THEORETICAL VIEWS UPON THE ROLE AND IMPORTANCE OF THE MONETARY POLICY

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ABSTRACT

The problem linked to the monetary theory, especially the part which refers to the monetary policy, represents a complex field to research. This comes from the fact that each country separately conceit and conducts its own monetary policy according to its established priorities, in the frames of the possibilities and in the function of achievement of the goals of monetary, and with it of the macroeconomic policy. Having that in mind, any comparison of the monetary policy between two or more countries would be inappropriate. The reason is simple, each country separately, according to the level of the economic development, the phase of the economic cycle, the level of the monetarism, as well as the goals of the monetary policy and the macroeconomic policy, establishes monetary policy which is in the function of successful accomplishment of the established goals, in the way and under conditions which secure optimal utilization of the available resources.
Given the fact that the influence of the monetary policy (along with the fiscal and other separate policies) upon the total macroeconomic conditions and changes is of a primary importance, a great significance is given to the problem related to the monetary policy in the modern monetary theory. From those reasons, beside the different theoretical views, the role and the significance of the monetary policy on all economic trends according to the opinion of the largest number of modern economic theorist is the opinion that the monetary policy have a great importance in securing stabile macroeconomic ambience, ignition of economic growth, and with that securing conditions for more dynamic economic growth. Special attention in monetary theory is dedicated to the influence of the monetary policy in the development of the banking sector in the modernly organized states which existence and development is based on implementation of measures (policies) of the state and other public organs and institutions.

THEORETICAL VIEWS UPON THE ROLE AND IMPORTANCE OF THE MONETARY POLICY

Theoretical thought in regard to the question of the role and the importance of the monetary policy up to the present historical development is characterized by the evolutional development of the views and stands of the most important bearers of the scientific thought in the area of the monetary theory. Their views and stands on the most important monetary issues are not always the same or identical. Their differences in the scientific views and opinions are understandable, if you consider the actuality of that problem in its historical (time) dimension on one side, as well as in dependency on the value which is given to the monetary factors on the other side. From historical point of view, the evolutional path of development of the monetary theory is connected or conditioned by the development in the usage of money, as well as the increase of the functions of the money.
The most important issues in the area of monetary theory, for which the views and

the opinions of the most significant barriers of scientific thought are equivalent, do diverge, and often have opposing opinions on the issues related to money, i.e. the amount of money in circulation, the value of money, the functions of money and the issue on the influence of money on the real economic trends. There are different, basically opposed views and opinions, regarding the mentioned issues in the monetary theory. According to ones, the development and changes of the real economic processes and trends are dependent on the factors of production, i.e. labor and the capital and the height of the interest rates, so the changes on the amount of money in circulation have no impact on real economic trends, neither on the amount of interest rates, consumption, investment etc. According to other theorists, money has a certain impact on the real economic trends, but only then, when the monetary balance is impaired, i.e. when the demand of money differ from the supply of money. In conditions of monetary balance, according to them, the monetary factors have no impact on the real economic trends. The reasons due to which the influence of the amount of money in circulation is relatively minor on the real economic trends are that the amount of money adjusts on its own, with the purpose to respond to the needs of trade, so the amount of money as a variable category gets down to the role of passive element in the development of the monetary cycle. If we agreed on the issue, that the role of the amount of money is passive, then it’s needed to identify some other variable which has an active role and impact on the changes (disorders) of the economic balance. According to the representatives of the third group of theorists, the money as a monetary instrument has a key role, or impact on the development and changes of the real economic trends. Every change of the amount of money in circulation in direction to its increase or decrease causes appropriate changes on the real economic trends. As arguments for confirmation of their views and opinions they point out that: the change of the amount of money in circulation can cause major oscillations in the economic activities; the relation of the money toward the rest of the assets of economic subjects is relatively stable, so the change of the amount of money can have relatively predictable effects on the economic trends; the amount of money in circulation is a monetary aggregate, and it can be controlled with a satisfactory accuracy with the measures of monetary policy.

