Editorial

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Although there is an important debate going on in the world over the effects of 'monetarism', only very rarely is it emphasized that 'monetarism' is far more comprehensive than a concern with the money supply and inflation.

At one level is the legitimate (if exaggerated) concern about the rate of inflation. As is well known, according to this school of thought, the rate of inflation is determined by excess aggregate demand; the main mechanism which causes an expansion of aggregate demand is growth of the money supply. This position is best summarised by Friedman's statement that 'Inflation is at any time and in any place a monetary phenomenon' [Friedman 1968]. Friedman puts forward the view that, in the long run, the quantity of money has a negligible effect on real income, its effect being mainly on nominal income. Therefore, the price level is a joint outcome of the monetary forces determining nominal income and the real forces determining real income [see Friedman 1970]. Whatever their limitations, the monetarists do make an important contribution in stressing that monetary expansion is inevitably inflationary in effect. They tend to ignore however, any analysis of the sociological, political and economic factors determining monetary expansion. The Latin American 'structuralist' school, as well as the Anglo-Saxon 'cost-push' approach (particularly in their more simplistic versions) consistently underplay the role of the monetary mechanism in inflation, viewing inflation as mainly a non-monetary phenomenon; such approaches run the danger of ignoring the inevitable impact which deficit financing and money expansion will have on prices.

However, hidden behind the monetarists' legitimate concern about inflation and its causes is a radical attempt to lay the base for a more successful and pure model of capitalist development, with almost exclusive reliance on free market forces. On the one hand, monetarist policies, particularly in the Third World and to a lesser extent in the UK, attempt to carry out structural reforms to eliminate previous 'distortions' in the price systems; 'correct' pricing requires 'privatisation' of state enterprises, rapid reduction (or elimination) of tariff barriers and exchange controls as well as elimination of government subsidies for basic foods, social services and private enterprises. On the other hand, the long-term aim of monetarism is to restore conditions for higher profits in the private sector, which are expected to lead to higher levels of investment and growth. Measures such as reducing direct taxation and attempting to weaken the power of the trade unions are geared towards this ultimate objective. One of the key paradoxes, which we will explore further below and in the articles of this *Bulletin*, is that even though direct taxation is reduced and wage claims decline substantially, profits of the private sector (particularly in industry) often decline in monetarist experiments. Although the private sector is given greater freedom to operate, and some of its costs are reduced, the environment caused by monetarist policies (high interest rates, an over-valued exchange rate—leading to export difficulties—and a reduced internal market, due to restraint in public expenditure and real wages) seems to stifle the private sector's potential for profits and investment. Naturally, public investment declines as a result of monetarist policies: this is one of their targets. It should be of greater concern to monetarists that private investment declines as well!

In the broader sense, monetarism in the Third World implies freeing the magic of the market forces, both internally and internationally. This has led all Third World monetarist governments, (as well as some others), to pursue outward oriented development strategies. The recently published book by Bela Balassa (*The Newly Industrialising Countries in the World Economy*. Pergammon Press) enthusiastically puts forward the merits of such a strategy. In his review of the book in this *Bulletin* MacLean basically endorses this positive appraisal of outward-oriented models. Geoff Lamb is more sceptical, emphasising particularly the question of consistency between rapid economic 'opening up' and political democracy. Many other authors (including those appearing in this *Bulletin*, eg Felix) also question the inevitable link between open economy and better economic performance which Balassa claims to establish.

Pessimism about the effects of monetarist policies may be exaggerated at the time of writing (September 1981). As the articles by David Felix and Philip O'Brien detail, in Argentina and Chile in 1981, the economic problems and contradictions seem to be increasing significantly. As Filgueira discusses in his article, the Southern Cone models also have perverse effects on the patterns of consumption of different strata of the population. Despondency in the UK about the effects

Bulletin, 1981, vol 13 no 1, Institute of Development Studies, Sussex

of monetarist policies affects not only workers and industrial entrepreneurs, but also the City, that alleged fortress of conservatism. Doubts are increasing in the United States about the effectiveness of monetarist policies in the largest industrial country; again, the fears are increasingly shared by workers, industrial entrepreneurs and financiers. It is possible that—as the 'monetarists' and some Marxists claim—these are only rough patches on the road towards successful capitalist development in the very long term. While the truth or falsehood of this can only be provided by future events, the results so far certainly justify current pessimism.

