended on the amount of economic variables or depends on the gross productivity mechanism, and the impact on the overall productivity by factors of production can interfere either by adapting to shocks or impact on foreign trade or openness in general growth speed.

But most economists attribute productivity growth to many channels of influence, and the final effect on the true nature of the relationship between the exchange system and the growth of international transactions remains uncertain and debatable.

Exchange rate fluctuations, along with increased protectionist pressures, have a good activity on sectors related to foreign trade with huge productivity, while the fixed exchange rate distorts price indices and prevents the efficient allocation of resources between sectors, all of which have negative effects on economic growth.

If we take another example of the relationship between the exchange rate and another variable is the level of development of the financial market, the theory argues that the privileges offered by the flexible exchange system, primarily enabling the financial market from an appropriate development. This system has a great impact on the volatility of nominal exchange rate, and as a consequence it reduces the volume of investments and the level of foreign trade transactions. Therefore, a country with high rates of economic growth under a floating system should have a sufficiently sophisticated financial system to absorb the impact of exchange rates and provide the tools necessary to reduce volatility. However, developing countries face the opposite: their financial markets are lagging behind, and financing the capital needs of producers depends heavily on the internal market; here we note the existence of a dimension and fear of dealing with international markets due to high risk.

According to the economic theories, large exchange rate stability causes a reduction in interest rates by reducing the risk premium, which contributes to increased production. A good integration into the international financial markets contributes to reducing this effect and thus increases the degree of flexibility in the exchange rate. The financial growth is showing well in the country which adopts a flexible exchange system, with a strong and developed financial sector that promotes economic growth regardless of the nature of the system.

Financial development and development are measured by the ability to mobilize savings, easy allocation of funds and good risk management. This can achieve economic growth through its role as an indicator of capital accumulation and resource allocation to give opportunities to local institutions. In this context, Fisman et Love(2004), Levine (2004), that the causal relationship is not one-sided, but that the level of economic activity and technological innovations affect the structure and quality of the financial system, in addition to other factors such as the legal system and bodies responsible for policy formulation in the country, play an important role in achieving Financial development and investment Natal in the country, which is facing critical challenges to reach a desirable level of economic growth.

8. EXCHANGE RATE SYSTEMS AND THEIR EFFECTS ON ECONOMIC GROWTH:

Economic theory used some indicators to determine the channels of influence of each type of exchange system to influence economic growth. Therefore, the exchange rate can affect productivity growth by focusing on the quantity of factors of production (investment or employment), or through productivity total.

8.1. THE CHOICE OF THE EXCHANGE RATE SYSTEM AND THE ECONOMIC GROWTH:

The problem of the optimal choice of the exchange rate system remains controversial in the economic debates. Here, a problematic research question should be presented about whether the floating exchange system or fixed exchange system is suitable and capable of achieving real and sustainable economic growth. Perrault, Lafrance, Bailliu (2000) concluded that a flexible exchange system is capable of promoting economic growth rates, in an economy that is flexible in prices and nominal wages to absorb economic shocks and adapt easily to global economic developments, Therefore, as the Nilsson K. et Nilsson L. (2000) in a study showing that the flexible exchange system gives a strong boost to exports, thus achieving very high economic growth rates. As for the Conservatives Fisher (2001), Ripoll (2002) say in their study that under a flexible exchange rate system, the economy is experiencing too many economic shocks, which hinder the economic growth. In addition, Sotckman (1989), Flood *et* Rose (1995) confirmed that the flexible exchange rate experienced sharp fluctuations and major and continuing imbalances, which was causing economic growth to deteriorate. In another study by Frankel *et* Rose (2000), a fixed exchange system such as the currency union demonstrated a growth in foreign trade. In the foreign exchange rate, Obstfeld *et* Rogoff (1995) suggests that the fixed exchange system gives the economy an opportunity to lower levels of inflation (Cnavan et Tommassi (1997) and Eichengreen (1999)). Under the fixed-exchange system, the economy is experiencing low inflation rates, but on the other hand it enjoys weak growth rates. This situation requires the monetary authorities to sustain intervention and significant costs to maintain exchange rate stability.

On the other hand, Frankel (1999) and Williamson et Fellow (1998) consider the importance and capacity of intermediate exchange regimes to achieve better performance, especially by economic growth, but Obstfeld et Rogoff consider that the intermediate exchange systems are the source of instability in speculative attacks; one of the basic features among the least resilient exchange rate systems in a world dominated by integrated capital markets.

