

## ON SOME APPROACHES TO MACROECONOMIC POLICY:

by  
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### I

This paper argues that the basic objectives of an economy constrain the effective and meaningful extension of the theoretical models, the basis of the policy recommendations in achieving the objectives. More specifically, it argues that extensions of these views to development policies in newly developing countries require the countries' close scrutiny. In a real sense, this is an obvious observation requiring, one might say, no great elaboration. But in the context of the current thinking and literature on economic policy matters, a restatement of the argument along these lines seems to be the order. The literature and debate on basic policy recommendations have in recent years grown. It is not the purpose of this paper to add nor make a comprehensive survey of this "unworthy but hotly contested current debate on the relative efficacy of monetary and fiscal policy . . ." <sup>1</sup> but to put the essential arguments in their proper perspective. Thus, it is necessary to outline the theoretical and empirical framework of these approaches.

Economic policies are the means by which economic objectives are pursued. The policies in turn are based upon theoretical models or perceived views on the workings of the economy. Although there are little theoretical differences among the models of these approaches, divergent views can clearly be seen with respect to their policy recommendations.<sup>2</sup> It is useful to distinguish 3 basic approaches to policy: (a) Fiscal, (b) Monetary, and (c) Eclectic. Adherents to them are called Fiscalists, Monetarists, and Eclectics, respectively.

Accordingly, the next section will give a brief outline of the recommendations of each of the approaches and the theoretical models on which they are based. The third section will provide some evidences which relate to these approaches including their unsettled issues, and the last section will digress on the relevant extension of these approaches to development objectives.

## II

To a fiscalist, variations in the government's spending and tax power — changes in the budget either in the direction of a surplus or deficit — have pronounced effects on the variations in the level of aggregate economic activity. In major depressions, it increases in the government's expenditures which can bail the economy out. At the other extreme during inflations it is the government's tax and expenditure functions which can halt the tide of a rising price level. And in between these extremes, it is again the government's behavior that can smoothen the cyclical variations in economic activity.

It is enlightening to examine closely how such policy actions are supposed to affect aggregate economic movement. Evidently, the theoretical force of this approach is inherited from Keynes's contributions embodied in his *General Theory*.<sup>3</sup> Keynes's argument was that the ultimate effect of fiscal policy is a multiple of the initial stimulus, i.e., the increase (or decrease) of income generated by fiscal actions is several times (the multiplier) more (or less) than the original increase (or decrease) of government expenditures and/or taxes.<sup>4</sup>

The financial side of fiscal policy matters, as discussed in textbooks in macroeconomics,<sup>5</sup> usually provide analysis on this policy recommendations under *ceteris paribus* assumptions. Initial injections of government spending increase consumer income. Consumers in turn spend a fraction of this additional income. Tracing the process out, the simple conclusion is that Gross National Product increases by the initial injection times the reciprocal of the marginal propensity to save.<sup>6</sup> At the intermediate level, analysis is extended with the use of the familiar IS-LM curves by showing that, with increases in government expenditures, the IS curve shifts and equilibrium level of national income rises.<sup>7</sup> Although there is an appreciable rise in the interest rate, it is argued the effect is still not totally removed because income rises. There is no mention, of course, of crowding out effect of such policy action.<sup>8</sup>

The fundamental points we made above do not really tell whether fiscal action has been taken or not for the simple reason that government budget surpluses (or deficits) are not independent of the level of GNP. That is, when incomes are high, tax receipts are high and for a given budget during rising incomes, a surplus may



generated which can be indicated as a contractionary fiscal policy. In fact, the surplus was a mere reflection of rising GNP. And vice versa for deficits during periods of falling GNP. For this reason, the concept of a full employment budget is used as a measure of discretionary fiscal policy as opposed to changes in the actual budget which may all be reflections of variations in GNP.<sup>9</sup>

Having a measure of fiscal policy still falls short of knowing the full effect of fiscal policy actions. We come to know the impact of fiscal policies after we know (a) how a deficit will be financed or (b) how a surplus would be disposed. If the expansionary fiscal action through a budget deficit is financed by money creation, then the theoretical model indicates the multiplier works fully; if financed by sales of securities or bonds in the open market, then the model shows the multiplier may not be fully operative but nevertheless works out. If a budget surplus will be frozen then the reverse multiplier works fully and if some part (or all) of the surplus retires some of government debt or increase governmental expenditures, then the effect of the reverse multiplier may be dampened.<sup>10</sup>

It is clear that knowledge of the indicators of fiscal policy and methods of carrying them out allows us to evaluate fiscal policy programs. But a lot more depends on (a) the particular shapes of the relevant curves upon which policies are based,<sup>11</sup> (b) the particular sectors affected,<sup>12</sup> and (c) the actual measured impact of fiscal policy on aggregate demand.