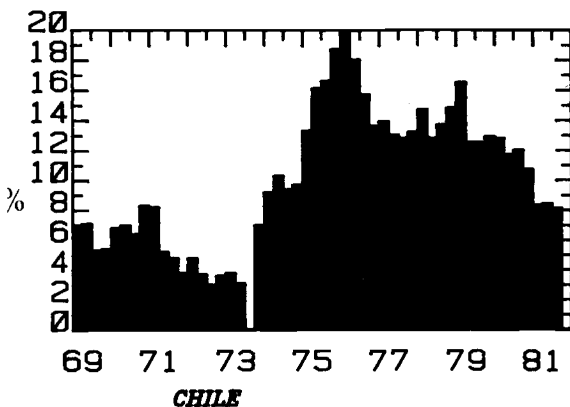
This *Bulletin* focuses on the effects of monetarist policies in the Third World. The cases of Chile and Argentina are analysed in depth in articles by O'Brien, Wells, Felix, and Beccaria and Carciofi. Besides their intrinsic interest, their importance lies in the thoroughness and pureness with which they pioneered the application of radical monetarist polices. Their experiences are therefore of interest not only to policy-makers in other Third World countries (who are beginning to apply or consider the application of radical monetarist policies): they also have relevance for policy-makers in industrial countries, even though there are important differences between industrial countries and those of the Southern Cone.

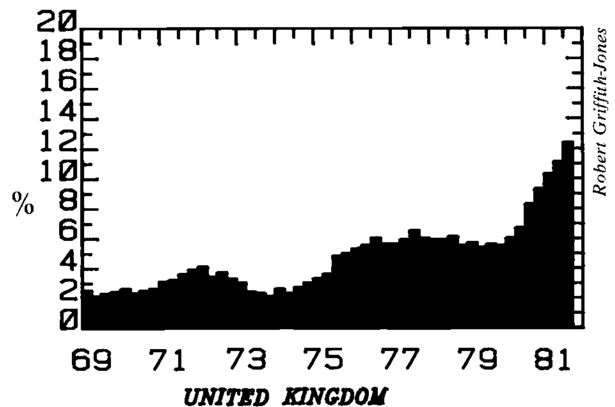
The effects of monetarism in the developing countries are not limited to the application of these theories there. As Dudley Seers points out in the Foreword, the implementation of monetarist policies in the industrial countries (and particularly in the United States) has a dramatic effect on the international framework within which developing countries have to operate, seriously constraining their own options for growth and development. Developing countries are doubly hit by monetarist policies in the industrial countries (and particularly in the US). Contraction of economic activity in industrial countries leads to slower growth or decline in the export markets of the Third World, affecting both their industrial and commodity exports. Simultaneously, the very high interest rates of the last two years, particularly, but not only in the US, has dramatically increased the debt service burden of the developing countries. In the 1970s, a rapidly increasing proportion of external finance to the Third World came via private banking loans, almost all negotiated on the basis of variable interest rates (which follow the US interest rate very closely). If the total variable interest debt to private banks by developing countries reaches $130 bn (a Morgan Guaranty estimate), then every percentage point that the US interest rate increases implies an annual increase of $1.3 bn for Third World debt servicing.

Monetarist policies in industrial countries will therefore seriously worsen the foreign exchange constraint (already made more serious by the rises in the price of oil) that governments of developing countries will have to face in the near future. It is to be feared that in their need to obtain greater external finance, governments of developing countries will increasingly have to accept loans from official international institutions, such as the IMF, where recent softening of conditionality may be reversed, mainly as a result of US government pressure (for an analysis of IMF conditionality and the economic theory behind it, see Philip Daniel's article in this *Bulletin*).

