

On the Role of Money in Removing World-Wide Growth Barriers

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1. The Coexistence of Capital and Demand Restraint

The Cambridge School of economics with its prominent theoreticians Kalecki and Keynes has shown that the main obstacle for economic growth in industrialised countries is the lack of effective demand. In contrast to this in developing countries the classical capital restraint remains the principal barrier for growth. Thus the question raises, whether there is a possibility to solve both questions at one stroke: If industrialised countries are able to produce more investments goods than they do and if developing countries need more investments goods, then an increasing production of investment goods solves the unemployment question by more effective demand (industrialised countries) and by a higher capital stock (developing countries), which makes possible the employment of more work. If we deal with international finance, the question is focused on monetary means: Can we imagine an rational international monetary system, which contributes to remove the barriers of growth in both types of countries? If such a draft is possible, we obtain criteria to judge the effectiveness of the international monetary system with respect to this objective. It may help to review international monetary policy, carried out by the monetary institutions such as the IMF, the World Bank and various creditor clubs.

To specify the question it is worthwhile to discuss briefly where the demand restraint in industrialised countries stems from and how, if at all, policy tries to settle the question. When discussing the under-consumption theory of Hobson, Keynes argues that he “laid too much emphasis (...) on under-consumption leading to over-investment, in the sense of unprofitable investment, instead of explaining that a relatively weak propensity to consume helps to cause unemployment by requiring and *not* receiving the accompaniment of a compensating volume of new investment, which, even if it may occur sometimes

temporarily through errors of optimism, is in general prevented from happening at all by the prospective profit falling below the standard set by the rate of interest.” (Keynes CW VII 1973: 370) The weak propensity to consume in turn depends among others on “the principles on which the income is divided between the individuals” (Keynes CW VII 1973: 91), or, more precisely: “People’s propensity to spend (as I call it) is influenced by many factors such as the distribution of income, their normal attitude to the future and – the probability in a minor degree – by the rate of interest.” (Keynes CW XIV, 1973: 119) In terms of classical political economy the underlying question is best described by the relation between the forces of production and of the mode of production: Productive forces has led to a high labour productivity and hence to a high surplus, but the state of technical development prevents a part of *potential full employment surplus* from being absorbed in the form of investment goods. (Schumpeter called it decreasing surplus goods (i.e. real capital in particular), the outcome is the production of less than potential surplus and by this less than full employment. The solution would be a lower full employment surplus, which requires a higher mass consumption. This in turn contradicts the mode of production: the antagonist mode of distribution is a investment opportunities.) As the effective surplus has to meet the demand for barrier for an increasing share of wages or state income in order to increase mass consumption. This contradiction may be solved by higher wages or taxes on profits and thus by increasing unit costs – or by replacing the required investment expenditures “by government expenditure which is financed by loans, so that no reduction of any incomes by taxation is involved.” (Kalecki 1993: 14) The solution is a sort of financial trick. For the following exposition it is important to note that the lack of effective demand obviously can also be cleared away by trade balance surpluses of industrialised countries. Deficit spending as well as unbalanced trade thus are monetary solutions of the question at stake. It is evident that developing countries cannot remove the capital restraint by the same means. This is at least true for balance of trade deficits, which mean a loss of scarce physical resources, whereas government deficit has to be assessed in a different way: If public

enterprises run a deficit in financing their economic activities, their deficit is identical with the common need of the business sector for credits. Hence the purpose of this credit is not to meet a lack of effective demand, but to finance accumulation. Public investment in infrastructure and the like is a similar case. And finally: even if demand restraint is in principle not the growth barrier of developing countries, we may imagine periods of industrial development, where capacities grow faster than the market expands. This may require temporary deficit spending.

2. **The outlines of a rational monetary system**

The first coherent draft for a rational monetary system to meet the requirements of capitalist accumulation, stems from John Law (1705)¹ Law's system is a serious attempt to break the money away from traditions, from the directness in the sense of the non abstract understanding of money as having a value in itself - and to transform it into a rational, by abstract reasons well founded instrument for economic development. The outlines of Law's draft are as follows: The parliament of the absolutist state installs a commission as bank of issue and a controlling committee. The commission supplies paper money according to the demand of the landowners, i.e. the owners of the prevailing means of production. As cross entry comes into being a loan, which may be paid off by paper money whenever desired. The loans are interest bearing to prevent landowners from making non-productive expenditures. The interest is public income.

