“Calla Wiemer has written a highly readable, accessible, and analytically rigorous volume that will be of great value to scholars and policymakers both in East Asia and for anybody with an interest in this fascinating, diverse, and dynamic region. *Macroeconomics for Emerging East Asia* is grounded in mainstream macroeconomic theory and practice. But the author is rightly at pains to emphasize that the standard US macro textbooks are generally written with the implicit assumption that economies enjoy the ‘exorbitant privilege’ of possessing an internationally accepted reserve currency, and that this framework needs to be modified for the East Asian economies. An attractive feature of the volume is its application to real-world policy issues and challenges. These range from the misleading allegation, frequently directed at China and some other East Asian economies, of ‘currency manipulation’, to the origins and management of recent economic crises such as those of 1997–98, 2008–9, and the current pandemic. Highly recommended.”

— Hal Hill, H. W. Arndt Professor Emeritus of Southeast Asian Economies, Crawford School of Public Policy, Australian National University

“This excellent work clearly explains the interplay of macroeconomics, international finance, and development in an important – yet not completely familiar – part of the world. The author, an expert long familiar with the region, compellingly lays out the models necessary for analysis, while deploying data that highlights how emerging East Asia differs from other regions in macro behavior and response to policies. This is sure to become the reference for this subject.”

— Menzie Chinn, Professor of Public Affairs and Economics, University of Wisconsin–Madison

“In *Macroeconomics for Emerging East Asia*, Calla Wiemer skillfully presents theoretical concepts and policy topics in a highly lucid manner. The liberal use of examples from East Asia makes it attractive both to intermediate economics majors and to advanced students in public policy, business, and area studies.”

— Shinji Takagi, Distinguished Research Professor, Asian Growth Research Institute, and Professor Emeritus of Economics, Osaka University
Macroeconomics for Emerging East Asia

Macroeconomics for Emerging East Asia presents a distinctive approach to the study of macroeconomic theory and policy. The author develops a unique analytical framework that incorporates: (1) both internal and external balance as aspects of macroeconomic stability; (2) both the exchange rate and the interest rate as monetary policy instruments, (3) government debt sustainability as a concern of fiscal policy, and (4) global capital flows as a force to be reckoned with. The framework provides students with the foundational knowledge to analyze macroeconomic issues common to emerging economies. Concepts are illustrated using the latest empirical data and extensive case study analysis for 13 economies of Northeast and Southeast Asia (Cambodia, China, Hong Kong, Indonesia, Korea, Laos, Myanmar, Malaysia, the Philippines, Singapore, Taiwan, Thailand, and Vietnam). The book's lucid exposition accommodates students of differing levels of preparation.

Calla Wiemer has taught at the University of Hawaii at Manoa, the University of the Philippines, the National University of Singapore, the KDI School of Public Policy and Management, and Claremont McKenna College. She was Editor-in-Chief of the Journal of Asian Economics from 2015 to 2020. As President of the American Committee on Asian Economic Studies, she moderates the Asia Economics Blog. She is bi-continental with homes in Los Angeles and Manila.
Macroeconomics for Emerging East Asia

Calla Wiemer
In memory of Charles Adams,
whose knowledge lives on in these pages.
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Acknowledgments

The essence of this book is due to Charles Adams, my colleague at the Lee Kuan Yew (LKY) School of Public Policy from 2006 to 2008. Charles arrived at the LKY School after a career at the International Monetary Fund, a colleague of his there describing him as “the smartest economist I know.” Not only was he that smart, he was generous with his knowledge. Charles and I were tasked by the LKY School to develop an executive program in macroeconomics and take turns teaching it in Vietnam. Charles masterminded the program, and I put together the charts and tables and prepared the slides. I thought the result was worthy of turning into a textbook, and Charles was game. He fed me ideas, and I did the writing, then got his feedback and revised. We talked for long stretches on the grounds of the LKY School where Charles would chain smoke. I was worried about how that would end, and rightly so, it turned out. I was left to carry on by myself, but Charles’s knowledge and insight permeate the book.

Two reviewers have read the manuscript in full and offered transformative commentary. From the economist perspective, Shinji Takagi has offered penetrating critique, pushing me to work to get it right. Like Charles Adams, he is generous with his knowledge, and I am grateful to have absorbed as much as I could from him. I got to know Professor Takagi as my favorite reviewer when I served as editor of the *Journal of Asian Economics*. He was tough, and that was just what I wanted for my own writing. From the non-economist perspective, political scientist and Asia expert Greg Anderson has provided guidance on keeping the presentation accessible and interesting. His ideas on what else to include could make for another book. Five others – Jerry Schiff, Corina Gochoco-Bautista, Laurence Kirsch, Menzie Chinn, and William Rohlf – have contributed valuable input on select chapters. My great gratitude goes to all.

During an interlude in Los Angeles, I was granted institutional haven at the Center for Chinese Studies at the University of California, Los Angeles (2008–2010), and the U.S.-China Institute at the University of Southern California (2010–2014). I’m grateful for the collegiality offered by these institutions and the access to outstanding library collections, augmented by that of the fabulous Los Angeles Public Library. While at the University of the Philippines (2015–2018), I received support for Chapter 8 from the UPecon Foundation and for Chapter 10 from the Philippine Center for Economic Development, which I appreciate.

