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## Stabilization of Money Value

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Marek MAZUR

### Stabilization of Money Value

Stabilizacja wartości pieniądza

*Impact of money structure and credit beside a language and morality was and still is one of these spontaneous orders, which offer most resistance to efforts aiming at their adequate theoretical explanation, and it remains the subject of serious differences of opinions among specialists.*

Friedrich August Hayek

Time is money. Money governs the world, so money is power, and power is money and banks.

Interest, liabilities and forming of capital are explicitly monetary phenomena, i.e. they occur in money sphere, although they are indirectly but very closely related to real production sphere and distribution of goods, first of all to investments. Money can be seen — depending on a point of view — in a different way, e.g.:

1. Clearly statistically in the sense of the problem of dividing various definitions of money quantity and infinite quantity of particular problems, described in an infinite quantity of literature. This aspect will play an essential role in future development of European monetary policy.

2. Less prosaically: money can be considered from the point of view of its meaning for a man. Dostoevski for example saw money as "the embodiment of freedom", Tolstoj as "the way to slavery", while one hundred years earlier Jean Jacques Rousseau underlined both aspects, i.e. the aspect of freedom and slavery — depending on whether one owns enough money or needs it badly.

3. Money can be treated also in its role as a means of payment, conversion unit and/or as a means of store of value.

4. Money can be seen in the end as an instrument and the issue of politics, e.g. monetary policy or taxation, policy and services on the side of expenses, e.g. in social and structural policy, at the end directly as an object of policy — monetary, stabilization and currency policy. Stable money however, does not always mean stable power. Since not each power has sufficient funds, having cover in goods, gold or reserves or store. In most countries of the world money is rare and scarce.<sup>1</sup>

That is why governments carry out adequate policy influencing the general level of price, profit, production, employment, unemployment and inflation rate. Since resources are scarce we must make difficult choice of the best allocation of resources in a scale concerning particular people, local communities and the whole country. Difficult choices and risky decisions are made in conditions of the market economy or centrally planned economy. The market economy functions "effectively" when the market price represented by money and the quantity of goods tends to stabilization and gains the point of balance. We may say that competitive market is effective or enables the effective allocation of relatively scarce and productive resources into relatively profitable economic domains which bring the biggest production or the greatest savings. Effectiveness means maximalization of production resulting from the proper rational allocation of resources at given limits of supply (costs paid by producers) and demand (consumers' preferences). Although the competitive market can be effective, it is not excellent. It may be seen as "unjust" because profit of the society or a country is never equally distributed. Markets do not always have to be effective, e.g. when they pollute the environment, produce goods considered to be socially harmful, cause waste of resources or use their monopolistic position and carry out illegal activities or inconsistent with customs. In the market economy money plays active creative role.<sup>2</sup>

In the centrally planned economy a plan is that an unseen hand dividing the limited resources of people and things among branches of

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<sup>1</sup> F. A. Hayek: *The Fatal Conceit. The Errors of Socialism*. Freiburg im Breisgau, April 1988. Hayek saw socialism in countries of Stalin and Hitler as well as in books of Marx and Rosenberg. Socialism always appears where state institutions relieve, replace, force an individual citizen-creator. Socialism always appears where collectivism and state-party interventionism tries to replace autoregulating mechanism of market, and initiative of people is forced by "urawniłowka" (equalization) and an umbrella of protective state. Compare: D. Filar: *Na wyżynach socjalizmu*, „Przegląd Polityczny” 1991, 1/13.

