THEORIES OF THE STATE REGULATION OF MONETARY PROCESSES

Bayarsaikhan Zolzaya
Financial University under the Government of Russian Federation

Today, the level of the monetary sphere has a strong impact not only on the development of certain sectors of the economy, but also on the economy and development of a country in general. Therefore, it becomes necessary to study and justify the methods and tools used by the governments and central banks for the regulation of economic processes, including monetary, in the modern economy.

Various economic schools offer different instruments of monetary policy. So that arose in the 30's of the 20th century Keynesian concept envisages an active role of the interest rates to stimulate investment and business activity and to avoid overheating of the economy, depending on the phases of the business cycle (fall or rise). Keynesian concept has been successfully applied in the U.S. to exit from the "Great Depression", and is widely used in Western Europe after the Second World War.

However, this tool is not always effective. When "liquidity trap" [*], and with the economic recession and stagnation, accompanied by high levels of unemployment and inflation, Keynesian theory goes down, and vice versa, increases unemployment and inflation, which in turn affects the socio-economic situation.

Thus, in the 70's and 80's of the 20th century when many market economies faced with the phenomenon of stagflation, when the economic recession and stagnation in the economy and the resulting parameters of unemployment and inflation, strengthened the position of neo-classical, especially the monetary concept. The main idea of the monetarists, represented by Irving Fisher and Milton Friedman is that the state is not appropriate to interfere in the economy; it should only be involved in the management of the money supply.

Monetarists pay particular attention to the temporary lag - the period between the economic decision-making by the government and central banks, and the reaction of the economic agents to these decisions. Monetarists consider it necessary to conduct long-term policy impact on the money supply. Also, according to the monetarists, the relationship between the money in circulation and GDP is stronger than the investment-GDP and the change in the money supply can strongly influence the level of prices, investment, unemployment and GDP.

---

[*] "Liquidity trap" - when the increase in the money supply parameters (that is, a large scale of the proposed liquidity) and, consequently, at lower interest rates, investors still do not have a desire to expand the demand for money. This situation arises when investors have no expectation of profit. In this case breaks the causal link between the drop in interest rates and an increase in the money supply on the one hand, and the expansion of investment, business activity and the extent of GDP, on the other hand.

Therefore, as per the monetarists, to put the country's economy in the mode of economic growth is needed each year to increase the money supply by 3-5% a year [Guseinov R.M., etc., 2012].

With an increase in the money supply more than 5% the inflation will grow. If the rate of infusion of money into the economy will be less than 3% per year, it will lead to a slowdown in real GDP growth, or even negative growth can be observed. In turn, if the government will stick to a constant rate of growth of the money supply in the identified parameters, entrepreneurs in the money market will always find the money they need to invest, for working capital, to pay wages [Guseinov R.M., etc., 2012].

According to monetarists, in order to fight inflation the government should make the currency stable, so as to prevent the expansion of speculative demand and make effective savings. If entrepreneurs know that the interest rate will be stable over a long period of time, and being assured that they will always find the money in amount they need at the market they can more accurately calculate their income from investments. Therefore, the higher price of money will not distract them from acting in favor of the realization of investments and allow for growth.

In the 1980s monetary concept finds its practical application as a theoretical basis for the economic policies of the governments of Ronald Reagan and George W. Bush in the United States and Margaret Thatcher in Britain. To date, monetarism is the official theory of international financial organizations like the International Monetary Fund, the International Bank for Reconstruction and Development, World Bank.

It should be noted that the monetarists and Keynesians observed similarity of views and opinions on many issues:

- the methodological basis of both concepts is the theory of general equilibrium analysis,
- the main place in their study of the macroeconomic effects play aggregate demand,
- both models money affect net national product (NNP) in the same direction – the expansion of the money supply increases the NNP and, conversely,
- as the main objectives of public policy Keynesians and monetarists consider the fight against inflation and unemployment.

Fundamental differences between the representatives of these theories can be traced to the following number of items:

- evaluation of the market system and the attitude to state intervention in the economy,
- analytical framework,
- methods for the conduct of monetary policy within the framework of overall economic policy.

The first step in the policy of Central Banks of monetarism was the inclusion of the monetary aggregates in their econometric models. In 1966 the U.S. Federal Reserve began to

study the dynamics of monetary aggregates. The collapse of the Bretton Woods monetary system influenced the concept in the monetary area. The central banks of major countries have stopped targeting exchange rate in favor of the monetary aggregates. In the 1970s, the U.S. Federal Reserve as an intermediate goal chose M1, but as a tactical goal - the interest rate on federal funds. After the U.S., Germany, France, Italy, Spain and the UK have announced the benchmarks of money growth. In 1979, European countries agreed on the establishment of the European Monetary System, in which pledged to keep rates of their national currencies within certain limits. This led to the fact that the major countries of Europe spent targeting, and exchange rate and money supply. Small open economies, such as Belgium, Luxembourg, Ireland and Denmark continued to target only Exchange Rates. Thus in 1975 most developing countries continued to support any kind of fixed rate. However, since the late 1980s, monetary targeting is beginning to yield its position inflation targeting. But by the mid-2000s, most developed countries have moved to a policy of determining the target reference of inflation, not monetary aggregates [Eyubov Z.V., 2012].

