FACTORS AFFECTING THE EXCHANGE RATE AND THE PECULIARITIES OF ECONOMIC LAWS IN DEVELOPING COUNTRIES
(The Case of Georgia)

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Abstract
After the 2007 financial crisis, which is also called the derivatives crisis, the issue of the place and role of economists and financiers was particularly acute. Paul Krugman tried to formulate what researchers in this category should do. First, they must foresee the dynamics of events, so called the correct "forecast", external and internal factors must be named and their impact on the country, need to research new trends, what is new in the market and also explore the impact of new circumstances on old content and form. The important thing is for the variations of form and content to be adapted to the existing reality and the actions resulting from it. In this respect economist have a great function, But at the same time, if we recall that the shock of the 2007-08 financial crisis was unexpected volatility and the currency war are still going on in the currency market, it turns out that economists are not able to predict what will happen tomorrow or why something has happened.
After World War II, especially in the 50s, it became fashionable to subject economics to mathematics. Many scholars believed that mathematical calculations would change the economist's thinking; It was far more accurate. This was helped by the fact that a group of scientists developed new mathematical models of economics and presented it to then US President Nixon and advised him to use the mathematical model. At the time, this method was justified and the world got sick with this mathematical modeling some even thought that economists were no longer needed and that mathematically it would be possible to calculate everything, but life has shown us that this is impossible. The works of various scientists are devoted to studies of these problems.

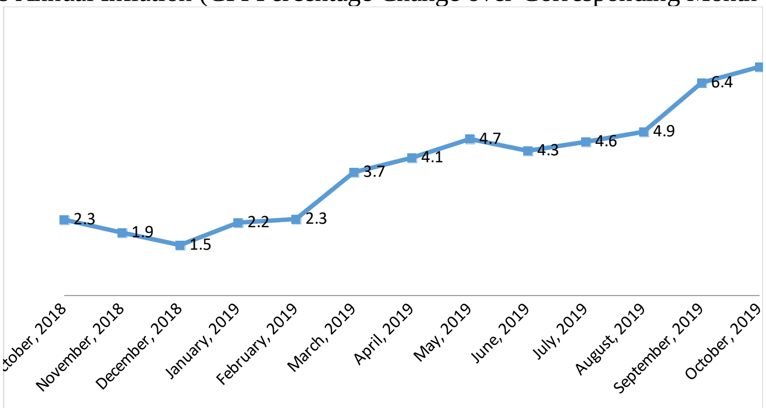
Keywords: *Exchange rate, economic laws, monetarism, developing countries, inflation*

JEL Classification: *E40, E43, E44*

I. GENERAL ANALYSIS

In this era of digital economy and cryptocurrency, I would like to explore two things, economists as researchers of new trends - whether or not economic laws in Georgia and other small countries are fully implemented. Let's say the 20th century law discovered by Irwin Fisher, Keynesian economic schemes and levers, Tobin's beta coefficient and its law, Friedman's Monetarism, the Model of Franco Modigliani and etc. Does the free floating course model in Georgia actually work fully, adequately as in the West? Stiglitz's "modern economy" (Stiglitz, J. 2016) is amazing, when we discuss some economic law, such as the single price law, the rules for calculating the value of stocks and bonds, the causes of currency volatility. We do not consider the features of a small market, a small country. A genius example of the peculiarities of the rule of law is the analysis of Georgia's economic indicators. For example, in October 2019, inflation was almost 7%, when the country's central bank, which has always had a strict monetary policy, tightened monetary policy to 8.5%. That is, annual inflation is rising and monetary policy is also tight. (Diagram 1-2) Curious for the West, but not for Georgia. What works and is natural for the economies of the United States and England is not natural for Georgia.

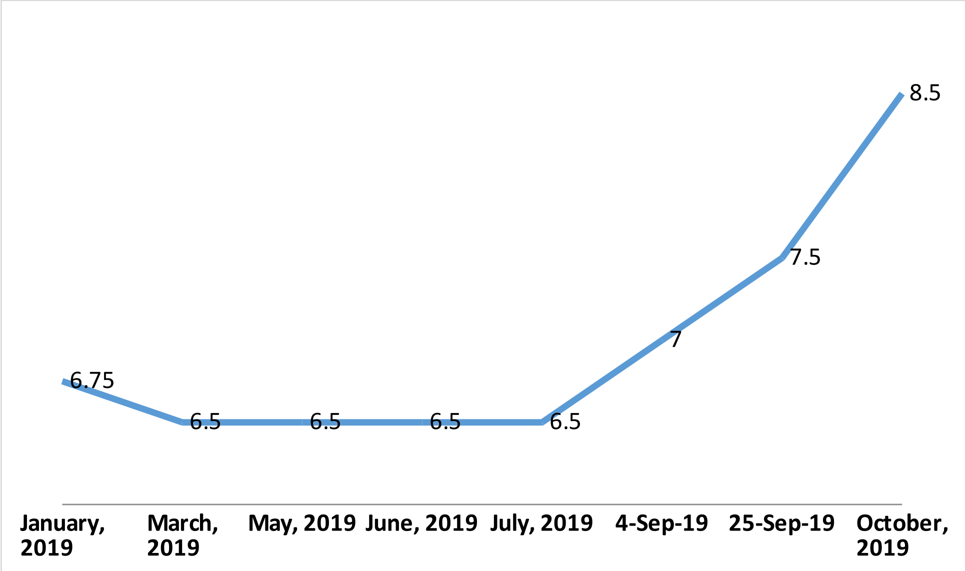
Diagram 1. Georgia's Annual Inflation (CPI Percentage Change over Corresponding Month of Previous Year), %