Although monetarism, as well as neo-classical economics have been well known in academic circles for several decades, their radical implementation in many countries is a relatively recent phenomenon. As Felix points out

Quarterly rate of unemployment in Chile and the UK (official figures*)





† *data for September 1973 not available*
* *excludes subsidised employment schemes*

in his article, monetarist stabilisation efforts in the 1950s and 1960s, particularly in the semi-industrialised countries of Latin America, had foundered on working class and populist political opposition; as a result their implementation was always partial and usually short-lived. Since the early 1970s, monetarism seems to have spread as rapidly (and some would argue as destructively) as a forest fire. Monetarist policies were first applied in a very radical form in the Southern Cone of Latin America in the mid-1970s. They have spread, sometimes in milder forms, not only to neighbouring countries (such as Peru), but also to other continents (Turkey's conversion to monetarism after last year's coup seems very determined). Asian countries are moving more gradually towards monetarism; (Michell's article on South Korea in this *Bulletin* details this more recent shift). As is well known, radical monetarism has now emerged in the industrial countries.

It seems necessary to examine, albeit briefly, the reason for this rapid spread of monetarism amongst policy-makers. As Wells points out in his article, in Chile and Argentina particular circumstances made the introduction of 'radical' monetarism easier. It is certainly no accident that these two countries (which reverted to such 'ultra-orthodox' monetarist policies) experienced at the time annual rates of inflation of over 400 per cent, while their foreign exchange situation was extremely precarious. In both countries, previous governments (socialist in Chile and populist in Argentina) had shown little inclination or ability to contain pressures for expanding expenditure and consumption. Serious financial disequilibria (accompanied by the fear of socialism in certain sectors) considerably strengthened the position ot those committed to strict economic orthodoxy and 'free-market' economics [see Griffith-Jones 1981]. Furthermore, particularly in the Chilean experience, the social groups which had traditionally opposed monetarism were repressed. As trade unions were suspended and political parties banned, the traditional political constraints to implement orthodox policies were eliminated. As the Chilean Minister of Finance, Sergio de Castro, pointed out in 1978, this 'allowed the economic management team absolute independence in pursuing precisely the policies they wanted'. Finally, in Chile and Argentina, as elsewhere in the Third World, the preference which international financial institutions (and particularly the IMF) and some governments have for 'monetarist' policies provided international backing for the supporters of ultra-orthodoxy.

The reasons for the spread of monetarism in the advanced industrial countries is an important subject, which somewhat escapes the scope of this *Bulletin.* However, as pointed out at the beginning of this Editorial, it seems clear that its main target is to lay the base for a more successful and purer model of capitalist development; this would require an increase in profits and investment. The reason for the systematic decline in post-tax profits in the last decade are clearly summarised in Rowthorne:

> for more than a decade the share of post-tax profits in output has declined through the advanced capitalist world. The immediate causes of this decline are as follows: *rising state expenditure,* often under the impact of popular pressure for better social services and benefits; *worsening terms of trade* with primary producers during 1972-74, in part because of a shortage of primary commodities and in part because of the organised power of the OPEC cartel; and finally, the existence of a *strong working class movement* demanding higher real wages and unwilling to restrain its consumption and free resources for use by the state and transfer to primary producers. Given the competing claims of workers, the state and primary producers, the amount left for profits was greatly reduced.
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> [Rowthorne 1976:110, my emphasis]

The paradox of monetarism in industrial countries is that it seems relatively successful in weakening the working class movement (via recession and increased unemployment), which has implied smaller wage claims; it also seems to have been relatively successful recently in weakening the power of primary producers, particularly OPEC, via the recession. It seems, however, much less successful in its ultimate target of increasing profits and private investment.

Thus many of the dilemmas encountered by monetarists in the Third World may repeat themselves in the industrial countries. The social cost of monetarism in the industrial countries will be attenuated by the existence of social security and unemployment benefits (which, however, make the economic success of monetarism more difficult); the social costs will also be moderated by political opposition to monetarism, which, fortunately, can probably not be repressed. However, the costs to the Third World of monetarism in the industrial countries will undoubtedly be very high in terms of factors such as shrinking export markets, more expensive foreign credit and debt. The indirect impact of monetarism in industrial countries may yet prove more costly for the Third World than the limited, national experiments in monetarism conducted by Third World Chicago Boys.

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