However, if the Keynesians do not take into account the expectation of their models, Monetarists formulated a theory of adaptive expectations, based on the fact that firms adjust their expectations in terms of events, past trends, and evidence of past errors or predictions. In this way, assesses the likelihood of the situation on the commodity markets, price trends, changes in market conditions. Such judgments are based on the theory of adaptive expectations, which dominated until the early 60's of the 20th century.

American economist Robert Emerson Lucas proposed the theory of rational expectations. According to the theory of rational expectations formation of expectations of future economic system is not only based on an extrapolation of trends in the past, but on the basis of the analysis of future opportunities. In contrast to the adaptive expectations rational expectations are focused more on the future than on the past, because economic agents do not tend to wait passively for change in course. Building on the broad information they anticipate the likely consequences of monetary and fiscal policy, make rational decisions, capable of balancing the actions of state agencies.

For example, suppose the government in order to stimulate business activity lowers interest rates, thus increasing the money supply. From the point of view of the Keynesian theory of such action on the part of the state will increase demand, as growth of the money supply reduces the value of money and increase the demand for them as an investment product. And all this in turn increases the demand for labor, increasing wages, thus increasing the supply of labor, thereby increasing output [Mishenko S.V., 2011].

But even as this provision does not agree proponents of rational expectations. According to them, the workers, being rational and informed actors understand that the increase in the money supply will lead to higher prices for the goods and do not accept an increase in money wages for the growth of real wages.

However, it should be noted that the theory of rational expectations recognize the possibility of an effective economic policy related to the suppression of inflation. This is not accident; the inflation rate depends strongly on inflation expectations. And as rational inflation expectations depend on the state's fiscal and monetary policies, the change that policy changes and expectations.

A weakness of the theory of rational expectations is a prerequisite to the full awareness of the decision makers. When the market price for the products of a company rises, the entrepreneur does not know sufficiently increased if the relative price of its products, or there is a situation of general price increases.

It should be noted that modern economics is increasingly becoming a theory of rational decision making [Evgenii N., 2012]. This process is accompanied by the desire to adopt an economic approach as universally valid explanations for all socio-economic phenomena. However, the current regulation of the monetary process can not be based only on the instruments proposed economic schools. It should be based on the characteristics of each country and suitable for her transmission mechanism, based on the main activities of central banks which includes [Guseinov R.M., etc., 2012]:

1. Development of a common legal and regulatory framework for monetary policy in the country;
2. Currency issue;
3. Protecting and ensuring the stability of the national currency
4. Development and strengthening of the banking sector;
5. Ensure effective and smooth functioning of the settlement system.

To achieve its objectives in the field of monetary policy central banks use the following methods and tools [Guseinov R.M., etc., 2012]:

1. Interest rates for operations;
2. Reserve requirements;
3. Open market operations;
4. Bank refinancing;
5. Interbank auctions;
6. Currency regulation;
7. Orientation of monetary growth;
8. Direct quantitative restrictions.

For years, the debate between monetarists and Keynesians portrayed to emphasize conflict, caused by two different specific approaches to the theory of money – modern quantitative theory on the one hand and upgraded versions of Keynes's general theory on the other. But to date, theoretical models purchased synthetic forms including common to both elements. Keynesian-neoclassical synthesis - a very broad term and includes a diversity of views on a number of issues of theory and practice.

According to modern Keynesian-neoclassical synthesis, monetary and fiscal policy, the federal government, provide it with significant opportunities for the control of nominal GNP. However, be aware that the effects of changes in nominal GNP changes in real output, on the one hand, and the absolute level of prices, on the other hand, are practically free from control by the authorities. The modern theory of fusion tunes economists less optimistic mood, leaving the old confidence in their ability to ensure the prosperity of the economy and beat inflation. But at the same time, the proposed model gives hope to avoid the same mistakes in the conduct of macroeconomic policies, improved predecessors.

References:

1. Evgenii N. (2012) Monetary Authority, Expert.
2. Guseinov R.M., Gorbacheva Y.V., Ryabtseva V.M. (2012) History of Economic Science, Infra-M.
3. Mishenko S.V. (2011) Macroprudential Regulation of the Monetary Sphere, SPb: IBJ.
4. Eyubov Z.V. (2012) Modern Monetary Policy, Modern Economy Issues.