¹ Law's paper money has first been introduced in France in the late reign of Louis XIV at the end of the Spanish war of session. It failed mainly for reasons of confidence: Before Law's money French government issued another type of paper money during wartime, which served as means of payment for French troops in France. But the state authorities did not accept this money to pay taxes. Voltaire's comment on Law's money was positive, but he remarks, that this paper money should have been introduced in times of prosperity in order to stand firm in an unhappy time. (Voltaire 1881: 411)

The important aspect of Law's paper money is less historical, but analytical. It shows the basic properties of credit money in a one step banking system with bank credit as the only means of financing investment. Basically, Law's outline of a monetary system as precondition for economic dynamics is identical with Schumpeter's ideas of the role of money and credit. Thus, his comment on Law is very positive: "(...) one great plan was behind all this, in fact well advanced in the road to success: the plan of controlling, reforming, and leading on to new levels the whole of the national economy of France. This is what makes Law's 'system' the genuine ancestor of the idea of managed currency, not only in the obvious sense of that term but in the deeper and wider sense in which it spells management of currency and credit as a means of managing the economic process." (Schumpeter 1959: 322)

From this basis the main characteristics of a rational monetary system can be derived: (1) In a first instance **credit money is pure national money**, the purpose of which is to put domestic economic resources into use. It replaces commodity money and cuts financing off the supply of precious metals, the production (or the import) of which absorbs domestic resources. It should be noted that – from the angle of a country, the currency of which is not international money – foreign currency is equivalent to commodity money. Hence, if local currency is free currency, the freedom to select between financing by credit in local or international currency may cause an avoidable loss of domestic resources by debt service. Free trade of goods and (financial) services should be reviewed under this aspect, too. It follows that the international coexistence of different local credit moneys requires a careful international management. (2) **The rate of interest is a means of allocation**, which is administered by public authorities. Its existence is a characteristic of a price controlled system. Thus the logic of interest is its quality to be a price for credit as a licence to use resources. This price has prohibitive properties: The scarcer the resources, the higher the price. This involves the question of information: If the rate of interest is mainly administered by monetary authorities, it may be concluded that the trust in the

market as generating information is low. (Note that even monetarists do not trust in the market forces when fixing the quantity of money by political institutions.) (a) Under the regime of capital restraint, the level of the rate of interest has to ensure that all these economic resources, which are not used for consumption, are put into use for the production of capital goods. This includes also forced saving as set off by monetary means. Accumulation thus is not limited by any shortage of financing (for instance by an inadequately high rate of interest), but by the availability of physical resources. This contrasts with a regime of pure commodity money: Here the stock of precious metals, the readiness to coin it, and further hoarding and liquidity preference of the money owners decide upon credit supply and hence upon accumulation, which all in all does not provide adequate information on the scarcity of physical resources. To a certain extent this is also true for international lending. It is not unlikely that foreign credit supply is subject to the same restrictions as atavistic lending of commodity money. (b) Under the regime of demand restraint the rate of interest has to ensure “the financial trick” to bridge the gap between full employment output and insufficient effective demand. In this case its allocation function is not to reconcile scarce resources with the need for real capital, but to encourage investment expenditures and to allow for public deficit spending at a low debt service. In this case the rate of interest has to be low and even zero: If investment at a zero interest rate does not bridge the gap, there is no reason, why public debt should bear a positive rate of interest. In terms of time preference resources left idle at a zero interest rate mean that there is no social preference for present consumption. (3) **Interest payment is a rent.** With commodity money, it *reflects* the scarcity of credit; it is appropriated by money owners by the same reasons as the rent for land leasing. With a rational credit money interest as an *active means* of resource allocation remains necessarily a positive rent as long as physical resources are scarce. But as interest is neither a reward for waiting and abstinence – saving is not determined by interest – nor a reward for forsaken liquidity – the creation of credit money can compensate for any hoarding – interest payment can be appropriated

by public administration.² This implies that information can be generated by monetary authorities. If not, private credit supply is unavoidable to generate information. Private interest income then is a by-product of the information generating process. The existence of a rent necessarily is subject of rent seeking. This explains the pronounced interest of international financial institutions in free movement of capital and free service transactions. (4) The appropriation of interest payment as public income requires the **non existence of securities** as alternative means of credit financing and a **one step banking system**. If these conditions are not fulfilled, the competition amongst banks for deposits and between the bank credit market and the security market will necessarily be followed by interest payments to depositors and security owners: in this case public authorities and the private sector share the interest income. The non-existence of securities (i.e. the non-existence of immediate contractual obligation within the private non-bank sector) involves the question of a simultaneous equilibrium on the credit- *and* the money-market. If there are good reasons to suppose that without a security market there may be scarcity of credit and undesired cash or vice versa at the given rate of interest, then securities in the form mentioned above may serve as buffer to adapt the desired quantity of credit to the desired cash. However, the existence of securities may jeopardise the indispensable permanence of financing projects. (5) Credit has to be a **reliable means of financing** expenditures. For creditors, but in particular for debtors it is extremely important that financing is secure. This does not only concern projects under way, but also the continuous financing of investment at a suitable rate of interest. In the case of capital restraint suitability means, as mentioned above, that accumulation does not fail because of prohibitive credit costs. Reliability also means that there is a wide-spread credit supply, which

