

SOME OPINIONS OF THE CURRENT INFLATION RATE

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I. MONEY AND OUTPUT

1. Inflation, money and output

According to the quantity theory of money, there's a close relation between the money stock and total amount of goods and services supplied (output). If the money stock and output increase (or decrease) accordingly, the price level will not change. The Fisher equation states that $MV = PT$, that is, the total money expenditure on goods and services (MV) in a period must equal the money value of goods and services supplied (PT). Thus, inflation is a rise in the money stock when there's no increase in the output.

2. Relativity of the quantity theory of money

In reality, we see that the quantity theory of money is right in normal cases. In an economy of small output, or being in danger of war or unrest, the price level tends to increase although the money stock is unchanged. On the other hand, in a stable economy, the money stock could be increased but the price level rises lightly only.

On *Thời báo ngân hàng* (Banking Times - Aug 30, 1995), Dr. Phạm Ngọc Long wrote that: "Since 1990, M2 usually increased by 10 to 15% compared with the rise of both inflation and growth rate. In comparison with the inflation rate, M2 increased by 24.6% in years of the lowest inflation rate". Thus, the money stock could increase by 10% or 15% compared with the output without creating a considerable rise in price level.

3. Total equilibrium and individual equilibrium in each market

In 1995, prices of rice, cement and paper in Vietnam have risen considerably, but the CPI has only in-

creased by 11% in the first half of 1995. Markets for these goods had their own causes of unrest: demand for cement has exceeded supply; excess exportation of rice has pushed up the price, while the high price of paper in international market has pushed up the price of paper in Vietnam. Thus, besides the equilibrium in the relation between the money stock and output, there's the individual equilibrium in each market which we should pay attention to, so we can keep these markets in equilibrium by adopting appropriate macro-economic policies.

4. Money stock and output

a. Money stock

As we know, in Vietnam's existing stock of money, foreign currency in circulation is of high percentage (foreign currency deposits with bank represented 21% of the money supply, according to the *Thời báo ngân hàng*-Sep 6, 1995). Thus, because foreign currency and gold represented a high percentage in money circulation, it was included in the money supply. Recently, the US dollar and gold came to Vietnam in large quantity from Vietnamese expatriates, foreign tourists, foreign aid and loans, while the trade gap is around US\$ one billion or two. Thus, there's a large sum of foreign currency in Vietnam which was (1) used to import contraband goods, (2) held by the public, and (3) bought by the State Bank.

The case (1) is harmful, because the Government can't collect import tax, the contraband goods compete and kill local products and edge local factories out of the market. However, this source of illegally imported goods has increased the amount of consumer goods and contributed to monetary stabilization.

In the case (2), because the public hold a large sum of foreign currency and spend it along with Vietnam currency, foreign traders can buy Vietnam's goods easily and the public can suffer losses if the foreign currency is devaluated.

The case (3) is acceptable. If the State Bank can buy foreign currency at a high price, the smuggling operation will be stopped, the sum of foreign currency will be used to import equipment and machines. However, to buy foreign currency at a high price, the bank has to increase the money supply at risk of creating inflation.

Besides notes and coins held by the public plus current and deposit accounts, there's the substitute money which includes bills of exchange, Treasury bills, stocks and shares. The substitute money attracts notes and coins held by the public and is considered as a means of deflation. In Vietnam, however, there must be a well-organized stock exchange which could help the public get into the habit of investing money in negotiable instruments before this means of deflation could produce the intended result.

b. Goods and services

- Local and imported goods: The relationship between total supply and total demand could be showed in the following equation:

$GDP + import$ (total supply) = $exports + expenditure + investment + stockpiling$ (total demand)

The total supply could be increased by two ways: increasing domestic output, or increasing imports. Increasing the total supply doesn't lead to a rise in price level, but it will slow down the growth rate. An effective way of struggling against the

inflation is to increase imports but this way is harmful to local industries. So the Government should control importation, and allow only importation of goods which can't be produced locally.

In other words, there must be an appropriate program for using foreign currency: it should be used for buying equipment and machines which can't be made locally, that is, besides using importation for fighting against inflation, there must be a plan to help local industries develop.

- Labor and full employment: labor is a special commodity in the market: the laborer has to sell labor for a wage. They will be happy if they are employed and paid well. Thus, in studying the inflation, we should pay attention to the prices of labor.

In HCMC, besides the public sector, there are the private and corporate sectors where the laborer could be paid well. In comparing the rise in price level and wage, especially in non-public sector, we couldn't tell which level rises faster.

The majority of Vietnam population are farmers. When the price of rice and foodstuff rises, so does the farmer's income. When the farmer's income rises because of an increase in the price of rice, we should feel happy about it instead of worrying, because the majority of Vietnamese people are farmers. Moreover, townspeople spend less money on foodstuff than on other goods and services because of their increasing income.

