TO STABILIZE PRICE OR MONEY SUPPLY?

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Many IMF specialists have advised that the Vietnam Banking Law had better target the operation of the State Bank at stabilizing prices, instead of stabilizing money supply. In judging this opinion, we should base on scientific arguments.

First of all, let's return to the Article 2 of the State Bank Ordinance which states that the operation of the State Bank aims at stabilizing the value of monetary unit and facilitating economic growth. This statement is appropriate to the socio-economic situation in the late 1980s and early 1990s when the market economy didn't come into being in Vietnam and prices weren't determined by the market mechanism, and prices of certain essential goods were under control, that is, they were fixed by government ministries. At that time, prices were affected by the market mechanism and government intervention. In such conditions, the State Bank couldn't undertake the task of stabilizing prices. Moreover, the government then wanted to make the innovation of the banking system a breakthrough in the economic renovation, and make the stabilization of the value of monetary unit a basis for the stabilization of prices, that is, to create macroeconomic bases for renovation of mechanism for controlling the economy.

The aim of stabilizing the value of domestic currency and facilitating economic growth was then more realistic than the aim of stabilizing prices (which was usually considered as the inflation control). Seven years after the State Bank Ordinance came into effect, we had better not feel satisfied with achievements and had better pay attention to our shortcomings. The aim of stabilizing the value of domestic currency is suited to the economic situation at that time, but at present the world economy witnessed a lot of changes and Vietnam is trying to integrate into it, so we have to change our view on the problem. The development of the market economy requires us to change our system of laws and management mechanism.

Now we can easily see that what IMF specialists advised us is well-intentioned and scientific. Why did they advise us stabilizing prices, instead of stabilizing value of domestic currency?

1. The value of a monetary unit is an abstract concept which many people fail to understand and many others disagree about. When this value shows itself in purchasing power, everybody could easily realize it. So the value of a monetary unit could be examined from two aspects. Firstly, the value of a monetary unit is the extent by which it can buy goods and services. Secondly, the price is the money value of a unit of a commodity or service. Thus when price rises, a monetary unit can buy a smaller amount of goods, that is, its purchasing power or value decreases. Theoretically, price is the indication of value in terms of money.

Because the value of a monetary unit shows itself in prices so the aim of stabilizing prices makes the role of the State Bank clearer and more appropriate to the economic development in Vietnam at present and in future. Is that aim beyond reach of the State Banks? The answer is no because the State Bank is a member of the Government.

2. We must base on principle of supplying money to estimate the reasonableness of the aim of stabilizing prices.

As we know, there are two principles of supplying money supported by two schools of thought.

Firstly, the currency principle put forward by David Ricardo maintains that the money supply should be based on gold reserve held by the central bank. However, many countries found it difficult to tie the money supply to gold reserve and started to issue money according to demands of the economy.

Secondly, the banking principle introduced by Took and Fullarton advocates that the central bank has the right to issue bank-note to facilitate the economic development. The money supply will decrease when money flows into the banking system. This principle is similar to the method of issuing money in the modern world.

The basis for the issue of money today is the amount of goods and services which is large enough to maintain the purchasing power of the monetary unit. The supply of money must be of service to the production.

Basically, the central bank supplied an amount of money in order to help the economy produce an amount of goods and services. Thus the role of money is to facilitate the production and distribution of goods and services.

IMF specialists have based their suggestion on the money supply principle adopted by central banks in the world today. Fluctuation in price is a sign given by the market for us to keep the value of monetary unit stable. In the market economy, price mechanism and policies constitute the nervous system of the economy, thereforce the central bank has to try its best to keep prices stable, thereby keeping the economy stable at macro level.

In the world, each central bank chooses an aim of its own, but in general, all central banks aim at stabilizing prices or stabilizing value of monetary unit, and encouraging economic development. Therefore, based on view and specific conditions, each central bank chooses one from the two said aims. Both choices have scientific and acceptable bases. In the development of the market economy and in the tendency towards the world economic integration, the aim of stabilizing prices is preferable■