² As long as in a pre-capitalist formation there is no systematic accumulation, there is no need for any interest. Here consumer credit dominates: The allocation function of interest concerns only the redistribution of consumption goods amongst different individuals or social groups. Then the readiness to borrow and to pay interest is often enough the result of the threat of starvation. Hence canonic prohibition of interest as endorsed by Islamic divines or by Thomas Aquin is a – well-founded – moral issue. If in a price controlled system interest is unavoidable, moral standards with respect to undesired effects on distribution could, among other means, be maintained by the appropriation of interest payment by public authorities.

includes smaller investment projects and remote areas. This is important for backward linkages and a well-structured development.

3. **Growth as precondition for free trade**

When Stiglitz (2002: 51p) describes the working of international monetary institutions, he qualifies their policy various times (and in particular this of the IMF) as “ideologically motivated measures”, as “market economy fundamentalism” and the like. Besides common understanding of ideology as someone’s else political views which one regards as unsound, the term “ideologically motivated measures” has to be spelled as measures, the underlying interest of which is hidden, or as measures, the result of which is proclaimed as common interest. In the former case, the actions are mostly not in accordance with the *proclaimed* targets; in the latter case, groups with opposite interests are agitated for believing that the result is in their interest. The aim of scientific investigation then is not solely to review whether the underlying officially proclaimed theory is right, but to point out whose interests are in accordance with the results. Seen from this angle actions and results are very often in accordance. This helps, not to qualify executives as foolish with respect to technical ability and understanding. (A rather psychological question is the individual conviction of staff members, for instance of the IMF. Do they believe in their own ideology or do they behave rather than augurs, who are not necessarily convinced of their art?)

The main feature of modern market fundamentalism is its extreme addiction to unregulated commodity and financial markets and by this the disregard of basic conditions in the area of macroeconomics. Thus, even if it is not at fashion and more a matter of earlier literature, it is necessary to stress again the importance of accumulation as a whole and its financing. It is certainly very important to analyse “the process and institutions by which capital is allocated” (Stiglitz 1989: 55), but before doing so, one has to scout out the frame

within which the monetary system operates, i.e. one has to find out that industrialised countries, characterised by demand restraint, are in a position to produce real capital without refraining from current consumption, and that – given balanced trade – the import of real capital by developing countries is restricted by their export, which in turn depends on the growth of the former. Here, money and finance enter the scene in three ways: at stake are deficit spending to foster the growth of industrialised countries, the financing of balance of trade deficits of developing countries to accelerate their accumulation and to increase simultaneously the output in industrialised countries, and finally to meet credit demand of investors in developing countries. The latter objective then is certainly a matter of optimal allocation and by this of screening and monitoring by the lending institutions. But this alone can hardly solve the two former questions.

If we follow this line it can easily be seen that free trade alone does not help a lot. Without adequate growth in industrialised countries, free trade simply fosters world-wide competition, which – beyond all positive effects – is used as propaganda weapon in distribution disputes and may thus help to keep down wages, with all its questionable effects on effective demand – and public opinion. How closely growth in both types of countries are interrelated, has already been outlined. The working of the system can be explained in more detail by identifying (for sakes of simplicity) the industrialised countries as the investment goods producing sector and the developing countries as the consumption goods producing sector. In practice, however, the division of labour between both types of countries is much more differentiating: besides wage-goods developing countries produce and export raw materials, very often there exists a manufacturing industry, which produces semi-finished products and capital goods – the same is true for industrialised countries with reverse sign. But these objections do not make the model useless: the import of raw materials as well as of semi-finished products is a relatively stable function of the GDP of industrialised countries; wage goods as consumed in industrialised countries are not entirely imported from developing countries, but these imports are a stable

and increasing part of consumed wage goods. Thus there remain good reasons for a simplified exposure in the form of a two sector model, which helps to determine a saving -investment-equilibrium and a balance of trade equilibrium.