In the light of this theoretical and empirical analysis, the relationship between exchange systems and economic growth can still be debated among the various economists.

8.2. IMPLICATIONS OF THE EXCHANGE RATE SYSTEM ON THE ECONOMIC GROWTH:

The theory of economic growth and its relationship to exchange regimes depends mainly on the nature of the exchange system adopted by the monetary authority of the country in order to know the results and implications of economic growth in the short term. This issue is ensured in two ways: either directly through its impact on the process of coping with shocks or indirectly by influencing the determinants of economic growth such as investment, trade and the development of the financial sector.

- The direct effects of drainage systems on economic growth: According to economic theory, the exchange system should not affect the long-term equilibrium values of real variables, but should affect the process of adaptation to shocks. Thus, the positive impact of exchange regimes on economic growth is detected by the degree of speed of adaptation to the informal disturbances affecting the economy.

According to Aizenman (1994), an economy that is easily resilient to shocks should have very high growth rates, which are generally on average but closer to their maximum potential.

In this context, the work of Mundell (1960, 1963) and Friedman (1953), stressing the place of the system of exchange in the formulation of economic policy; and in this context, Friedman preferred a flexible exchange system that enables the economy to cope with external shocks. However, Boyer (1978) found that the disparity and the common divergence of the various external shocks were critical to the identification and selection of the exchange rate system. The study focused on a small open economy through two kinds of shocks: cash, and real. The study concluded that if the economy is experiencing purely monetary shocks, the fixed exchange system is optimal. If it is a real shock, it is advisable to adopt a flexible exchange rate system. In the case of two types of shocks, managed float is preferable.

The economists concluded that if the economy is facing real shocks, the fixed exchange system is better, from the point of view of consumers; and the more real shocks, the greater the desire to fix the exchange rate. On the contrary, if the economy is diversified in terms of shocks to demand for money, The more flexible of the exchange rate is preferable.

- Indirect effects of drainage systems on economic growth:

In addition to its impact on the process of coping with economic shocks, economic theory suggests that the exchange rate system can affect economic growth by influencing determinants of economic growth, such as investment, openness to foreign trade, and the development of the financial sector. Aizenman, Barro *et* Sala Martin (2003) examined a study that proved that investment was improving under fixed exchange rate systems (Campa *et* Goldberg (1999), Goldberg (1993), Bénassy-quéré; Foutagné *et* Lahréche Révil (2001)). Thanks to its contribution to reducing uncertainty in the results of economic policies, real interest rates and foreign exchange fluctuations, since the fixed exchange system requires a permanent adjustment in the direction of the exchange rate in the desired direction through the utilization of the exchange reserve. This in turn affects the distribution of investments to different sectors. In the same context, Bohm *et* Funke (2001) believes that exchange rate fluctuations, regardless of the nature of the exchange system, can be an influence on the level of investment spending. In this context, exchange regimes are likely to affect economic growth through their impact on the volume of foreign trade. On the other hand, the traditional theory of trade calls for an ambiguous relationship between exchange rate fluctuations and trade, and that there is a negative correlation between foreign exchange fluctuations and trade-offs due to risk aversion (Clark, 1973, Hooper *et* Kohlhausen, 1978). Economists attribute the weakness of the relationship to several considerations, including the hedging techniques adopted by institutions to protect against currency risk (Viaene *et* devries (1992)).

According to Rose (2000), the use of one currency between two countries contributes to the increase of trade between them by up to 300%, as Frankel *et* Rose (2002) argue that the currency union not only contributes to the improvement of the status of trade between member states, but also to other countries that deal with them. In addition to this, Rose (2004) concluded that the currency union leads to an increase in the volume of trade between the member countries in the currency union between 30 and 90%.

Many researchers have focused on the key role of the financial sector's development in the choice of the exchange system, and therefore often see a strong and evolving financial sector as a condition for the adoption of a floating exchange system, as this system is experiencing large fluctuations in the exchange rate. It can affect the real economy and the financial sector unless it is able to absorb exchange rate shocks, which would place economic agents at the disposal of economic agents. For example, the study by Aizenman *et* Hausmann (2000) cites gains from a fixed exchange rate, which may be greater for emerging economies than industrialized countries, and Chang *et* Velasco (2000) warn against the combination of a backward financial sector and a fixed exchange system.