https://www.geostat.ge/ka/modules/categories/26/samomkhmareblo-fasebis-indeksi-inflatsia 10.09.2019.

Unfortunately, the permanent rise in the national currency deflation has finally led to the rise in consumer price-inflation.

Diagram # 2. Monetary policy rate in Georgia, 2019 Year



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Transmission channels in Georgia either operate slowly or do not operate at all. In Georgia, the situation is that banks do not care about attracting deposits, they prefer to attract cheap resources from Europe and other world countries, especially as the regulator in Georgia has lowered the required reserves for dollar deposits. In such an amorphous environment, open market policies cannot work as there is no open market and the deciding factor in the exchange rate factors is direct investment, that is, the FDI indicator and transfers of population from abroad, which is equal to exports. That is why GEL is valid. That is why it is very interesting to research this area in developing post-Soviet countries. Course factors in these countries are different than in the US and Europe, there is no open market here and regulators in these countries do not have the same leverage as in the US and Europe, The same Georgian Lari is not a fully independent currency and a fully fledged player. There are also some interesting ideas or theses - what will happen if the Georgian Lari is connected with any strong currency, such as the US dollar or the euro?

Our goal is to investigate the factors affecting the exchange rate. There is a situation in Georgia where everyone is interested and "everyone knows" what the exchange rate factors are and all this discussion around this issue, including that of state authorities, is based on theory and practice of highly developed countries (United States of America). My opponent might say angrily that the law is not written for either America or Georgia, of course, I agree, but we must remember that the law works in a certain environment, if it is not, the law does not work. The same can be said for laws in chemistry, physics, and in economics as well. When the water is boiling at 100 degrees Celsius, if it is not 100 degrees Celsius does it boil? That is, certain conditions are needed to bring the water to boiling condition. So it is in economics, as well as physics and chemistry, economics needs a further step - under what circumstances the law operates. In research we always make some assumptions and abstractions from something and say that this quantitative shifts into this qualitative, if not quantitative, there is not qualitative. Therefore, we say that the exchange rate is the estimation of the number of goods between two currencies, what quantity of goods one can buy, the price of one currency depicted in the other currency. This is a very rough definition. We teach at universities, according to the guidelines of Frederic Mishkin [3-4], Zvi Bodie [2], F Fabozzi [5] and other authors, written for the US or Europe, based on their actual events, cases that are diametrically different from those of Georgia and even the economies of Moldova and Armenia, both quantitatively and qualitatively. For example, many factors affect the exchange rate of states at the exchange rate level, including trade wars, quotas, accumulations, derivatives, and so on. Which is different in developing countries.

All the economists, including Irwin Fisher and Joseph Stiglitz, do this quite interestingly. In general, the countries are divided into developed and developing countries, no one has started discussing this deeply, though there has been some attempt to separate the BRIC countries, the former Soviet Union countries, and so on. However, countries are not economically divided, but it is necessary to understand where the law works and what does not. Firstly, let's say one thing, that is obvious in all studies: The world has one unique economy in the form of the United States, it is unique in recent years particularly because its currency is the number one reserve in the world, the price of any commodity in the commodity markets is quoted exactly in this currency, and its economy is number one in size and defines the dynamics of the world economy. So it is irrelevant to compare our economy and problems with the US economy and even the Chinese economy. Moreover, it will not give us the right result. Ther eis an idea, that the exchange rate in developing countries to be linked to the large economies. This is a serious indication that these types of countries are so called anchor countries, that play a leading role: The United States, which has different qualitative aspects because of quantity, according to the law transition from quantitative to qualitative, also Germany and France, England, Japan and China which we will discuss separately. What is valid and accepted in the United States won't work exactly in Georgia, for example the factors affecting the exchange rate, decline of the exchange rate and etc. The currency war is going on around the world from Canada to Australia, every country is trying to devalue its currency and that is its advantage over its trading partners, In Georgia it is on the contrary, the depreciation of the Georgian currency has become a subject of mourning and tragedy The question is why? What should economists answer? In addition, we apply the worldwide practice of Inflation "targeting" and that's fine, but we are not doing currency targeting, which is also a common practice. We do not use so called anchor currency advantage, which is also a very important moment, and we never explicitly state where the 5% inflation target is from.

