

NEOMONETARISM AND STABILIZATION

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I. INTRODUCTION

Given the fact that in the West monetarism is largely associated with homo economicus, the free market and private ownership, it is curious to find a literature emerging in Yugoslavia which argues that monetarism would be most effective in a market-planned rather than a free-market economy. The purpose of this article is to discuss the approach of this neomonetarist school, placing it within the general literature on inflation in Yugoslavia, and to suggest that it is used as an argument for strengthening the role of central planning in the Yugoslav economy.

II. NEOMONETARIST SCHOOL

The most concise statement of neomonetarism has been expressed by Milutin Ćirović.¹ Others who openly support this position include Srboljub Jović and Spase Petreski and Stanko Radmilović.² According to this view, neither classical Keynesian nor orthodox monetarist policy prescriptions for stabilization are adequate in a stagflationary economy with structural distortion in the market mechanism. In the 1970s, Yugoslavia's economic strategy of using expansionary monetary and fiscal policy to help reduce unemployment and increase per capita income led to inflationary pressures and balance of payments deficits. As Jović, Radmilović, and Ćirović argue, basing economic growth on high rates of domestic consumption, investment and imports and accomodating

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¹ Ćirović, M. 1980. "Monetarizam i Stabilizacija". *Ekonomist*, XXXIII, 3, 1980.

² Jović, S. 1982. "Problemi Inflacije i Politika Dezinflacije." *Ekonom-ska Misao*, XV, 4, 1982; Jović, S. 1984. "Ekonomski Sistem i Inflacija." *Eko-nomska Misao*, XVII, 2, 1984; Jović, S. 1984. "Strategija Dezinflacije." *Jugo-slovensko Bankarstvo*, 1, 1984; Petreski, Spase. 1984. "Aktuelni Problemi Realne i Monetarne Neravnoteže." *Jugoslovensko Bankarstvo*, 10, 1984; Radmilović, S. 1983. "Inflacija i Domet Monetarizma u Jugoslaviji." *Ekonomist*, XXXVI, 2—3, 1983; Radmilović, S. 1982. "Monetarno-Kreditna Politika." *Jugo-slovensko Bankarstvo*, 12, 1984. See also Ćirović, M. 1983. "Ekonom-ska Sta-bilizacija i Monetarni Sistem." *Finansije*, 9—10, 1983; Ćirović, M. 1982. *Novac i Stabilizacija*, Savremena Administracija, Beograd, 1982, especially Ch. 9.

it with a rapid growth of the money supply without improving underlying structural and sectoral problems are the causes of Yugoslavia's economic crisis. And in the early 1980s, strict monetarist prescriptions to reduce the money supply in an effort to curb inflation were also disappointing; they were ineffective in reducing real spending.

For the neomonetarist, the key to understanding why inflation has persisted since the 1970s and why the variety of incomes policies, price controls, selective crediting problems, etc. have failed to improve Yugoslavia's macroeconomic performance in the 1980s is that the economy is too decentralized. In the strongest statement in this regard, Jović argues that the Yugoslav economy is disintegrated and shattered and that decentralization of decision-making is inconsistent and illogical.³ Petreski likewise cites the general disintegration of the economy and its superstructure and the lack of coordination within the economy as a leading source of instability in the economy.⁴

For the long-term viability of self-management, this school calls for a return to centralized control over many critical aspects of the economy. Jović and Radmilović both propose centralized coordination of the credit-banking, fiscal, price, and foreign exchange systems because only through centralization will discipline be imposed on economic actors.

III. MONETARISM AND NEOMONETARISM

In the literature on inflation, the monetarist position is associated with the argument that "inflation is always and everywhere a monetary phenomenon, produced in the first instance by an unduly rapid growth in the quantity of money."⁵ That is to say, inflation occurs when there is an increase in the *general* level of demand for goods and services. An increase in the *general* level of demand, as opposed to a change in the composition of demand, can occur either because the money supply has increased or because of expectations of future price increases; however, the monetarist school places emphasis on the former cause.

