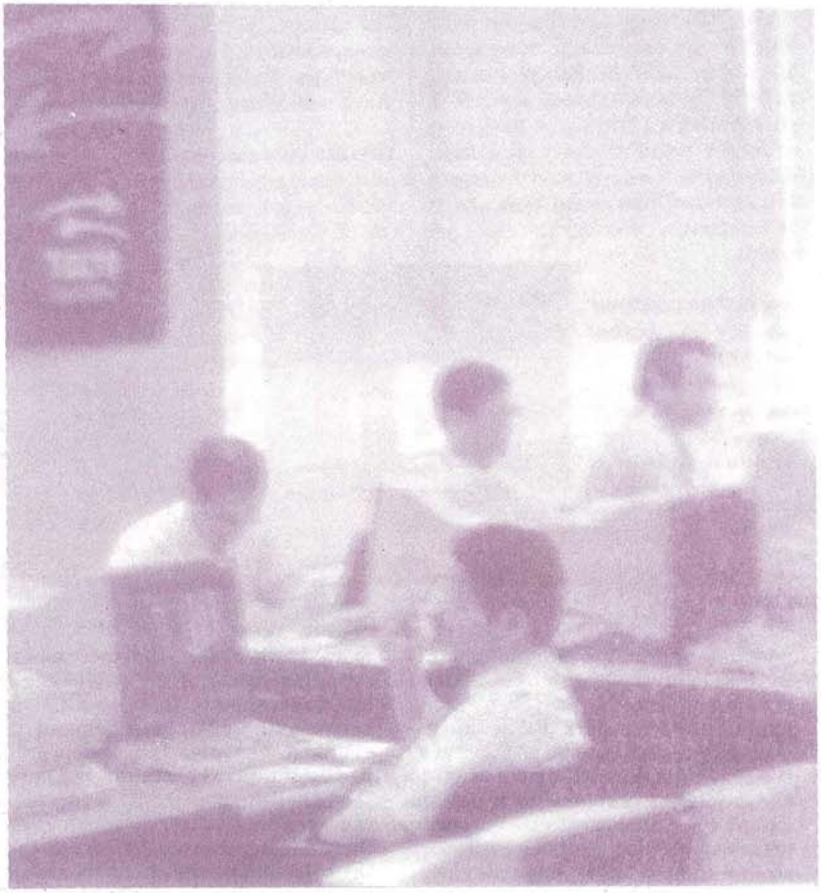
When dealing with the problem of aggregate demand and aggregate supply, capitalist economists have implied that the aggregate demand means wants, or effective demand, and paid no attention to need of the poor that isn't always based on the ability to pay for a product. Amartya Sen, the 1998 Nobel Prize winner, has proven that the poor could die from hunger even if the supply of food exceeds the demand because they have no ability to pay for their need.

To address this problem in such a way means recognizing cyclical crisis as an irremediable defect of the capitalism because the effective demand could suddenly falls and causes oversupply. Contrarily, if we pose the problem of relation between the aggregate supply and the aggregate need (I consider "demand" as effective demand while "need" includes wants that aren't backed by the spending power) we will have to deal with a lot of questions: Why do farmers die from hunger even if the harvest is good? Does the capitalist distribution includes such serious defects that the oversupply takes place from time to time and causes cyclical crises? Is there any measure to raise the aggregate demand thereby avoiding oversupply? J.M. Keynes has suggested that we could use the inflation to deal with economic crises and unemployment; and



COULD MONEY SUPPLY BE USED TO MAINTAIN A BALANCE BETWEEN SUPPLY AND DEMAND?

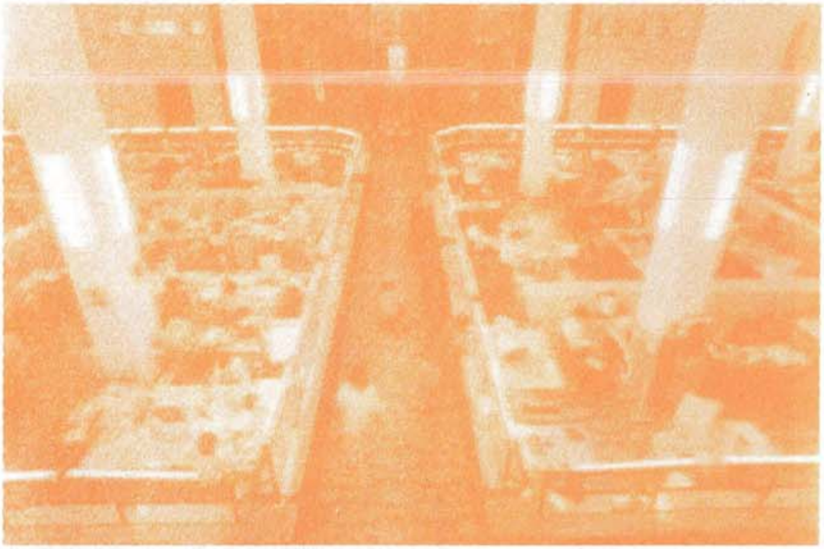
by VŨ NGỌC NHUNG

he thought the capitalism would never collapse when those two problems were solved. We had better examine if the Keynesian theory could be used to keep a balance between the aggregate demand and aggregate supply.