In general outlines of the model are as follows: Given investment expenditures and thus the output Q of the investment sector I, the output of consumer goods C of the consumer goods producing sector II is determined by the demand for wage goods as financed by the wage bill in sector I, W_I and by the wage bill in sector II, W_{II} . Thus in equilibrium

$$(1) \quad C = W_{II} + W_I$$

Expression (1) implies that wage earners do not save and that profit earners do not consume. Profits in sector I are symbolised by R_I and in sector II by R_{II} , $R_I + R_{II} = R$. As

$$R_{II} = C - W_{II} = W_I$$

and $R_I = Q - W_I$

it follows that

$$R = W_I + Q - W_I$$

$$R = Q,$$

which, as $S = R$, leads to the common equilibrium expression in terms of saving and investment.

From this (I confess) common text-book wisdom it follows that an increasing output of the investment good industry and thus of its wage bill leads to more demand for consumer goods. If we identify the output of the capital good producing sector with the GDP of industrialised countries and the output of consumer good industry with the GDP of developing countries, it is evident that industrialised countries as the investment sector is *the* leading sector in the capitalist world economy. More investment expenditures put a multiplier process at work with the result that both the output in the industrialised as well as in the developing countries increase. Analysing this outcome not in terms of exchange

between two sectors, but as international trade makes the issue more complicated: Now the restriction of balanced trade enters the scene.

If we maintain the assumption that developing countries only produce consumption goods and industrialised countries investment goods, then, *in the case of balanced trade*, the volume of foreign trade between the two groups of countries equals the wage bill of industrialised countries W_I . This wage bill also determines the rate of accumulation in developing countries. The remaining output of capital goods $Q - W_I = Q^{ic}$ is domestic investment of industrialised countries. It follows that an increasing domestic investment of industrialised countries increases their wage bill, by this their import of consumer goods, hence the export of developing countries and *their* import of capital goods.

$$(2) \quad Q = Q^{ic} + W_I$$

From this a multiplier expression can be derived. From the equilibrium

$$Q = S = R_I + R_{II}$$

it follows, if the share of wages in industrialised countries is denoted by b_{ic} and in developing countries by b_{dev} :

$$Q = (1 - b_{ic})Q + (1 - b_{dev})C$$

$$b_{ic}Q = (1 - b_{dev})C$$

$$\text{As } Q = Q^{ic} + W_I, W_I = C - W_{II} \text{ and } W_{II} = b_{dev}C,$$

$$Q = Q^{ic} + C(1 - b_{dev})$$

Using this expression to replace Q in the equation above we get:

$$b_{ic}[Q^{ic} + C(1 - b_{dev})] = (1 - b_{dev})C$$

Rearranging terms we get:

$$(3) \quad C = \frac{b_{ic}}{(1 - b_{dev})(1 - b_{ic})} Q^{ic}$$

As C denotes GDP of developing countries, the multiplier expression (3) shows that – given the restriction of balanced trade – growth in developing countries depends on the investment expenditures and on the share of wages in the industrialised countries: a low share of profit in industrialised countries fosters the rate of accumulation in developing countries. (For sakes of accuracy it should be noted that the real value for C is object of capacity restrictions, which in turn are a function of previous imports capital goods.)

Consequently, a low rate of investment in industrialised countries (as a consequence of their state of development) dampens the speed of industrialisation in developing countries: International division of labour and international trade transfer the demand restraint of industrialised countries as barriers of growth into developing countries. If in a first instance one could suppose that absolutely free trade and an adequate financing of world-wide investment reconciles demand and capital restraint, a more detailed analysis shows that demand restraint in industrialised countries remains the main obstacle for accumulation in developing countries. The free access of developing countries to the markets of industrialised countries – if it is in fact realised – is per se not a long term and solid solution: it only increases the share on a restricted market, it may lead to cutthroat competition and is thus difficult to maintain. The reaction very often is an alliance between threatened business and workers, followed by government imposed tariffs, quotas and the like. Apparently, the conditions for the social acceptability of free trade and thereby for its permanence are that idle resources in the industrialised countries are under use by an increase of their domestic demand or by continuous trade deficits of developing countries. (On financing of these deficits see below.) Free trade then is accompanied by the creation of more employment in industrialised countries. Consequently, the traditional question of how to come to more growth in industrialised countries remains on the agenda: (1) increasing consumption along the line of Keynes' determinants of the propensity to consume by interfering with

the income distribution or (2) solving the problem by deficit, i.e. by monetary means.