As Friedman points out, there may be a variety of reasons *why* the money supply has been increased. For instance, labor unions may have pushed up the wage rate so high as to create some unemployment. A government committed to maintaining full employment may, due to political pressure, print more money to finance "needed" state expenditures to restore full employment.⁶ Similarly, if the government finances its deficit by printing money, i.e., if investment exceeds desired saving, then inflation may result. In all cases, however, an increase in the money supply must accompany an increase in demand in order for the price level to rise. And, of course, monetary restriction is called forth to curtail inflation.

³ Jović, S. 1984. "Ekonomski Sistem i Inflacija." *Op. cit.*, p. 25.

⁴ Petreski, S. 1984. *Op. cit.*, pps. 63—64.

⁵ Friedman, M. 1968. *Dollars and Deficits*, Prentice Hall, New Jersey, p. 18.

⁶ Friedman, *op. cit.*, p. 29.

Over the past seven years there has been little disagreement among Yugoslav economists and bankers that the growth of the money supply is fueling inflation. Whether from the camp of the left Keynesians/Marxists⁷, the Keynesians⁸ or the neomonetarists, there is virtual unanimity that the money supply is currently out of the control of monetary authorities and that it is inflationary pressures *stemming from the real sector* that explain the uncontrolled growth of the money supply. Soft budget constraints which condone investment without the cover of accumulation and "paper over" illiquidity and enterprise indebtedness with the issue of central bank reserves as well as widespread use of administered (as opposed to auction) prices such that oligopolies pass on higher costs with higher prices explain much of the real sector inflationary pressures.

Neomonetarists disagree with the orthodox monetarist prescription that severe monetary restriction be imposed to bring down prices because the instrument, monetary policy, is neither designed nor intended to affect *real* variables but rather adjust them to their long-run paths. Hence, the neomonetarists argue that monetarist models constructed for a free market economy operating at full employment have little relevance to the economic structure and institutions of the Yugoslav market — or for that matter the advanced capitalist economy.⁹ But, as mentioned earlier, what makes this school neomonetarist is that it believes that the monetarist model would be very appropriate for the Yugoslav market-planned economy *if* monetary policy were supported by other actions, such as restrictive incomes and price controls and other strict policies aimed at controlling *a priori* the distribution of income.

Milton Friedman notes that if an attempt is made to compensate for the slow working of money aggregates by use of excessive monetary policy, the monetary system, instead of being a stabilization mechanism, can be turned into a source of destabilization. But from this good observation Professor Friedman drew an insufficient conclusion namely that fluctuations of short-term rates of monetary growth should be reduced as much as possible and that is his famous proposition about fixed rates of monetary growth. However, Friedman's idea can be re-interpreted in a different context. It is not only necessary to reduce fluctuations of monetary growth but there is also a need to unburden monetary policy by activating other instruments of economic policy (and first of all the policy of income distribution). ...It is my con-

⁷ Perišin, I. 1980. *Kamata i štednja*, Ekonomski Institut, Zagreb, 1980; Perišin, I. 1985. "Monetarno-Kreditni i Bankarski Sistem." Unpublished manuscript, no. 3521, Ekonomski Institut, Zagreb, 1985; Stranjak, A. 1979. *Depozitni Novac i Monetizacija*. Ekonomski Institut, Zagreb, 1979; Stranjak, A. *Savremeni Novac: Stvar ili Društveni Odnos?* Informator, Zagreb, 1981.

⁸ Ribnikar, I. 1981. "Novčani, Kreditni i Bankarski Sistem." *Jugoslovensko Bankarstvo*, 1981; Ribnikar, I. 1983. "Promene u Emisionom Mehanizmu." *Socijalizam*, 26, 1983; Jakšić, M. 1984. "Kritika Monetarizma." *Socijalizam*, 27, 1984; Bajt, A. 1982. "Autonomno Pravo Monetizacije." *Jugoslovensko Bankarstvo*, March 1982; and Bajt, A. 1983. "Mehanizmi Inflacije u Jugoslaviji." In *Savremeni Problemi Ekonomske Stabilizacije*, 1983.