In summary, fiscalists approach their policy recommendations through changes in expenditure patterns and tax functions of the government. They are in turn based on a consumption-expenditure multiplier theory, i.e., that fiscal policies based on these views exert independent influences on economic activity.

To a monetarist, the view is somewhat different. It is money — money narrowly or broadly defined<sup>13</sup> — that has a direct link and impact on aggregate economic activity. It is changes in monetary aggregates that influence GNP. Thus, it is in the control of money where the monetarist approaches his policy recommendations. In times of economic recessions, increasing money supply can directly bring about increases in GNP; and during inflations decreasing (or a slower rate of increase in) the money supply can halt the rise of price level.

To a monetarist, the conception upon which such policy recom-

recommendations are based is quite simple and direct. It is based on the notion of a stable income velocity of money. Expressed differently, for a given level of GNP, there is a desired level of money balances held. If and when actual money holdings exceed (fall short of) desired holdings, changes occur in the economy which restore the relationship back to equilibrium at that given income level.<sup>14</sup> In the process of moving toward equilibrium, aggregate economic activity is directly affected. For example, in times of recession when the Central Bank (the Federal Reserve) increases money supply, the public will find its holdings of money balances exceeding desired holdings at current levels of income. To the monetarist, this is not an equilibrium position. Equilibrium will be restored only when actual equal desired money holdings are reached. In the move to restore monetary equilibrium, the public by getting rid of excess balances, can spend them on real goods and services and real assets, thereby increasing GNP. If the economy is already at or near full employment, the movement toward equilibrium, because of excess balances, drives up prices. The reverse process takes place in case of reduction in money supply. The public finds itself with less cash holdings than desired. They spend less than before, thereby decreasing purchases of real goods and services, in turn contracting GNP.

The monetarist's notion of the transmission process, therefore, works through the public's portfolio of liquid assets. By altering this portfolio, monetary policy can directly affect economic magnitudes of prices, income and employment.

Instruments of the monetarist's policy actions center on monetary aggregates — money supply, monetary base, free reserve or some other monetary variable but more precisely, their rates of changes and growth.

It is quite clear now that monetarists by virtue of their assumption of the relative stability of monetary velocity place heavy reliance on monetary policies to restore to equilibrium fluctuations in income, employment or prices while the fiscalists by virtue of their assumption of the workings of the consumption-expenditure multiplier theory stress reliance on fiscal policies.

On a more formal level<sup>15</sup> fiscalists generally assume an inherent instability on the real sector of the economy due to its internal mechanism. Given this assumption, fiscalists rely on fiscal policy to stabilize the economy. On the other hand, monetarists believe that



internal dynamics of the real sector are more stable although "the operation of the monetary mechanism provides the dominant impulse generating observable economic fluctuations".<sup>16</sup> In this sense, control of the monetary mechanism is its approach to policy recommendations.

A third approach is a compromise between fiscalists and monetarists — the eclectic approach which is more popularly associated with the names of Samuelson<sup>17</sup> and Tobin<sup>18</sup>. Being a "middle-of-the-road position," it can be said to have not really developed a unique model of its approach but rather originated from differences, criticisms, or refinements of either the fiscalists or monetarists approaches. Examining the points of differences in the preceding discussions will therefore lead us to an intuitive feel of the eclectic position.

Firstly, to the eclectic, expansionary fiscal policy still has some significant effect even if it is not financed by expansion of the monetary supply.<sup>19</sup> Since government fiscal deficit is financed either by borrowing from the Central Bank or from the public, monetarists say it is not really the fiscal deficit which influences aggregate demand but the money created by borrowing from the Central Bank in the former case and reallocating to government hands existing in the latter case government-influenced increases in GNP may be just equivalent to (or even less than) the reduction in private-sector-influenced increases in GNP.<sup>20</sup> In short, fiscal policy can have its impact on the economy only if interest rates do not rise simultaneously to contract private investment. And the only way this can be done is to increase the money supply. Since it is the increase in the money supply which actually causes the change in aggregate economic activity why go through the roundabout method of fiscal policy? Why not just increase the money supply?