4. Solving Demand and Capital Restraint by National or Foreign Deficits

A durable increase of the propensity to consume requires to interfere by policy with property rights on economic flows such as wages and profits, interest income, investment, which all are policies, claimed or inspired by Keynes or traditional social democracy. These policies mean a reform of the mode of production to adapt it to productive forces. (Productive forces require less investment than full employment surplus provides, hence surplus has to be diminished in favour of mass consumption, which implies to alter social relations.) Evidence shows that this is not the actual policy of industrialised countries, even if this policy (the social democratic mixed economy) was very successful from the 1930ths on to the 1970ths. Present policy in industrialised countries goes the other way round: lower wages and profit taxes, less social contributions of business and a smaller public sector dampen the effectiveness of the income multiplier. However, these measures are hailed as an adequate response to international competition, which in turn is said to foster world-wide growth. Privatisation of public enterprises seem to be a precautionary measure to make sure that public opinion never more moves against distribution policy and nationalisation in all those cases, where by this policy the share of profit and hence the rate of profit falls below a level which is too low for private business..

(a) special drawing rights with development link

If a renewal of income policy is not possible, there is no other way out than deficits – which in principle are easy to finance with modern credit money. The classical form to promote growth is domestic deficit spending, i.e. functional

finance as developed by Samuelson on the basis of Keynes in the late 1930ths. As long as the output is not understood as determined by the neo-classic equilibrium on the labour market, but as a function of effective demand, deficit spending will increase growth as long as economic resources are left idle. (The process works in the same way as the multiplier above: government deficit increases the wage bill and hence the import of industrialised countries.)

Since the late 70ths, policy in industrialised countries mainly aims deflation. This is in particular true in the years after 1979, when at the end of the Carter administration the beginning cyclical downswing in the USA was accompanied by a policy of extremely high interest rates. (The justification for this was to fight inflation, but also to lower wages by a revaluation of the Dollar. - Economic Report of the President 1983: 59) The consequence was a long and very marked downswing – in the USA as well as in the other industrialised countries which followed the US example. By this, export markets for developing countries shrunk, whereas high interest rates increased the debt service. (Schui 1988: 20pp) To make matters worse for oil importing indebted countries, the oil price rose in this period.³ The result is well known. It is the beginning of the debt crises which lasts until now with its distinct phases. A more responsible policy of the international monetary institutions at this time (and further on) would have been to finance current account deficit of the countries in question by cheap credit, before the debt crises arose. A responsible policy would also have been not to raise debt service by increasing the rate of interest in the name of a doubtful monetarist policy.

But apart from these short term measures to avoid crises an appropriate international monetary system can be used to decrease unemployment in

³ There are good reasons to suppose that the former Shah government of Iran as a close ally of the USA has made a special effort that the price increase was higher than initially planned by OPEC countries; in the 80ths oil companies made the most of the strikes in Iran – the oil exports of this country declined sharply in this period – and of the oil reserve policy of the USA – they increased their reserves during this time instead of selling oil to stabilise prices. OPEC then followed with price increases to appropriate a part of the growing profit of oil companies. (Terzin 1983: 231p, 311p)

industrialised countries and to foster accumulation in developing countries. The principle is to finance deficit expenditures – and therein not common deficit spending, but trade balance deficits of developing countries. Balanced trade between the two groups of countries means in terms of the model above that accumulation of developing countries equals the wage bill of industrialised countries. Thus all depends on domestic investment of the latter. If the full employment output in these countries is not yet reached, a balance of trade surplus in the form of capital goods can be produced. This rises the wage bill with the described consequences. If there is a solid possibility of financing them, the effect on real output will be positive for both partners: for industrialised countries there is more effective demand, growth and employment, for developing countries the scarcity of capital is alleviated. The wage bill of the former increases, which rises the demand for wage goods with its positive effects on export of developing countries and their investment good import. This also helps to enlarge external markets, if possibly the internal market falls behind domestic production. With respect to ‘real’ economy the difference in both kinds of deficit is that domestic deficit spending of industrialised countries increases first output and then import, whereas foreign trade deficit increases first export and then domestic output. So the difference lies in the fact that industrialised or developing countries are favoured by the first round of the income multiplier process. In principle there are two possibilities of financing this trade deficit: direct investment linked with capital import (no increase in external debt) or credit. Credit may take the form of traditional international indebtedness with all its well known consequences, or credit becomes the basis for international money creation. This latter possibility has been largely discussed in the early 1970ths. It has been inspired by Keynes’ ideas of how to organise the IMF and the international monetary system. Beyond the traditional well known disadvantages of direct investment (loss of national sovereignty, uncontrolled outflow of surplus) there are at present a very serious objections against direct investment: given restricted world-wide markets, direct investment takes more the form of buying existing firms and thereby markets (very often former state enterprises) instead