According to these economists, the adoption of a fixed exchange system reduces the probability of a balance of payments disparity and increases the possibility of bank crises. In contrast, floating exchange rates can help to prevent these crises, since bank deposits denominated in the country's currency must be played by the central bank considered as the last lender.

9. THE IMPACT OF THE EXCHANGE RATE REGIMES ON THE ECONOMIC GROWTH: STANDARD AND EXPERIMENTAL STUDIES:

In light of the previous theoretical analysis, we can see that the effects of exchange systems are multiple and sometimes conflicting, and the final effect is not easy to determine in advance, and so has recently increased empirical work to study the relationship between exchange systems and economic growth.

In a study by Baxter *et* Stockman (1989), using a sample of 49 countries to compare the behavior of some major economic groups (production, consumption, foreign trade and real exchange rates) during the period 1946-1986. These economists found no systematic differences in their behavior (Milles *et* Wood, 1993), based on the experience of Britain during 1855-1990. The result shows that there is no effect of the exchange rate system on economic growth. On the same vein, Rose (1994) found similar conclusions by studying the case of Germany during the period 1960-1992.

In another study using statistical data for 136 countries during the period 1960-1989, Ghosh, Gulde, Ostry *et* Wolf (1997) found that countries adopting fixed exchange systems recorded the lowest rates of inflation compared to countries that adopt flexible exchange rate systems. Any variation in economic growth rates and fluctuations in production volume is observed in different exchange regimes.

In an IMF study in 1997 that found the same results as Ghosh, this study also notes that FMI did not take into consideration the determinants of economic growth. Ghosh, Gulde *et* Wolf (2003) examined the impact of exchange systems on inflation and economic growth. Using a sample of 165 countries in 1973-1999, this study found that fixed exchange systems recorded a low inflation rate compared to countries adopting flexible exchange systems, and there is no statistically significant relationship between exchange systems and economic growth. These studies note that they used classification of the IMF's payment systems, which was a major reason for the lack of strong results with regard to the impact of different exchange regimes on economic growth. In another study by Bailliu, Lafrance *et* Perrault (2001) using statistical data for 25 emerging countries during the period 1973-1998, and using their classification of exchange rate systems, they found that flexible exchange rate systems showed high and rapidly developing economic growth, but only for open countries in terms of international capital flows. In the same vein, Levy-Yeyati *et* Sturzenegger (2003) used annual

statistics for 183 countries during the period 1974-2000 and concluded that rigid exchange rate systems were associated with a significant reduction in economic growth in developing and industrialized countries. In a recent study by Rogoff, Husain, Mody, Brooks *et Omes* (2003), which analyzed the real GDP behavior of 160 countries during the period 1940-2001, this study found that there is no strong correlation between exchange rate elasticity and economic growth. When developing countries are taken separately, analysts have found that the flexible exchange rate is negatively correlated with economic growth, but this effect is not statistically significant for emerging economies. For developed countries, floating exchange is the best system to improve the performance of economic growth.

Recently, the focus was on the Reinhart *et* Rogoff (2004) classification of exchange rate systems. Husain, Mody *et* Rogoff (2004), using a sample of 158 countries during the period 1970-1999, concluded that the selection of the appropriate exchange rate system depended on the level of economic development of the country. For developing countries for instance, the rigid exchange system gives low inflationary rates without affecting economic growth. Under the flexible exchange system, these countries enjoy high inflation but do not benefit from improved economic growth. For developed countries, the exchange rate flexibility is accompanied by low inflation rates and growth rates.

Conclusion

Immediately after the establishment of the Bretton Woods system in 1944, countries faced difficulties in reaching a parity exchange rate consistent with the balance of payments, in addition to the currency crises imposed on the monetary authorities to reconsider the parity prices. These considerations led to a constant discussion on fixed exchange rates against exchange rates. The choice between a fixed exchange rate and a flexible exchange rate (according to Mundell analysis) is based on real or nominal shocks and the degree of free movement of capital. In an open economy, the floating exchange rate protects the economy from real shocks

Currently, the economies of developing countries face the challenges of global economic and financial integration, and more capital movement. These conditions necessitate reconsidering the choice of an appropriate exchange system for their economy, which can contribute to raising the level of economic performance and enhance their competitive position. Economic theories have also shown that inappropriate selection of the exchange system can have undesirable effects on economic growth in the medium term, by influencing adaptation to economic shocks or influencing determinants of economic growth.

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