Secondly, the eclectics admit the contention of the monetarists of viewing the transmission mechanism as a portfolio-adjustment process. But that the mechanism is much more indirect than assumed, i.e., money supply increases do not affect GNP directly. To the eclectics, increases in money will induce purchases of financial assets which then add to the prices of these securities. But GNP has not been affected. The increase in prices of financial assets decrease interest rates. If decreases in interest rates or the decreasing cost of credit, firms or consumers are induced to borrow and then purchase real goods and services, then only will GNP increase.<sup>21</sup> In

this sense, interest rates indicate the effectiveness of monetary policy. However, to the monetarist, if interest rates do not change at all, monetary policy has been considered most effective because the increased balances were spent on real goods and services. There is a sharp line of distinction with regard to portfolio adjustments because the eclectics view the process as occurring in well-defined markets with well-defined structure of interest rates while the monetarists view the process more generally involving goods and services with imputed interest rates not traded in formal markets.<sup>2 2</sup>

Thirdly, monetarists posit more direct links between monetary policy and economic activity while the eclectics view it as function of security price expectations, in the case of interest rate reduction and business profit expectations, borrowing to occur, for increasing GNP. Monetary supply increases may not therefore increase GNP directly.

The theoretical differences appear formidable, and although they may perhaps be only differences in the degree of emphasis, the distinctions are sharper when it comes to determining indicators of monetary policy. The eclectics rely more heavily on interest rates while the monetarists say that interest rates are poor indicators of the impact of monetary changes because they affect the whole spectrum of interest rates.

In the ultimate analysis, empirical verification is resorted to support the contentions of the basic approaches to economic policy.

### III

The evidences provided in support of or against the basic approaches to policy are numerous, wide and varied. There has been no attempt here to cover them. What we can do however, is to provide the points made earlier with empirical meaning, both positive and negative.

The work of Friedman<sup>2 3</sup> has been the pioneer in lending evidence to the monetarist position. The evidence provided by fiscalists in support of their views, that is, the ineffectiveness of monetary policy during the Great Contraction, has been convincingly disputed by Friedman and Schwartz.<sup>2 4</sup> By extending their historical and statistical work, Friedman and Schwartz<sup>2 5</sup> also present evidence that business cycle peaks and troughs are associated with money supply movements with a lag averaging six months. Friedman has



provided evidence that interest rates are not significant arguments in the demand for money function.<sup>26</sup> Friedman and Meiselman<sup>27</sup> investigated the relative stability of the consumption-expenditure multiplier against the monetary velocity multiplier and found monetary velocity to be more stable.

On the relative effectiveness of either monetary and fiscal policy Andersen and Jordan<sup>28</sup> provide evidence by relating measures of monetary and fiscal policy to changes in economic activity that show monetary policy variables to be significant and fiscal policy variables to be insignificant. Keran<sup>29</sup> has extended the empirical study to several other countries in Europe and in Japan and has shown that monetary influences are more significant and consistent in countries studied despite the different institutions. Brunner<sup>30</sup> takes a more suspicious look at the economic policies of the late 60's with a monetarist tone.

It would be difficult and offensive to make a definite judgment on the evidences presented by either the monetarists, the fiscalists or the eclectics. Though we can be sure fiscalist and eclectic empirical evidence are scanty, this is no reason for us to accept wholeheartedly the positive monetarist empirical evidences. For where one can find a positive support, one can also come across similar studies but with diametrically opposite results.

If Keran finds monetary policy more effective in some countries, Lindbeck<sup>31</sup> finds in his study a few countries where fiscal policy, though not continuously used, has been effective. If Anderson and Jordan results are in favor of monetary policy, Artis<sup>32</sup> results are against it although he employed the same techniques and definitions and definitions for the United Kingdom.<sup>33</sup> And varying definitions give varying results as what De Leeuw and Kalchbrenner<sup>34</sup> Corigan<sup>35</sup> or Hamburger<sup>36</sup> have discovered.