The opinions and views of the largest number of economic theorists for a long time are that is not an issue of acknowledgement or not of the role, importance and the impact of the amount of money on the real economic trends, but the crucial question is down to what manner and size is the impact of the change of the money in circulation on the real economic trends. More precisely, the issue is about how, when and how big is the impact of the change of the monetary factors in the real economic trends. According to another group of economic theorists, the issue of the role and the impact of money, i.e. the amount of money in circulation on the real economic trends are absolved for a long time, and as such is more of an experience rather than a theoretic issue. So, according to the worldly known English economist Charles Goodhart, there is little left unexplained and contentious on the theoretic plan on the issues which are related to the role and the significance of money, i.e. the influence of money on real economic trends, especially the way of functionality of transmission (process) mechanism of monetary policy. But, according to Goodhart, there is a major disagreement on the strength of the influence of money, as well as the time which is needed to achieve the desirable effects of the acts of the measures of monetary policy on the real economic trends. These disagreements and contradictory opinions have led to a further development of the scientific thought, while different views of the pointed problem have brought the creation of basics for occurrence of different monetary theories.

THE DEVELOPMENT OF THE SCIENTIFIC THOUGHT (MONETARY THEORIES)

In the previous period, the scientific thought in the area of monetary theory has developed accordingly to the changes of the socio – economic circumstances, as well as the observations about the evolution of money, of their role and importance, the value of money, their usage, i.e. functions of money as a monetary instrument and other similar issues. From historical point of view, the development of scientific thought in the area of monetary theory begins with the appearance of money in the function of exchange tool up until today. There are several phases which are characteristic of this area, with the creation of a number of monetary theories, like[65]:

a. Metal theory (covers the period of the usage of metal coins up until the appearance of so-called paper money);
b. Nominal theory (covers the period from the appearance of paper money up until the period of so-called full convertibility of the paper money);
c. Theory of production opportunities;
d. Psychological theory of money;
e. The period of classical and neoclassical theory (until the end of 30's of the last century);
f. The period of Keynesian theory (from the end of the 30's until the mid 50's of the last century);
g. The period of monetarist theory (the 50's of the last century);
h. The period of polarization between monetarists and non-monetarists (until the middle of the 50's of the last century);
i. The period of counterrevolution of the Keynesians (from the middle of 80's until the beginning of the 90's of the last century);

Basic issues, upon which exist differences between the representatives of the monetary theory are: the role and the importance of money, the amount of money in circulation, the value of money, the transmission mechanism of the monetary policy, and also the issue of the influence of money on the real economic trends. Different stands and views of the most important theorists in the area of monetary theory were formulated on the basis of the results obtained from the research of pointed problem. As a result, in the literature of monetary theory can be found completed theoretical conceptions about the most important issues related to the appearance of money, the value of money, the amount of money in circulation, the influence of money on real economic trends and other similar issues. These kind of completed theoretical researches related to money can be found in the works of Adam Smith, David Ricardo, Karl Marks, John Keynes, Paul Samuelson, Milton Friedman, A. Patinkin, J. Tobin and others.
The modern scientific thought does not deal with the problem of money and its influence on the economic trends, because these issues and dilemmas are considered absolved. The essential challenge for the modern scientific thought is the issue of the level of monetarism of separate economies, but not the issue whether one economy is monetary or not. The dominant opinion is that each economy in which exist money in modern shape is considered as monetary, while the level of monetarism is much larger in the developed market economies, rather than in the countries in development or non-developed countries.

METAL THEORY OF MONEY

Metal theory of money incurred in the period after the appearance of metal coins.

[65] Tihomir Jovanovski – Economic faculty – Skopje, 1998, page 133.

The basis of this theory is the stand that the money as an exchange tool, but also as a measure of value, must have its own substantial value, which is inserted in the metal from which the metal coins are made. If the money does not contain own substantial value, then the same cannot serve as an exchange and payment tool, from the reason that they don't have its own equivalent value in relation to the goods with which they are exchanged. For these reasons, according to the metal theory, the metal coins of gold and silver with their material form present a value[66]. The views of metal theory of money present a base for profiling the stand of Mercantilist school, according to which, the gold and silver are the only forms of permanent wealth, and accordingly only the metal coins of gold and silver can be used as money in circulation, i.e. in the function of exchange and payment tool.