of building up new production capacities. Moreover direct investment fosters concentration and shrinks international competition. In view of these properties of direct investment, it is doubtful whether it supports research and development in the host countries, albeit it may improve labour productivity by modernising the firms in question. It follows that investment of domestic institutions may be more advantageous. Combined with international financing of trade balance deficits this means that additional import of capital goods is financed by special drawing rights and that domestic investors organise accumulation. Financing additional investment by international money creation – the link between special drawing rights and development – basically is less exotic than it seems to be at the first go: Most international money is created by trade balance deficit of countries, the currency of which serves as international reserve money. Trade balance deficit of developing countries can serve for the same purpose, if it runs through the balance sheet of an official international monetary institution (such as a reformed IMF) to get sufficient guarantees for its quality as means of exchange and as store of value. (IMF 1985, Vol. I: 199pp, Vol. III: 69pp) Changing international money creation in this way at present is closely related to the international indebtedness. But nevertheless this arrangement would help to increase the import of capital goods, even if debt service has to be maintained. It is evident that the renewal of ancient plans provokes the well known objections such as the control over the utilisation of the funds. But if there is now wide-spread consent that the IMF has the right to set up conditions for his assistance – and to control their realisation (Driscoll 1998: 3p), then new policy tools with a changed Fund majority would have a good chance.

(b) *the point for national money to mobilise national resources*

As long as it is not possible to come closer to an international money, where there is common access to a global money, but where an undesired outflow of physical resources can be stopped, it has carefully to be considered which resources can be mobilised by local currency and where foreign credit is

unavoidable. This involves in the first instance the question of saving and financing. To make the point clear it is better not to speak about saving as an element of income and a flow variable, but about consumption which decides to which amount the stock of physical resources is used for the production of consumer goods. Given this, investment plans decides upon whether the resources left idle are used for the production of capital goods. Investment depends among others on financing. Investment demand increases production and income and creates saving. Logically, investment precedes saving. So it is not precise to say that financial institutions “collect” saving to make possible the financing of investment. Financing instead is a matter of revolving credit and of creating new credit. The rate of interest herein has to make sure that the use of resources is maximised. Given this and the corresponding volume of credit, the task of the various financial institutions is to distribute the credit and to screen and monitor. To avoid the outflow of scarce physical resources, interest payment should remain within the domestic economy. (If not, it has to be ensured by export surplus.) To make an example: if an entrepreneur plans to build a new hall and if construction material can be produced by the domestic economy, and if further additional workers can be nourished by domestic agrarian production, and if furthermore an increase of the production of food can be secured by domestic production, then it is not rational to rise foreign loans to finance the investment. (As mentioned the debt service would mean an avoidable loss of domestic production.)

A fully convertible currency thus helps to cause externalities: if firms are free to choose between domestic and foreign credit, the domestic central bank with its currency reserves – and not the lender – is obliged to make ensure the debt service in foreign currency. If the bank is unable to do so, austerity programs are likely to enforce more exports. Hence the final price for foreign lending may be higher than its specific rate of interest. In other words: externalities express in retrospect that the relative prices of financing were not exactly expressed by the rates of interest. This is certainly one of the reasons

why, in “Keynes’ proposals, the Fund would have been able to require countries to impose capital controls.” (Kruger 1998: 1995) But if there is unanimity for more and deeper international economic relations in all facets, then there has to be globalisation which holds logically, i.e. which includes international finance. This does not only mean convertible currency and free services: the more world-wide economy resembles a national economy without borders, the higher the need for a unique currency and for one responsible lender of last resort only – and not a variety of currencies within an hierarchy of quickly changing ranks. (The history of the European Union shows that economic integration requires from a certain point on a unique money.) This need seems to be the mere reason for tendencies to introduce the US-Dollar as local currency or to maintain a fix exchange rate to the Dollar, as it is for instance the case in Equator, Argentina or Nicaragua. But this arrangement has two serious defects: in the case where the US Dollar is local currency, the US FED nevertheless does not serve as lender of last resort for local banks; in both cases local banks have to compete for the Dollar which leads to a higher rate of interest than in the United States. Usually this is explained by the risk premium. Evidently this makes credit and investment more expensive and has the usual effects on economic activity. Furthermore international companies realise advantages by this arrangement relative to their local competitors. They can use their traditional channels for cheaper financing; in addition, in most cases their self-financing is higher. The mere reason for this outcome is that within such a structure the rate of interest does not fulfil its true function, i.e. to indicate the scarcity of physical resources. Instead it informs about the scarcity of foreign currency, just as the rate of interest in a commodity money regime informs about the scarcity of gold and the readiness of money owners to contract at the credit market. In this case the advantages of credit money are not taken – despite Schumpeter’s idea of “currency and credit as a means of managing the economic process.”