We can find comfort at best in the realm where the empirical works clash: (a) the methodology (b) the choice of variables and (c) the definition of the variables. The Friedman-Meiselman and Friedman-Schwartz studies have been put to severe tests and criticisms by fiscalists and eclectics alike with respect to their methodology and the best conclusions are more of association than strict causalities.<sup>37</sup> The Andersen-Jordan study has been given careful scrutiny with respect to (a), (b), and (c) above.<sup>38</sup> And alternative definitions of the variables show contradictory con-

clusions or empirically equal significance to fiscal policies. The liberal use of reduced form estimation by monetarists seems to be the crucial question in methodology, while the choice and definition of variables center on whether the variables can be considered independent and exogenous or associated with the endogenous variables thus giving bias to the estimates.<sup>39</sup> Another interesting aspect of the debate is the possible overacting on the part of the fiscalists on the effectiveness of fiscal policy in the short run. Thus several of the studies examine this assertion. The questions raised, however, are much too complex to be subsumed under simple bivariate relationships.<sup>40</sup>

Nevertheless, in spite of the debate around the empirical studies with respect to the approaches to economic policy we find more constructive concrete policy proposals: (1) That because of our insufficient knowledge of time lags, the best stabilization policy is to have no stabilization policy at all, according to Friedman,<sup>41</sup> (2) That temporary tax changes do not affect aggregate demand at all, giving the validity of the permanent income hypothesis<sup>42</sup>, and (3) That even if there are evidences in support of positive policies, active delaying time lags intended to be anticyclical will only tend to end up being procyclical. Fine tuning is no fine tuning at all.<sup>43</sup> For these reasons, Friedman's<sup>44</sup> proposal is to keep the money supply growing at a steady rate and not bother with the other aspects of the monetary mechanism. Indeed, such policy would seem attractive given the conflicting evidences. But the immediate social costs and political repercussions of initiating such a policy appear to be quite significant.

In summary, monetarists favor rules rather than discretion; concern themselves with long run situations and long lags; stress the quantity theory and money stock, money and prices rather than money and interest rates; and demand for money rather than the consumption function.<sup>45</sup>

#### IV

To examine these basic approaches in the context of development policies necessitates the explicit recognition of the implicit assumptions inherent in the discussion above.

First, it is obvious that the policy approaches we discuss whether fiscalist, monetarist or eclectic operate more as stabilization tools. That is, they have the primary aims of (a) smoothing min



business cycle fluctuations, (b) reviving major business depressions, and (c) reducing price buoyancies in situations at or near full employment levels.

Second, the approaches imply the existence and operation of the institutions through which the transmission mechanism works. For the eclectics, this means a relatively active financial, securities, and capital markets while for the monetarists this means a relatively high degree of capital formation for both households and firms.

Thirdly, the effect of so-called leakages are either negligible or secure within the economy. That is, in the purview of the fiscalist approach, leakages are necessarily negligible in order for the full impact of the multiplier to work out.

With respect to the first assumption, a much more crucial assumption coexists with it. It is the implication that the economy being considered is at or near its full employment capacity; that in times of major depressions though unemployment may exist, it exists side by side with unutilized plant and equipment and the problem becomes one of recombining the existing resources; that at times of rising price level it is not one where rates of increases of consumption precedes production but rather where rates of increases of consumption is catching up, which policy tries to dampen.

Obviously, the first assumption and the underlying conditions with it lose validity in the context of developing economies. For one, the problem of development is not of one of recombining unused resources as depressions but of combining unemployed resources which are entirely different arguments.<sup>46</sup> For another in a very real sense, it is a characteristic in developing economies that consumption leads to production and adoption of policies intended to halt inflation may hamper other sectors deemed crucial to development.<sup>47</sup>

The second assumption shows the existence of a transmission mechanism in the developing economies as conceived either by monetarists or eclectics is more theoretical than operational because of the following reasons: (1) Financial securities or capital markets are hardly existent in some developing countries although their development has been recognized as necessary for growth.<sup>48</sup> And even if they existed they would be undeveloped and less sophisticated; they cannot be relied for all purposes as equilibrating mechanisms the way either monetarists or eclectics view them; (2)

Too often there are no clear distinctions between savers and investors in under-developed economies, thus investment flows generally do not pass market tests.<sup>49</sup>; (3) Real assets per capita or real assets per household are low in absolute terms thus diminishing the range of degree of substitutability as implied in the framework of monetary policies.<sup>50</sup>

The third assumption hardly needs elaboration because its validity is suspect in developing countries. The relative absence of financial markets, undeveloped banking sector, and high degree of dependence on foreign trade (ratios of imports and/or exports to GNP are high) all point to the wide possibilities of leakages.