Although the beginnings of the metal theory of money can be found in the Roman time, yet to completion of the theory comes in the time of Mercantilism. The most famous representatives of mercantilist school which firmly stand on the positions of mercantilist theory are Stafford (XVI century) who thinks that the precious metals by nature are money, then Galliani (XVIII century) with his stand that the value of money need to be identified with the value of the substance itself of the money, then Knies (XIX century) and Morgan Webb with the work "The outlook for Gold" published in 1938, in which the author openly advocate to respect the basis of metal theory of money.

The essence of the metal theory consists in the matter that the value of money is directly connected to the value of the precious metals contained in the metal coins. Only the metal coins from precious metals are real, i.e. real money, while the value of the paper money according to them is taken out from the value of metal money, for which they can be exchanged in any time[67]. Abandonment of the so-called system of golden currency represents an end of metal theory, as a theoretic approach, but also as practice of leading a monetary policy. In the later period, especially during the economic crisis, when it usually comes to increase of disbelief toward monetary authority, it can be noticed at several economists a certain dose of bias and support of the concept of metal theory, as the safest approach to lead a monetary policy.

NOMINAL THEORY OF MONEY

A contrary to the metal theory of money, the concept of the nominal theory of money starts from the fact that the value of money (it refers to the paper money) depends on what is written on them (in denominations) as a nominal value. Therefore, in order money to be used as a payment and exchange tool, it doesn't have to have its own material (substantial) value but it's enough in the same to be written a certain number which marks the nominal value of the currency. But, in order this money (paper money) to be used as an equivalent of the goods in the process of exchange, a certain authority need to be upon them. This sort of authority in the past had the kings, great commanders, and later it was the institutions of the state, i.e. the monetary authorities.

As the most significant representatives of the nominal theory of money are James Tewart, John Lock, and George Knapp. According to Tewart, the money (it refers to the paper money) is an arbitrary measure with equal components and as such has nothing in common with the real equivalent. According to Lock, the money is a result of a general agreement between

[66] Tihomir Jovanovski – Economic faculty – Skopje, 1998, page 133.

[67] Ljupcho Trpeski, Monetary economy, Skopje, 2010, page 124.

people, with which is given an imaginary value to silver. The silver is convenient to serve as money due to the characteristics of silver. The evolution of the views and opinions of the nominal theory on the issue of the authority who stands behind the nominal value of the money according to Knapp is that the money is a product of the legal order. Money made of gold and silver apply the function of money only because the state with its authority has given to it its function[68]. In his famous work "The basics of science about the money", Dr. Vjekoslav Mejhsner starts from the nominal positions while explaining the manner of determination of financial obligations, says[69]: the financial obligation once and for all is determined with the number of currencies, so the same don't have to be changed according to the oscillations of the purchasing power of the money. Supporters of the theory represent the stand that the obligation is completed when the nominal sum of the debt is paid, independently whether the money at that moment has the same or a smaller material value (example: The golden money with the same nominal value but with a smaller material value)[70].

As a weaker side of the nominal theory of the money is considered the opinion that the issue about the value of money is considered an absolved issue, for the reason itself that the amount of financial obligation of the debtor remains the same (unchanged) independently whether the material (substantial) value of the money or its purchasing power is changed. The concept of the nominal theory of the money was applicable at the time of the so-called golden rule, when coins of precious metals were applied, as well as in the time when there was a full convertibility of the paper money.

THEORY OF PRODUCTION OPPORTUNITIES

The theory of the production opportunities is considered as an old theory of money. According to the representatives of this theory of money (Petty, Cantillan, Senior, Smith, Ricardo Marx and others), the value of money is determined by the amount of the production costs of the financial matter (the value of the substance from which the money is made). The basics of this theory come from the theory of the classical school of political economy. According to them, the money is goods as any other goods; therefore in the process of exchange each side receives equivalent value. In the times of the golden rule standard, if the price of gold is fixed then there's no possibility to change the value of money because the price of the substance which is used to make the (coins) money is unchanged, independently of the amount of production costs of the certain producers of gold.

If the price of money is not fixed, i.e. it forms freely depending on the supply and demand of gold, than the producers of gold who have lower costs of production of the price of gold formed in the market, will continue to produce furthermore, while the other producers with higher costs of production will have to decide either to stop with the production of gold or to reduce the costs of production of gold. If the market price of the gold is lower than the production costs of gold, it comes to decrease of the amounts of producing gold (part of producers give up from a further production due to higher production costs) and with that a decrease of the amount of golden coins. As a consequence of a reduced supply of money, it comes to a state of deflation in the national economy due to the increase of the value of money and decrease of the prices of goods and services in the market.