⁹ Cirović, M. 1980, *op. cit.*, p. 360.

viction that monetarism could make a qualitative jump forward if reformulated in the context of a market-planned economy. Such reformulated monetarism would be a really "new monetarism".¹⁰

It should be noted that this position — that monetarism as a theory and policy might work better under conditions of centralized macroeconomic planning rather than under free market anarchy — has been echoed in the West by Richard Portes and Michael Ellman.¹¹ In their work, however, they argue that the institutional structures of state socialist countries — the centrally planned economies — make tight monetary policy entirely rational. According to Ellman, what is wrong with monetarism is that it is concerned essentially with planning only one small sector of the economy, namely money, and not with planning the rest of the economy as well. It is precisely under socialist conditions that one has the best opportunities for, and the least problems with, monetary policy.¹²

IV. NEOMONETARISM AND THE CALL FOR RE-CENTRALIZATION

One key issue that distinguishes the neomonetarist from Yugoslav Keynesian and left Keynesian/Marxist interpretations of inflation is whether monetary authorities *can* control the stock of money circulating in the economy, and if so, how this can best be accomplished.¹³ This is tied directly to the issue of how financial discipline is to be imposed on Yugoslav enterprises, or to use Kornai's terms, how budget constraints are to be hardened so that excessive inter-enterprise crediting and the emission of endorsable bills of exchange and other credit money can be curtailed.

The emergence of neomonetarism and the call for recentralization comes at a time when the *political* problem of enforcing credit contracts, imposing harsh sanctions in the case of insolvency and bankruptcy, forcing mergers and sellouts cannot be readily solved. The non-monetary factors which are the immediate cause of the monetary expansion in Yugoslavia, as Friedman might phrase it, are political in nature and represent the *political* problem of resolving conflicts over who can acquire the economy's resources in order to re-invest. The impasse which Ćirović, Ribnikar, Radmilović, and many others discuss is that currently commercial banks are caught in the middle of a political struggle between credit-hungry enterprises attempting to maintain pro-

¹⁰ *Ibid.*, pps. 360—361.

¹¹ Portes, R. 1983. "Central Planning and Monetarism: Fellow Travelers?" In *Marxism, Central Planning, and the Soviet Economy*, Padma Desai, ed., MIT Press, Cambridge, 1983; and Ellman, M. 1983. "Monetarism and the State Socialist World." In *Monetarism, Economic Crisis and the Third World*, Karel Jensen, ed., Frank Cass, London, 1983.

¹² Ellman, M. *op. cit.*, pps. 108—109.

¹³ For a review of this literature see Gedeon, S. 1987. "Monetary Disequilibrium and Bank Reform Proposals in Yugoslavia: Paternalism and the Economy." *Soviet Studies*, forthcoming; and Gedeon, S. 1985—86. "The Post Keynesian Theory of Money: A Summary and an Eastern European Example." *Journal of Post Keynesian Economics*, VIII, 2, Winter 1985—86.

duction schedules and the central bank attempting to control inflation, retire international debt, and improve the country's balance of payments.¹⁴ Local banks are pressured by republican political leadership to purchase enterprise-issued commercial paper, even if the bank runs the risk of becoming illiquid since this implies the bank borrow short and lend long. Threatening a collapse of the local banking network, local banks pressure the central bank to monetize their portfolios — as their lender of last resort — which introduces new reserves and hence a growth of the money supply.

The call for re-centralization — monetary policy along with a binding policy of income distribution and policy of structural development is intended to place the power to create and allocate central bank money in the hands of the central bank. It would abridge the rights of enterprises to make production and investment decisions and to compete for funding, as Ivo Perišin has tirelessly pointed out.¹⁵ But more significantly, it is a statement about the instability of market decentralization. The call for central planning is a concession that the market works *too* well in the sense that monetary control is ineffective as long as economic agents can create their own private instruments to accommodate their needs of trade. Indeed, excess demand for credit is and has been a structural characteristic of the Yugoslav economy since the 1974 reform. But the neomonetarist position, like the monetarist, is weakest at explaining just how the lowering of real wages through incomes policy and the allocation of loans by centrally-determined criteria will correct for this structural characteristic.

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¹⁴ Cirović, M. "Ekonomaska Stabilizacija i Monetarni Sistem." *Op. cit.*, Ribnikar, I. "Promene u Emisionom Mehanizmu." *Op. cit.*; Radmilović, S. "O Promenama u Novčano-Kreditnom i Bankarskom Sistemu." *Jugoslovensko Bankarstvo*, XII, June 1982.

¹⁵ Perišin, I. *op. cit.* See also Novac, *Monetarni Sistem i Udruženi Rad*, Informator, Zagreb, 1978.