All this is not meant to deny the use of either or all the policy approaches as we outlined them. Their use, however, is constrained by the validity of the assumptions of the theories upon which they are based.<sup>51</sup> To increase money supply as a development policy or run a deficit government would hardly move the economy into the path of development.<sup>52</sup> Nor would running a government deficit either. And initiating or legislating rules by which monetary policy would operate (such as constant money supply growth, as Friedman recommends) will certainly not uplift a lagging economy.

To students of economic development, there seems to be a favorability in the use of fiscal, monetary or eclectic approaches to development policies. But discretion is favored to rules but the swing from disequilibrium to equilibrium is a tempting solution.<sup>54</sup>

For one, outright increases in money supply will not directly or indirectly increase GNP, in a monetarist or eclectic sense, but may without accompanying discriminatory restrictions exacerbate an already perilous balance of payments position.<sup>55</sup> For another, unlimited autonomous increases in government expenditures without accompanying increases in real investment may increase nominal but not real GNP.

In effect, the goal of development and the development policies associated with it are much too complicated institutionally and economically to make a fine line of distinction among the fiscal, monetarist or eclectic approach to macroeconomic policy.<sup>56</sup>



## FOOTNOTES

<sup>1</sup>H. T. Shapiro, "The Efficacy of Monetary and Fiscal Policy," *Journal of Money, Credit and Banking* 3 part 2 (May 1971), p. 550.

<sup>2</sup>F. R. Glahe, *Employment, Money and Wealth: An Introduction to Macroeconomics* (mimeo), Chapter 18.

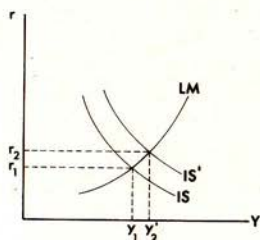
<sup>3</sup>J. M. Keynes, *The General Theory of Employment, Interest, and Money* (New York: Harcourt, Brace and Co., 1936).

<sup>4</sup>Keynes, of course, qualified his definitions on the impact of pure fiscal

<sup>5</sup>E. G. T. F. Dernburg and D. M. McDougall, *Macroeconomics* (3rd edition: Tokyo: Kogakusha, 1965), Chapter 6; P. A. Samuelson, *Economics* (8th ed.; New York: McGraw-Hill, 1970), pp. 228-232; R. A. Wykstra, *Introductory Economics* (New York: Harper and Row, 1971), pp. 159-166.

<sup>6</sup>Given a consumption function  $C = bY$  where  $b$  is marginal propensity to consume ( $0 < b < 1$ ),  $Y$  is disposable income, and the aggregated demand  $Y = C + I + G$ , where  $I$  is investment,  $G$  government expenditures, both assumed autonomous, equilibrium level of national income is  $Y = \frac{1}{1-b} (I + G)$ . A unit change in  $G$ ,  $dY/dG$ , is given by  $1/1-b$ .  $1-b$  is marginal propensity to save.

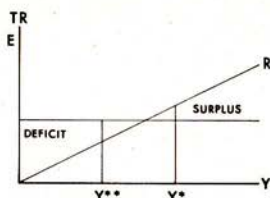
<sup>7</sup>Dernburg and McDougall, *op. cit.*; G. Ackley, *Macroeconomic Theory* (New York: Macmillan, 1961), Chapter 14.



In the figure above, LM is the locus of equilibrium points in the monetary sector consistent with a given interest rate and income; the IS curve is the locus of equilibrium points in the real sector consistent with a given interest and income. In other words, the LM curve consists of points where demand for money equals the money supply while the IS curve consists of points where investment equals savings. Given initial conditions  $Y_1$  at interest rate  $r_1$  increased government expenditures is shown as a shift in the IS curve. Thus, the movement from IS to IS' increases  $Y$  to  $Y_2$  despite increase in  $r$  to  $r_2$ .