(c) allocation and reliability of financing

At present, the discussion on finance and lending deals less with “macro-economic co-ordination as stressed in the earlier development literature, but with microeconomic problems of selecting (quite specific) projects and choosing good managers to manage these projects.” So emphasis is given more to allocation problems. The aim is “to channel funds to the most profitable opportunities (the selection or screening function) and to ensure that those funds are well used (the monitoring function).” (Stiglitz 1989: 66) This is certainly of importance, but emphasis should also be given to the short and the long term aspect of profitability. Furthermore the production and the appropriation of surplus has to be discussed. This is decisive, if the market structure does not allow that profits are appropriated where they are produced. (These externalities are in particular likely for public investment. They must be included to estimate the over all benefit of an investment.) (Stiglitz and Weiss 1981) After all, there “is no clear evidence from experience that the investment policy which is socially advantageous coincides with that which is most profitable.” (Keynes CW VII, 1973: 157) This leads to two more questions of particular interest: (1) does the financing of a project correspond with the basic justification for free trade, and (2) is there a systematic difference between financing a private project on the one hand and the economy as a whole of a country on the other hand.

The first point concerns the fact that Ricardo’s criterion for foreign trade are comparative advantages. Thus, there is a rationale not to select only projects with absolute cost advantages. Will international financial investors allocate their funds according to this criterion? Or are there good reasons for them to choose the project with the absolutely lowest costs and highest profitability? This leads to the point of reliable financing a country’s economy. External financing of a firm is a matter of solvency. Finance is withdrawn or not prolonged, if there is no profitability. This selection mechanism of the market is said to be *the* momentum of capitalism. The neo-classic treating of the labour market gives a first hint, which problems rise, if, within the frame of financing, nations are regarded as if they were firms. If the full employment wage rate respectively the corresponding

marginal productivity of labour is too low even to make a bare living, a negative income tax is proposed to prevent starvation. Something similar is provided for nations as a whole in the form of, for instance, structural adjustment facilities of the IMF or low interest loans of the World Bank and its affiliates. The price for this stand-by is the de-facto surrender of the state sovereignty in economic affairs to international financial institutions. The treating of the unemployed in industrialised countries is not unlike: By struggling for a job they have to prove continuously with sufficient servility that they are worthy poor. It would surely be interesting to continue this reasoning by trying to predict whether and how long the unemployed and those whose (flexible) wages and social benefits show a marked downward tendency, will accept this loss of livelihood – and dignity. But I will not bore you with tales about this large segment of the population in industrialised countries.

If solvency, credit worthiness and a renewed access to international financial markets is at stake, it has to be considered that countries do not go out of business as firms do. “They may be happy or unhappy with their economic performance, but they have no well defined bottom line. As a result, the concept of national competitiveness is elusive.” (Krugman 1997: 6) But not only this: the concept of credit worthiness is elusive, too, because the criteria for the international financier to provide or to withdraw his funds, are rational for him, but not necessarily with respect to economic performance. Consequently, there are two objections against free private international lending: a nation is not an enterprise and the aim and rationality of the borrower and the lender are not identical, even if financial crises are often hailed as the objective judgement and severe punishment of the market, as a means of education for obstinate governments and politicians. It is Keynes who has very clearly described what the very ground of the market reaction in financing is. To avoid losses on financial markets with flexible prices for equities, (foreign) currency and the like, the essential objective for the financial investor is not simply to be informed about the economic performance of the firm or the country, but in particular to know the

assessment of other investors. Even a *secure* information of good performance is no reason to maintain financing, if others believe the contrary. Another reason for withdrawing funds is a change in the rank of the project in question, even if its absolute performance remains unchanged. This could be compensated by an increasing credit supply, but if monetary authorities do not allow for this, a switch is likely.