Studies have shown that the time to transfer regulations to the market in these economic systems is also different. According to Professor Mishkin [3-4], the result of today's monetary policy will come in a year or two. In fact, Alan Greenspan [6] has the same opinion: - If we want to get any results after two years from now, we should take care of that today. In Georgia, in 2019, when the exchange rate of the GEL was steadily falling against the US dollar, the regulator stated that it did not concerned him and the main object of his attention was inflation, in October 2019, he got both together - 6.9% inflation and a falling GEL rare - 1/2.97. In different countries, it takes different time to take effect, for example, if the US monetary policy gives result in two years, it takes half a year in Europe, and so on. How long does it take for Georgia to develop and launch a new monetary policy to be effective against inflation? The second one, The goal should be transparent as to why the inflation target in Georgia is 5%, what its purpose is and what its consequences will be. Ben Bernanke, in his paper, emphasizes that in times of financial difficulties, the National Bank is responsible for financial and economic stability. What economic and financial stability caused the 5% inflation target? It is no argument here that the IMF is supporting it. The Foundation has made many mistakes in Georgia and in other countries, so this is not an argument. So let's consider the law and approach this issue scientifically. In addition, it would be good to publicize the ways in which inflation will go from 1% to 5% in Georgia and what will happen to other macroeconomic indicators. If we are not interested in the exchange rate, in the resulting reduced imports, the demand for dollars, the decline in GDP growth, then why do we raise inflation to 5%, which is a pretty high rate, and what our plan is. It seems to me that we just name 5% as a target and after it there is no calculation or we don't know, it's not publicly known, so it should be absolutely open and transparent.

We economists see it all in the long, short and medium term. Currency Factor Changes are affected by the expected return on foreign deposits R^F, expected return of domestic deposits R^D the impact of inflation, expected return i. Now consider a concrete example of how elementary economic laws are deformed in developing countries, based on Irwin Fisher's formula.

Let's consider an example, a pair of dollar/euro. With respect to these two currencies, we have the picture that these two currencies are close to the point B of the historical equilibrium, when one dollar equals one euro. What has this event caused? - This has led to lower prices of European goods for export, Europe took advantage, production and employment increased, and they hope that the current deflation will turn into inflation. This was partly facilitated by Mario Drag's "softening" policy, who sold bonds with a certain target and circulated money, he increased supply of the euro and the deposit in the euro became 3.8%, this is very important, this saved the euro. But developing countries do not have the same leverage, as they do not have open market operations and a solid capital market. Suppose we have a spot price on something abundant based on commodity parity and uniform price law, then we have the forward price, which is based on the value of money and is based on the percentage of the deposit in these countries or Libor in America and Europe. We must take into consideration that here capital mobility is fast, if there is a large percentage of the dollar on deposit, capital flows out, if there is a large percentage in Europe, it flows into Europe. But the main thing is that this is not happening in Georgia, as the Georgian lari is a quasi-convertible currency, so we are not worried about this factor, our capital is not as mobile, and the lari is not an investment currency, so its rate is not directly set by the percentage of the deposit. Uniform pricing law does not apply in Georgia because there is no accumulation in Georgia, there is no capital market and the leverage of companies is low.

We can do targeting of currency exchange. It has its positive moments, allowing us to bring some exported commodities to a similar figures and figures of leading country by controlling inflation. Secondly, It allows us to conduct strict monetary policy automatically and have a stable exchange rate, and the third one is very clear and simple. But targeting has its disadvantage; It means losing independence in monetary policy and if something goes wrong in the leading country, it will spread automatically to your country. That is, what happened in the case of Switzerland and Europe. In addition, it paves the way for currency speculators to attack and weakens the reporting of politicians in relation to the fall of exchange rate, what is happening in Georgia today. Currency fluctuations are also associated with fixed exchange rates and dollarization which may also be considered as negative indicators.

II. CONCLUSION

Overall, Georgia and other developing countries need to study the realities of the world economy, identify the peculiarities of the operation of economic laws in such countries and develop a model for small countries development. The paradigm, with its monetary policy, inflation leverage, and exchange rate mechanisms that will be adequate to their economy and help integrate them into the united world map.

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