<sup>8</sup>The "crowding out" effect of fiscal policy actions is discussed by H. Spencer and W. P. Yohe, "The 'Crowding Out' of Private Expenditures by Fiscal Policy Actions," *Review* (Federal Reserve Bank of St. Louis, October 1970), 12-24. The authors indicate that Keynes himself recognized this. Also J. Culbertson, *Macroeconomic Theory and Stabilization Policy* (New York: McGraw-Hill, 1968), Chapter 20.

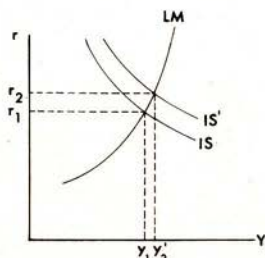
<sup>9</sup>Full employment budget is what the amount of fiscal surplus (or deficit) would be at full employment level, usually defined at some unemployment rate (e.g., 4 percent)



Let us suppose that a given level of government expenditures is horizontal line E and given tax structure yields receipts R. If  $Y^*$  is full employment GNP, the full employment budget surplus is shown by the vertical distance between R and E at  $Y^*$ . If actual GNP is  $Y^{**}$  full employment budget shows a deficit.  $Y^{**}$  may indicate expansionary fiscal policy when in fact this only shows a low level of GNP and thus tax receipts. Shifts in either tax rates or government expenditures shift the curves R and E indicating discretionary fiscal policy. This figure is adopted from W. L. Silber and L. B. Ritter, *Money* (New York: McGraw-Hill Books, 1970), p. 169, and "The Full Employment Surplus Concept" in *Annual Report*, Council of Economic Advisers, January 1962, pp. 77-81.

<sup>10</sup>The tax function of the government reduces the size of the multiplier. Continuing on footnote 6, if  $C = bY$  and  $Y$  is now disposable income after tax  $tY$  ( $0 < t < 1$ ), then  $C = bY(1 - t)$  and equilibrium level of income becomes  $1/1 - b(1 - t)(I + G)$ . In this case  $\frac{1}{1 - b(1 - t)} < \frac{1}{1 - b}$

<sup>11</sup>If from the figure in footnote 7, the LM curve is much steeper as is the case in an economy at or near full employment, shifts in the IS curve *cet. par* may have negligible effect on income. This is shown in the figure below:





<sup>11</sup> Fiscal policy programs are sometimes evaluated in terms of increased or decreased government activity and/or intervention in the market system or allocation of resources.

<sup>12</sup> It must be understood that there is no general agreement on the definition of money and while this statement may appear to mean the formal definition of money does not matter as long as it is money, it is not correct. Strictly speaking, for purposes of policy recommendation, the correct definition of money must be precisely identified.

<sup>13</sup> This assumption relates to the stability of the demand for money. See D. Laidler, *The Demand for Money: Theories and Evidence*, (Scranton, Pa.: Educational Textbook, Co., 1969).

<sup>14</sup> E. Brunner, "A Survey of Selected Issues in Monetary Theory," *Schweizerische Zeitschrift für Volkswirtschaft und Statistik Revue suisse d'Economie Politique et de Statistique*, March 1971, pp. 68-78.

<sup>15</sup> *Ibid.*, p. 76

<sup>16</sup> F. A. Samuelson, "Monetarism Objectively Evaluated," Reading 18 in J. R. Nelson and R. A. Wykstra (editors), *Readings in Introductory Economics* (New York: Harper and Row, 1971), pp. 120-132; *Idem*, "The Role of Money in National Economic Policy," in Federal Reserve Bank of Boston, *Controlling Monetary Aggregates* Monetary Conference June 1969, pp. 7-13.

<sup>17</sup> J. Tobin, "Commercial Banks as Creators of 'Money'," in W. L. Smith and R. L. Teigen (editors), *Readings in Money National Income and Stabilization Policy*, (rev. ed., Homewood, Illinois: R. D. Irwin, 1970), pp. 224-231.

<sup>18</sup> F. A. Samuelson, "Monetarism. . ." pp. 126-127.

<sup>19</sup> M. Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), pp. 81-84.

<sup>20</sup> F. A. Samuelson, "Money, Interest Rates and Economic Activity: Their Interrelationship in a Market Economy," in W. L. Smith and R. L. Teigen, *op. cit.*, pp. 398-414.