[68]Prof. Dr. Tihomir Jovanovski – Economic faculty – Skopje, 1998, page 135.
[69] .Prof. Dr. Vjekoslav Mejhsner, The basics of science about the money, Skopje, 1958, page 79.
[70]Prof. Dr. Ljupcho Trpeski, Monetary economy, Skopje, 2010, page 127.

The views and the stands of the theory of production costs are considered as exceeded, due to the reason that the value of money in the modern monetary systems is not connected to a certain determined standard, but behind its value stands an authority of the state, i.e. the monetary authority which has a task to secure conditions to maintain the stability of the purchasing power of the money. The maintenance of the stability of purchasing power of money from the monetary authority is one of its tasks which have public legal character as many other duties, like: the education, the judiciary, the defense and other similar duties of the state[71].

PSYCHOLOGICAL THEORY OF THE MONEY

According to the representatives of the psychological theory of money, the value of money is determined by the influence of certain psychological factors. According to them, beside the relation between the supply and demand of money, the value of money also depends on certain psychological elements such are: the behavior, the mood, the predictions, expectations etc. So, Albert Aftalion (1874-1957) while explaining the income theory says that the variations of the incomes or the prices are primarily determined by the psychological factors, and not only by the growth or reduction of the amount of money[72]. According to Aftalion, the level of prices is a function of predictions, while the variations of the prices are dependable on the variations of the incomes, and not the amount of money in circulation. When their incomes grow, individuals are prone to spend more money on a unit of good, even when the prices go higher.

In terms of influence of the psychological factors on the value of money, the views and stands of the representatives of this theory evolve, depending on the importance which is given to the psychological factors on the changes of the value of money, while several theoretical directions of development of the psychological theory of money separate, like: quality and marginal theory of the value of money. A contrary to the other theoretical concepts, to which the psychological factors play an important role, to the representatives of the psychological theory, the psychological factors such are: the trust, the mood and the behavior of individuals as buyers or salesmen, as well as the expectations and predictions based on the subjective valuations of individuals or groups, present basic or primary factors which influence upon the prices, and therefore to the value, respectfully the purchasing power of money. Apart from the existence of certain differences between the representatives of the psychological theory of money, among them still prevails the stand that the psychological factors play a dominant role on determination of the value of money.

CLASSICAL QUANTITATIVE THEORY OF MONEY

Quantitative theory of money is considered as one of the oldest, but at the same time as one of the most influential theory of the money. The basis of the classical quantitative theory of money comes from the so-called primitively formulated quantitative theory of money which main representatives are Jean Bodin (1530-1596) and B. Davanzati (1529-1606), and later David Hume (1711-1776). Different views can be found in the literature of monetary theory, often even opposed views on that, whether the appearance of the so-called primitively formulated quantitative theory of money is a reaction to the views and

[71]Prof. Dr. Vjekoslav Mejhsner, The basics of science about the money, Skopje, 1958, page 85-86.
[72] Tihomir Jovanovski, Ekonomski fakultat –Skopje, 1998, str. 142.

stands of the mercantilist theory or, according to the views of some other theorists, that the beginnings of the quantitative theory of money appear during the time of mercantilism or even before the appearance of the mercantilist theory.
While treating the problem of growth of the price, Bodin considered that the reasons for increase of the prices (expensiveness) need to be looked in: wealth of gold and silver, the monopoly of gold and silver as a monetary metal, as well as the satisfaction of kings and the great gentlemen who raise the prices of the items that they desire. Jean Bodin and B Davanzati consider that the main reason for increases (increase of the prices) in Europe is the bigger influx of gold and silver from America. The general level of money, according to them, depends on the amount of money in circulation and the amount of goods in the market.

$$P = M / Q$$
$$M = PQ$$

P –General level of prices
M –The amount of money in circulation
Q – The amount of goods in the market