Keynes describes the circumstance with the following metaphor: “(P)rofessional investment may be linked to these newspaper competitions in which the competitors have to pick out the six prettiest faces from a hundred photographs, the prize being awarded to the competitor whose choice most nearly corresponds to the average preference of the competitors as a whole; so that each competitor has to pick, not those faces which he himself finds prettiest, but those which he thinks likeliest to catch the fancy of the other competitors, all of whom are looking at the problem from the same point of view. It is not a case of choosing those which, to the best of one’s judgement, are really the prettiest, nor even those which average opinion genuinely thinks the prettiest.” (Keynes CW VII, 1973: 156)

Surely, this can be elaborated more sophisticatedly in term of likelihood, dilemmas and the like, but the mere basis remains the metaphor above. Thus; there is no reason for trust in the information creating capacity of the market: with respect to economic performance, the judgement of the market is rather arbitrary. Common theory is debating this outcome in terms of global public goods or externalities, which could, among others, lead to analyse alternative mechanisms for supplying them in appropriate amounts. (Kruger 1998: 2005) Besides these liturgical terminology of modern economics it is the point for policy. “The introduction of a substantial government transfer tax on all transactions might prove the most serviceable reform available, with a view to mitigating the predominance of speculation (...).”(Keynes CW VII, 1973: 160) So why not the Tobin tax, as actually claimed by anti globalisation movement like “attac”? The main obstacle surely is that such a rule would restrict the opportunities of

international financial investors. Apparently, the advantages of credit money as briefly outlined at the outset require that this money is embedded in a system of institutions and rules. Only then it can develop its advantages such as the independence of credit supply on hoarding, on production or import of gold (as equivalent to foreign currency), i.e. its quality to be the adequate *financial* means for economic development. These necessary rules are in conflict with the interest of financial business. The underlying ground is that price governed economies need the rate of interest as a means of allocation, that interest payment is a rent and that obviously there is a common interest of the financial sector to appropriate this rent as private income. Hence there is competition amongst the various financial institutions for this rent: free convertible currency and free trade of services describes in this context the desire of foreign financial investors to participate in the allocation rent of a country

(d) developing countries, inflation and monetary policy

Monetarism and by this the IMF understand inflation as a purely monetary phenomenon. As real output is determined on the labour market i.e. by the production function and the supply function of labour, monetary policy has to secure that there is not too much money chasing too few goods. Coming to lower rates of inflation then means to reduce the growth of the stock of money which implies a higher rate of interest and less credit supply. In this context public borrowing is of particular attention. The public sector borrowing requirement ratio as initiated by the IMF has to reduce in particular credit supply for public enterprises, which results in liquidity shortages and bankruptcy or sale to foreign investors under the cover of debt to equity swaps. If this policy is successful in reducing inflation, then by slowing economic activity down to a point where price increases are impossible because of a lack of demand. But the real causes of inflation in most developing countries are not cleared away by this sledgehammer approach: at bottom it is not an anti-inflationary, but an anti growth policy. The writings of Kaldor (1978) and Kalecki (1993) give a good

insight which the reasons are for inflation in developing countries, such as in Latin America. Above all it is due to the fact that the agrarian production falls behind the growth of the industrial sector: a shortage in food, hence increasing prices for livelihood (in the lack of subsidies) and by this increasing money wages led to higher prices in the industrial sector, which in turn makes the input for the agrarian sector more expensive and so forth. If in this case a recession is brought about by advice of the IMF, the shortcoming of demand for food dampens inflation. As a result the growth of the industrial sector is not only adapted to the effectiveness of the agrarian sector, but the performance of both sectors decreases. High interest rates, shortage and rationing of credit hinder the agrarian sector to increase its productivity. This is even more likely if cash crop production is promoted to foster export and if credit supply is dominated by foreign banks which are less interested in developing remote agrarian areas. Furthermore, the government is prevented from reforming the agrarian sector, if this would require to interfere with property rights.

5. Political Regulation for Making rational Use of Credit Money

If Kalecki argues that demand and capital restraint coexist in the world economy as a characteristic of industrialised respectively developing countries, then the rational use of an international credit money is a precondition for faster growth in both types of countries: It helps to increase the demand for investment goods as produced in industrialised countries and it fosters by the use of these capital goods the industrialisation of developing countries. Thus both, the demand restraint and the scarcity of capital are removed. So, money is a useful tool, which could help to improve living conditions. But as credit money is an artefact more than any other result of human history, it needs to be administered by intellect. But as intellect is in relation to interest, the prevailing interest decides for which purpose money is used. This raises the question what makes interest prevailing. Self determination helps to give effect to the interest in using our economic, our productive facilities to improve our conditions of life, i.e. the

conditions of life of the many. This is the essential step; it goes hand in hand with the awareness of one's own interest and with increasing knowledge, which in turn is needed to become conscious of the economic possibilities, which really exist, and of the way how to put them to work. Thus scientific work is needed to fathom out all what is really possible. The economics of the Kalecki, Kaldor or Robinson type, as outlined above, may be helpful to guide our efforts. But this does not mean that other guidelines or paradigms would not come no meaningful results.

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