<sup>21</sup> F. R. Glahe, *op. cit.*, pp. 17-9 to 17-15 for a better and fuller discussion.

<sup>22</sup> Almost all the works of Friedman have some bearing on the monetarist approach to policy but what we are citing here are only those with immediate implication to the discussion in II.

<sup>23</sup> M. Friedman and A. Schwartz, *A Monetary History of the United States: 1867-1960*, (Princeton: Princeton University Press, 1963), Chapter 7.

<sup>24</sup> *Idem*, "Money and Business Cycles," *Review of Economics and Statistics*, 45 part 2 supplement (February 1963), pp. 32-64.

<sup>25</sup> M. Friedman, "The Demand for Money: Some Theoretical and Empirical

Results," *Journal of Political Economy* 57 (August 1959), pp. 327-251. This has been denied in other studies. See Laidler, *op. cit.*

<sup>27</sup>M. Friedland and D. Meiselman, "The Relative Stability of Friedman Velocity and the Investment Multiplier in the United States, 1897-1958," *Commission in Money and Credit, Stabilization Policies* (Englewood Cliffs, N. J. 1963) pp. 165-268. The issues this paper created are discussed in S. K. Meiselman, "The Relative Stability of Monetary Velocity and the Investment Multiplier," *Australian Economic Papers* 6 (December 1967), pp. 192-207.

<sup>28</sup>L. C. Andersen and J. L. Jordan, "Monetary and Fiscal Actions: A Test of Their Relative Importance in Economic Stabilization," *Review* (Federal Reserve Bank of St. Louis, November 1968), pp. 11-24.

<sup>29</sup>M. W. Keran, "Monetary and Fiscal Influences on Economic Activity: A Test of Foreign Experiences," *Review* (Federal Reserve Bank of St. Louis, February 1970), pp. 16-28.

<sup>30</sup>K. Brunner, "The Monetary Fiscal Dilemma," *Ohio State University Bulletin of Business Research* (June 1969) pp. 1-5.

<sup>31</sup>A. Lindbeck, "Fiscal Policy as a Tool of Economic Stabilization: Comments to an OECD Paper," *Kyklos* 23 (1970), pp. 7-32.

<sup>32</sup>M. J. Artis, "Two Aspects of the Monetary Debate," *National Institute Economic Review* No. 49 (August 1969), pp. 33-51.

<sup>33</sup>Artis, who finds completely opposite results in his study concludes that the results are "more salutary in underlining the defects of the procedure. . . than the results. . . produced." Indeed if behavioral relations are invariant (or at least the significant differences not so divergently wide) institutionally, the results under a legitimate procedure would be more acceptable. *Ibid*, p. 42.

<sup>34</sup>F. De Leeuw and J. Kalchbrenner, "Monetary and Fiscal Actions: A Test of their Relative Importance in Economic Stabilization-Comment," *Review* (Federal Reserve Bank of St. Louis, April 1969), pp. 6-11. Instead of the full employment surplus, an initial stimulus accounting concept is used. The results showed that fiscal policy variables along with monetary variables are significant.

<sup>35</sup>E. Gerald Corrigan, "The Measurement and Importance of Fiscal Policy Changes," *Review* (Federal Reserve Bank of New York, June 1970), pp. 133-140. Corrigan uses a different measure for fiscal policy variable. Instead of the full employment surplus, an initial stimulus accounting concept is used. The results showed that fiscal policy variables along with monetary variables are significant.

<sup>36</sup>M. J. Hamburger, "Indicators of Monetary Policy: The Arguments and the Evidence," *American Economic Review* 50 (May 1970), pp. 32-39. Hamburger collated diverse empirical work on monetary policy and finds conflicting views with respect to the appropriate monetary policy variable to use.

<sup>37</sup>Artis, *op. cit.*, pp. 34-35.



<sup>22</sup>J. Tobin, "The Role of Money in National Economic Policy" panel, in Federal Reserve Bank of Boston, *op. cit.*, pp. 21-24.

<sup>23</sup>In cases where monetary policy is accommodating, "money supply increases, in terms of the model specification, *de facto* endogenous. . ." and because changes are not independent of fluctuations in national income, statistical procedures to test this independent influence are likely to give biased estimates of it." Artis, *op. cit.*, p. 36.