According to David Hume, the amount of prices of the goods depends on the relation between the changes of the money supply in circulation and the changes of the goods in the market. According to him, the goods enter in the exchange process without prices, while the gold and silver without value. Then, the prices of the goods depend on the money supply in circulation. According to Hume, the changes of the amount of money in circulation have a proportional impact on the increase of the prices of the goods in the market. With his views and stands, especially on the issue of the way of determination of the prices of goods and the value of the money, as well as he never talks about the speed of the money in circulation in his researches, David Hume is rightfully among the group of representatives of the primitive quantitative theory of money.
The quantitative theory of money, since the primary so-called primitive quantitative theory has suffered evolutional changes, so some theorists rightfully represent the view that it’s not about only one theory but for several quantitative theories of money. Major contribution to the development of this theory is given by Adam Smith (1723-1790), David Ricardo (1772-1823), Malthus, Says, Mill, Walras and others. Although Smith with his researches didn’t give a complete theory about the money, still his researches in the area of the monetary theory, especially the issue related to the appearance of the money, value and the functions of the money, the relation between prices of the goods and the amount of money in circulation, the relation between the level of the interest rate and the profit, are of a great importance from a scientific point of view. The basics of his researches are down to the stands that[73]:

- the division of the labor in society has caused that each individual to be dependable on the other people, because he produces only one or few goods, while the surplus of the goods over the required ones has to be sold to others, and from them to buy the goods that he himself doesn’t produce. Up until the appearance of the money, different kinds of goods have played the function of an exchange tool;
- the money has an exchange function. Emphasizing the exchange function of the money, essentially he didn’t understood the essence of the money as a generally accepted good, through which is expressed the value of other goods. Although he knew the other functions of the money, like the exchange tool, measure of value, a payment tool and tool for wealth, he however puts them in

[73] Prof. Dr. Todor Todorov and Dr. Armen Kadroski, International economy, Skopje, 2006, pages 58-65.

one single exchange function as a primary function of the money;
- prices of the goods are a factor on which depends the required amount of money in circulation. According to Smith, through the required amount of money in circulation the surplus goes abroad, or is used in metal industrial purposes (he was thinking about metal coins);
- the level of the interest rate depends on the achieved profit, while the amount of profit depends on the growth, stagnation or decrease of the national wealth. As the interest rate in one country changes, the profit from the capital will also change, or more precisely, as the interest rate goes down or up, so the profit from the capital increase or decrease;
- the capital, according to Adam Smith is divided into fixed capital and the capital in circulation. The fixed capital is composed of the machines and other working tools, business buildings and other objects and acquired useful abilities of all the habitants in one society. The circulated capital is composed of the money, the stocks of nutrients, the reserve of raw materials and semi-fabricated products and the serve of the finished products.

A major contribution to the scientific thought in the area of monetary theory is also given by David Ricardo. Regarding the fact that Ricardo was a good knower of the monetary theory, as well as the fact that the issues related to the emission of paper money (banknotes) in the beginning of the XIX'th century in England have become very popular, he was encouraged to be dedicated to this problem. His first article published in 1809 with the title "The price of gold" has awaken major interest in the public due to his critical overview to the damage of the excessive emission of money. A year later he publishes his work with the title "The high price of bullion, a proof of the depreciation of banknotes" which has caused major attention in the scientific public at that time. Later on are published other significant works in this area, with which Ricardo takes his deserved place among the scientific thought of the English classical school. The basis characteristic of Ricardo's theory of money which basely is a further processing of Smith's theory of money is composed of the following[74]:

- As Smith before him, Ricardo also thinks that money is a goods as every other goods, and accordingly the value of money is determined as the value of every other goods, i.e. by the amount of labor needed for its production.
- According to Ricardo, the natural price of all goods is determined upon the value of goods and money. The changes in the value of goods causes change in direction of the rise of the prices of those goods; while the change of the money in direction of growth or fall will cause decrease or increase of the price of those goods. It can be concluded from this that if the amount and the value of the goods remains unchanged, then the required amount of money in circulation depends on the value of money;
- Same as Smith, Ricardo thinks that the money are goods as any other goods and as such it serves as an exchange tool, so the replacement of gold and silver coins with bank notes doesn't change anything. According to Ricardo, the bank notes can also conduct the exchange function same as the money made of precious metals;
- The prices of the goods are determined with the ratio of the amount of goods and the amount of money. When the amount of money in circulation is increased in the same volume of goods, then it comes to the rise of prices, and vice versa;
- The amount of money in circulation (gold and silver) is regulated