- Exchange rate and inflation: According to *Thời báo ngân hàng* published on Sep 13, 1995, the CPI increased by 67% in 1990, 67.5% in 1991, 17.6% in 1992, 53% in 1993 and 11% in the first half of 1995 while the prices of gold and the US dollar had no fluctuation. The exchange rate fell by 20.4% in 1992 compared with 1991, increased by 0.7% in 1993 and 0.4% in 1994. From Jan 1, 1992 to June 30, 1995, the CPI increased by 35% and imports increased faster than exports (imports/ exports ratio was US\$2,001 million/2,049 million in 1991; 2,540/2,552 in 1992, 3,924/2,952 in 1993; 5,000/3,571 in 1994). Just because of the increase in imports, many local industries nearly succumbed to foreign competition.

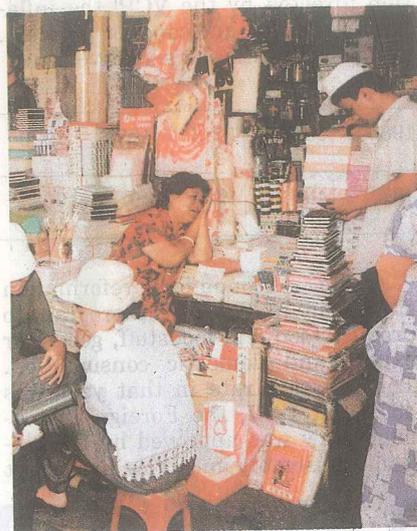
Thus, the exchange rate should be raised in order to protect local producers. But doing so, the bank should increase the money supply and face the danger of inflation.

- Investment and expenditure: To increase GDP, we should increase investment and/or expenditure.

In the market economy, it's difficult to increase expenditure, because

the laborer's income can't be raised without limits. But it's rather easy to increase investment. In developed countries, from 30% to 40% of GDP became investment. To increase GDP, the best way is to increase investment. Investment is a function of profit: high profit attracts big investment.

In Vietnam nowadays, the biggest obstacle is that the imported goods are abundant, so investment in business produces small profit only. This situation makes businesspersons feel reluctant to invest or borrow money from banks.



II. WHAT'S THE INCREASE IN THE MONEY SUPPLY FOR?

According to *Thời báo ngân hàng*, M2 has increased by over 24.6% compared with the inflation rate, even in years of the lowest inflation rate. Because M2 wasn't publicized, so the rise in price level was considered as the inflation rate. In the first half of 1995, the inflation rate was 11%, because the CPI rose by 11%. Thus the money supply has increase by $(24.6/2) + 11 = 23.3\%$. The price level didn't rise by 23.3%, because the GDP increased by 4% in the first six months of 1995 along with an increase in importation of consumer goods.

What did the bank use the increase in the money supply for? According to the *Thời báo ngân hàng*, only a small amount was allocated to commercial banks, the rest were used to buy the US dollar flowing into Vietnam (foreign aid, loans, investment; immigrant remittances). Par-

ticularly, there's a budget deficit of US\$1 billion (around 7% or 9% of GDP). This deficit was balanced by the Government by selling Treasury bills to the public and securing foreign aid and loans. The State Bank had to issue more notes to buy these amounts of foreign currency. This was the main cause of the inflation.

How can the inflation be curbed? In my opinion, if state enterprises can give bigger contributions to the budget, the deficit will be reduced.

Unlike other Southeast Asian countries, there's a bigger public sector in Vietnam. But the business performance of this sector is poor so its contribution to the national budget is small. Therefore, the Government should adopt many macro-and micro-economic policies in order to enhance the business performance of state enterprises:

- Loss-making enterprises should be dissolved, only healthy ones are maintained (as done by An Giang authorities).

- Many state enterprises should be equitized, the Government could retain around 50% of shares in order to control the board of directors.

- There must be an appropriate plan to control importation and protect local producers.

- The Government should accept the floating exchange rate. When the exchange rate increases faster than the inflation rate, then the business profit can reach over 10% and stimulate businesspersons to invest more money in business.

However, most of the measures to develop the economy require an increase in the money supply which could lead to the inflation. Therefore if we want to develop the economy, we should be prepared to take that risk.

When all sources of foreign currency are used for importing equipment and machines, all businesses are profitable and smuggling operation is stopped, the economy will develop although there's a risk of inflation at the time being, but in future, the inflation will be curbed. On the other hand, an increase in importation of consumer goods can reduce the inflation rate at present, but in the long run, we will face a lot of dangers, especially when foreign loans become mature and foreign aid comes to a full stop.

In my opinion, the main problem at present is that we should industrialize and modernize the economy as fast as possible, and the inflation is only a minor problem which can be solved easily when the main problem is solved well. ■