<sup>24</sup>Christ concludes this after testing a structural model on monetary and fiscal effects. "A Model of Monetary and Fiscal Policy Effects on Money Stock, Price Level and Real Output," *Journal of Money, Credit and Banking*, 1 (December 1969), pp. 683-705.

<sup>25</sup>This seems to be the implication made by Friedman, "A Monetary and Fiscal Framework for Economic Stability," *American Economic Review* 38 (June 1948), pp. 245-264.

<sup>26</sup>H. Eisner says the error in expecting the tax surcharge in the 60's to be an inflation depressant was failure to take account of the permanent income hypothesis. "Fiscal and Monetary Policy Reconsidered," *American Economic Review* 59 (December 1969), p. 898.

<sup>27</sup>It is argued that the forecasting ability which this prescription would require is nonexistent. Moreover, in a "narrow-band" fluctuations at or near full employment what is needed is a much more disaggregated approach like increasing the mobility of factors of production or retraining programs. See Lindbeck, *op. cit.*, pp. 28-29.

<sup>28</sup>M. Friedman, "The Role of Monetary Policy," *American Economic Review* 58 (March 1968), pp. 1-17.

<sup>29</sup>D. Fand, "The Controversy Over Money," *Nebraska Journal of Economics and Business* 9 (Autumn 1970), p. 76.

<sup>30</sup>In the former, most institutions and important catalysts in the production process are already existent and developed and all that need be done is revive the environment; in the latter case, either or both is absent.

<sup>31</sup>G. P. Kindleberger, *Economic Development* (Tokyo: Kogakusha, 1965) Chapter 13. Schools of thought are divided in this respect. The monetarists (in the field of economic development) believe inflation as the consequence of expansion of spending financed by bank money creation while the structuralists believe inflation is a mere symptom; that even without bank expansion there still could be rising price level due to structural rigidities, e.g., inelasticities of supplies.

<sup>32</sup>J. G. Gurley and E. S. Shaw, "Financial Aspects of Economic Development," *American Economic Review* 45 (September 1955), pp. 515-538, D. P. Yiftanueva, "A Survey of the Financial System and the Saving-Investment Process in Korea and the Philippines," *Finance and Development* 8 (June 1971), pp. 10-19.

<sup>49</sup> A. O. Hirschman, *The Strategy of Economic Development* (New Haven: Yale University Press, 1958), p. 35 et passim.

<sup>50</sup> Any United Nations *Yearbook of National Account Statistics* contains data which point to this fact.

<sup>51</sup> H. C. Murphy makes a similar conclusion but fails to emphasize the appropriate reasons nor the conditions under which they are obtained. "What Does It Really Mean? Fiscal Policy?," *Finance and Development* 7 (July 1970), pp. 14-20.

<sup>52</sup> It is true that monetary factors as we described it have discernable effects, whether direct or indirect, on aggregate economic activity. But in the context of economic development, these policies are more accommodating or permissive rather than inducing.

<sup>53</sup> Transforming underdeveloped areas to the development path needs a critical minimum effort in the form of social overhead capital. Below this level no inducement takes place and above it, it ends up in less pressure for development. See A. O. Hirschman, *op. cit.*, Chapter 5.

<sup>54</sup> It is sometimes argued that rather than finding equilibrating mechanisms in development policies, or eliminating disequilibrium, a useful policy would be one of keeping alive disequilibria, create tensions and disproportions, as in the process of reaction, the movements lead to equilibrium. *Ibid.*

<sup>55</sup> A case in point is an aspect of monetary policy in the Philippines. Expansion or contraction of money supply is achieved through reserve requirements and rediscount rates rather than open market operations for the reasons cited in the text. Expansionary monetary policy however is discriminatory through multiple discount rates, lower for high priority projects such as agro-industries and higher for non-productive endeavors (imports or luxury consumption). While the administrative problems are numerous, the policy can be effective in directing monetary flow to the right direction. This, of course, assumes the priorities are welfare optimal in some Paretian sense.

<sup>56</sup> The recognition of the limitations of the basic approaches should never be underestimated especially when (a) foreign missions are sent overseas as formal technical assistance, and (b) graduate students in economics from underdeveloped countries blindly transplant learned tools from advanced countries.



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