[74]Dr. Todor Todorov, The economic theories and the economic thinkers, Economic faculty – Prilep, 2002.

automatically, but still differently, depending on that whether exists foreign trade or not. Namely, the increase of the money in circulation over the required level leads to its decrease of value, but also to the rise of the prices. When there is a foreign trade, the increase of the money in circulation over the required level, leads to increase of import of goods up until the level which marks a balanced relation of the amount of money and goods. When there isn't a foreign trade, the increase of money in circulation over the required level leads to the decrease of production of money to the level which fits the needs of the exchange. A completely opposite effect is achieved when the amount of money in circulation is decreased under the required level of the exchange. According to Ricardo, the free market automatically regulates the amount of money in circulation in accordance with the needs of the exchange;

- according to Ricardo the interest rate is not regulated with the policy of the emission bank and the banking sector at all, but the interest rate depends on the profit rate. This implies that Ricardo had a negative opinion in relation to the role of the banks and the crediting in general.

Beside the great contribution of the representatives of the classical monetary theory in the development of the scientific thought, we consider that this theory is full of major disadvantages. The treatment of money as goods like any other goods, the negation of the influence of the amount of money in circulation upon the prices, then equation of the banknotes with the money made of precious metals in performing the role of the exchange tool, and other disadvantages[75] are considered as the main disadvantages of this theory. Due to these, basically wrong views and stands of the representatives of the classical monetary theory, other monetary theories appeared which, although incomplete, in each one of them new elements are embedded, so the same can be considered as variations of the classical theory of money.

CONCLUSION

In the modern market economies, the function of the monetary policy is to provide, before all, maintenance of the stability of the prices in long term, as well as the increase of the production to level, or approximately to the level which would mean a complete utilization of the available capacities in the economy. But, in order to achieve that, there is a need to identify the obstacles (variables) which stand on the way of success, which instruments should be used, how should be their dosing, and which are the measured categories (goals) to which we strive. According to the views of the modern monetary economy, the money supply in circulation is the main lever of the monetary authority, whose proper regulation affects not only the movements of the other variables, but also the success in accomplishment of the goals of macroeconomic, and to monetary policy. If is accepted the opinion that the money supply is the main lever through which is regulated the movement of the other variables, then the question arises about how to determine the growth of the money supply, i.e. should the money supply in circulation vary in accordance with the needs to secure monetary stability in long term, or should the money supply in circulation be conditioned by the need for correction of the oscillations in the economic activity.

Several concepts on the growth of the money supply in circulation can be met in the literature of the monetary theory. According to the first one, the so-called neutral concept, the growth of the money supply in long term is neutral, if with such a growth of the money supply, the average

[75] Dr. Aleksandar Zhivkivic and Gradimir Kozhetinac, Monetary economy, Economic faculty – Belgrade, 2005, pages 362-365.

level of the prices remains the same or approximately the same during several years, while the economy functions in the level of the potential GDP. According to the second concept, the expansive growth of the money supply exists when that growth is above the level of the neutral growth of the money supply. According to a third concept, the restrictive growth of the money supply exists when the growth of the mass is below the level of the neutral growth of the money supply.

As is already known, the real income, the interest rates and the prices remain under the impact of the change of money supply in circulation, and that is in direction of their increase or decrease. On short term, the measures of the monetary policy affects to all three abovementioned variables, while on long term, the impact of the change of money supply is only directed towards the prices, i.e. towards the change of the general level of prices. If the growth of the money supply is sufficient to answer to the growth of the real income and the prices, what will happen in the monetary authority decide to decrease the rate of the monetary growth? In the beginning it will be felt a shortage of money, and later this problem will be more acute. In order to secure the required liquid funds, they will start to sell the securities which they posses, or some other property, other subjects will reduce or prolong buying of goods and services. These changes are the so-called primary effects of the change of monetary policy. The decrease of the demand will cause a decrease of production, decrease of the prices and the salaries of the employees, as well as the inflation which will decrease as a reaction to the changes of the monetary policy. It is considered that the problem with inflation is overcome if the rate of inflation is below or to the level of the monetary growth.