According to the Marxist-Leninist theory, it is the capitalist distribution of wealth that is the cause of oversupply and many socialist governments have thought that all social inequity would be eliminated when the private ownership of means of production was removed. That is why in Vietnam, it was thought that after two years of socialist reform and the establishment of the public ownership of means of production, the socialist revolution would be completed. This way of thinking led to the distribution system undertaken by the state-run commercial machinery: everybody believed that the social equity would be established when all factories and cooperatives sold all their output, regardless of its quality, to state-run commercial companies. Therefore the Government got rid of the market forces, used administrative orders to fix prices regardless of the fact that the inflation made prices fluctuate day after day.

So deciding to develop the socialism-oriented market economy is the correct way to escape from the crisis caused by the voluntarist socialism. Realities of over 10 years of economic reform show that the socialism-oriented market economy is better than the purely capitalist economy and it also saves us from feeling guilty about betraying the socialist ideal.

However, to develop the market economy means that we should deal the relation between the aggregate received annually from foreign loans and aid.



demand and aggregate supply according to laws of the market instead of commanding the market by using administrative orders. From this aspect, Keynes' solution is good because it adjusts the unequal distribution in the capitalist economy to a certain extent when it suggests issuing more money to provide the poor with more ability to pay. It is unemployment that reduces income and the aggregate demand; Keynes asks governments to increase the money supply thereby causing inflation in order to start major projects with a view to providing the unemployed with jobs. U.S. President F.D. Roosevelt followed his advice and maintained high economic growth rates during his three President's terms.

Although the Keynesian monetary theory isn't a basic solution to the unequal capitalist distribution that causes the aggregate demand to fall suddenly, it is still a feasible measure when we have no perfect method to solve the problem of balance between the aggregate demand and aggregate supply. To work out such a method, we should understand how strong effects of a monetary policy are and what limits we should observe.

The present aggregate supply hasn't yet satisfied all need of human being, not to mention an excess over demand. Thus the supply is only bigger than the effective demand and oversupply only takes place when a fall in the effective demand makes the aggregate demand decreases while the total need doesn't. Issuing more bank notes can increase the spending power of the public and allow governments to keep a balance between the aggregate demand and aggregate supply. But the price to pay is the price instability. Thus, if the benefit generated by increases in the spending power is much bigger than damage caused by increases in the price index, the cheap money policy is considered as effective. Vietnam has gained achievements in terms of the monetary policy that was considered as "striking" by the world in 1989 when the money supply increased by 262% while the price index fell from 700% to 34.6%. Thus the value of benefits generated by the inflation was 7.57 times (262/34.6) higher than the damage caused by falls in the price index. The benefit was even much bigger because the Politburo's decision to issue thousand billions of đồngs in June 1989 allowed the state-run trading machinery to purchase some two billion tonnes of rice for export, and thus helping Vietnam become the world's third biggest rice exporter.

The effect of the monetary policy repeated itself many years after, in 1993 for example, when Vietnam increased the money supply by 31.45% in comparison with 1992 while the price index rose by 5.2% only, and the benefit was 6.04 times (31.45/5.2) higher than the damage. Statistics showed that 5,953 billion đồngs (or US$583 million) were issued in 1993, equaling one- fourth of what Vietnam received annually from foreign loans and aid.

Such great effects of a cheap money policy, however, weren't put in use in 1999 to stimulate the spending power when there was no determination to struggle against low inflation rate: in 1999, the central bank increased the money supply by some 20% in comparison with 58.45% in 1992 or 31.45% in 1993. If more money had been injected through government expenditures, Vietnam would have overcome low growth rate and been able to keep the inflation rate at 4% at most.

The limit that should be observed when issuing money is the one-digit price index; that is this index shouldn't increase by more than 9%, according to a concept supported by many governments after the global hyperinflation during the 1960s and 1970s when the average rise in the price index in many developed countries was 22%. In my opinion, we should observe the 9% limit in the long term and we could allow it to rise higher at times when the spending power should be stimulated, for example, it was allowed to rise to 17.5% in 1992. When the spending power rises by 31.45% or 58.45% in comparison with the inflation rate of 5.2% or 17.5%, the people are still thankful for such a cheap money policy because the living standard is improved and unemployment reduced.

To gain such achievements as in 1989 when the economic reform was started, policy makers should spend a lot of time studying laws of money circulation put by Marx, instead of obeying the IMF experts who suggests issuing money in accordance with the growth rate and not higher than 10% because they are afraid of inflation and pay no attention to laws of money circulation. Their suggestions show that they had confused the PQ (in Fisher's equation MV=PQ) with the GDP while in fact we could allow the PQ to exceed the GDP. We should be alert to such suggestions. In 1989, if Vietnam had taken such advice and increased the money supply only by 1.027% (equaling the growth rate) or even 10%, it wouldn't have gained such striking achievements in monetary policy and rice production and export admired by the world.

I petition the central bank to organize workshop on this problem in order to get access to different opinions and viewpoints before opening negotiations with the IMF, an organization is facing urgent demand for reform■