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Preface

The idea for this book originated with my teaching a macroeconomics course to mostly Asian students at the Lee Kuan Yew (LKY) School of Public Policy at the National University of Singapore. For my first year teaching the course, a standard US principles text had already been adopted for our use. Teaching macroeconomics from the standpoint of a country that prints the world’s reserve currency and gives no thought to external balance or debt sustainability to students from Singapore, China, and Laos seemed altogether inappropriate. To even begin thinking about macroeconomics for these countries requires an understanding of the balance of payments and exchange rates, and yet these topics were relegated to the final chapter of the text like an afterthought.

In my second year at the LKY School I had the opportunity to work with a colleague, Charles Adams, in designing a macroeconomics executive program for Vietnamese government officials. Charles had spent most of his career in Asia with the International Monetary Fund advising on macroeconomic policy in the region. He knew exactly how to structure a course in macroeconomics for Asia, and I caught on quickly enough that we were able to take turns delivering the program in Hanoi. It struck me that someone ought to write the textbook for such a course.

Around the same time, China was coming under fire for “manipulating” its exchange rate. I wrote a series of op-eds for the Wall Street Journal defending China’s currency policy as rooted in sound macroeconomics. The anomalousness of this position prompted the paper’s opinion page editor to ask me whether there was anyone else who agreed with my view. And again, it seemed to me that someone ought to write a textbook that would establish a way of thinking about macroeconomics for the Asian context.

I decided to step up. The book is designed from the outset for Emerging East Asia. It encompasses 13 economies: Cambodia; China; Hong Kong; Indonesia; Korea; Laos; Malaysia; Myanmar; the Philippines; Singapore; Taiwan; Thailand; and Vietnam. As different as they are in many ways, these economies can all be subsumed within a common framework for purposes of macroeconomic analysis. And a substantially different framework it is from the one conceived for the USA.

The economies of Emerging East Asia share the following salient features: (i) both internal balance, involving output growth at potential with inflation low and stable, and external balance, involving sustainable foreign trade and capital flows, matter for macroeconomic stability; (ii) the exchange rate figures importantly in macroeconomic policy; (iii) the role of the interest rate in monetary policy is circumscribed by the pressures of global capital flows (Singapore and Hong Kong being extreme cases) or by insensitivity of credit to interest rate movements (China being a case in point); and (iv) sustainability of public debt is a concern.
By contrast, because the USA is in the unique position of printing the world’s reserve currency, external balance and debt sustainability are not at issue there. Further, because the US financial system is well developed and globally dominant, the interest rate serves as an effective, finely tuned instrument of monetary policy, while the exchange rate does not figure in.

A technical summary aimed at the initiated follows in this and the next paragraph, with the novice invited to hang on for inspiration. The book treats the balance of payments and exchange rates as foundational. Once the system of national accounts for measuring the domestic economy has been laid out, the balance of payments accounts are introduced. This sets the stage for presenting the basic identity equating an excess of national saving over domestic investment with a capital outflow that must be matched by a trade surplus. The basics of money creation are then explained with reference to the central bank balance sheet so as to illuminate the parallel between domestic bonds and foreign currencies for purposes of central bank trading operations. A full elaboration of foreign exchange markets follows with the implications of central bank intervention highlighted. Foundations thus in place, attention turns to theories of how an economy responds to shocks and why performance is prone to fluctuate over time. The policy chapters follow. Monetary policy is discussed with reference to both the interest rate and the exchange rate as instruments. Fiscal policy is examined with emphasis on debt sustainability. The coordinated exercise of monetary and fiscal policy for pursuit of combined internal and external balance is then analyzed with use of the Swan diagram. Two further chapters deal with macroprudential policy and the origins and management of crises.

To cap it off, the Epilogue circles back to a motivating issue for the book: “currency manipulation”, as charged most vociferously against China, but also against Vietnam, Taiwan, and in broader brush potentially any economy that relies on central bank intervention in the foreign exchange market to pursue macroeconomic stability. That means all 13 economies covered in this text. Central bank buying of foreign currency in exchange for newly issued domestic currency stimulates the economy by expanding the money supply and by making exports cheaper and imports more expensive to favor domestic production. Central bank selling of foreign currency and withdrawal of domestic currency does the opposite. Importantly, a central bank can only sell foreign currency to the extent that it has previously bought it. And it may need to sell a lot to stabilize an exchange rate in the face of heavy capital outflows, a leading cause of which is the pull of higher interest rates in the USA when authorities there tighten monetary policy. When the USA acts, the rest of the world must react. Foreign exchange market intervention is a prime tool for such reacting and for pursuing macroeconomic stabilization more generally. This book lays the foundations for understanding and justifying the exchange rate management behavior we observe.

No prior knowledge of economics is assumed on the part of students, although novices should be prepared to get up and running quickly. Those who have taken macroeconomics courses using standard US textbooks will find the training helpful in grasping the material even as they discover much that is new here. Those who are well versed in the discipline will
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appreciate the substantially different approach taken in this book to fit macroeconomics to the Asian milieu.

Finally, as this book goes to press, the Covid pandemic continues to cause economic disruption and pose policy challenges. For updates on the situation applying the framework developed in the book, interested readers are referred to the Asia Economics Blog of the American Committee on Asian Economic Studies. The website for this textbook keeps a running tally of posts keyed by chapter. Further to those with a broad interest in Asian economies, the Blog provides an open forum for presentation of research and analysis.