<sup>2</sup> D. R. Kamerschen, R. B. McKenzie, C. Nardelli: *Ekonomia*, Gdańsk 1991.

economy is the most effective one. In the plan objectives, control of its realization and results of managing are expressed in physical units, quantitatively, by volume. Money plays an inactive, helping and informational role. In international settlements of the ex-east block a fictional kind of money was used — transfer rouble, the value of which was fixed as 1.5\$. In Moscow at the black market people paid 5—7 roubles for 1\$. In settlements with western countries ex-countries of the Council for Mutual Economic Aid used foreign, exchange, and in home settlements — buffer money — exchange zloty (and its equivalents), being various kinds of conversion of foreign exchange currency to home currency. Polish zloty was exchangeable neither at home nor abroad. Separation of Polish zloty from the world currency, the world value and prices, similarly as separation of the Polish society, economy, science and culture from the rest of the world caused the lack of real information about prices, a level of social costs of production and a level of social working capacity. Thus monopolistic party-government bodies in the Polish People's Republic made economic decisions and choices of solving problems based on fiction to quite a large extent. The results of these choices brought more waste and harm than rational economic effects. Communistic economic interventionism consisted in a choice of outworn production structure and investment and intentional fixing of prices of exported goods by satellite countries to the ex-USSR under their real value. The result between the official price and the real value of goods produced by the so-called "losing heavy industry" was covered by the Polish state in a form of endowments. In this way plunder of the Polish state happened by the way of legal redistribution of home national profit. For example, in the years 1950—55 about 35—40 million tons of coal a year were exported to the USSR which paid 1\$ for 1 ton. The price of 1 ton of coal at the western markets was 6\$ at that time, and in 1956 — 12\$.

In Poland at the turn of the eighties over 60% of national business was "ill", ineffective, it required endowments or credits, and a half of it qualified to liquidation. About 2/3 of the Polish export, assigned to the east market so far, did not find a receiver or payer.

The stable money value, not of home zloty but of foreign currency — dollar, mark, pound sterling, etc. decides so far about conduct of home and foreign subjects at the Polish market to quite a large extent. Credits and investments of western countries placed in our country depend on stable value of dollar to quite a large extent. Large inflow of capital to Poland will allow to start investments and modernization enabling way out of our country from economic recession. The International Monetary Fund and World Bank settle the rate of exchange of US dollar for the

Polish zloty, speed of repression of inflation (inflation rate) and a level of country budget deficit at the level of 5% of gross national profit, which will be partly covered by credits drawn at western banks.

Stabilization of money value allows to compare by the same measure, the same parameter, costs of production, prices, rate of interest, working capability and capital of various producers, various countries and continents. Unstable money value breaks that basic economic pattern binding all physical and legal persons, acting on free competitive money-commodity market. When money value is unstable a state, economy and society immerse in chaos.

#### ACTUAL STATE

Transactions on the market are carried out according to a rule: money—commodity—money, or money—money. In the act of buying—selling goods (consumption goods, production means, man power, soil) are sold according to their value. Thus exchange of goods, money, man power has equivalent character, not payable, or free of charge. It means that at the time of exchange both sides do not lose and do not gain anything as far as value is concerned, and considering usefulness — they fulfill their wants and demand.

Exchange of goods according to their value means that they are exchangeable according to time of work socially necessary for making them (i.e. costs, outlay). Money expresses value, is a symbol of abstract work of mind and man's muscles. If time of work, labour consumption or the reverse of labour consumption — social work capability is higher or lower than socially necessary (of a country, region or the world), then goods' value and price of goods represented in money will also be higher or lower. It means the possibility of gaining higher or lower profit and lower or higher loss.

In all countries in market economy as well as in non-market economy stabilization of money value is proclaimed as an important aim of hierarchy of objectives of economic policy.<sup>3</sup>

Empirical experiences of the world range are however in a distinct discrepancy with objectives of policy of governments. Especially on the background of Latin-American countries in which exaggerated excessive rate of inflation has become as if obvious, gains of western industrial countries happen to be less than satisfactory. Western countries were able to reduce considerably high rate of depreciation of money from the period of international economic crisis which took place on the turn of

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<sup>3</sup> Issing: Geldwertsabilität. Einführung in die Geldpolitik, München 1990.

the seventies, but that process resulted only in stabilization of prices selectively. Since 1987—1990 the rates of price increase go up again, and since 1991 they decrease in some countries (see Table 1).

Even such currency as German mark which in international comparisons can be a pattern or an example of stability, reduced about 2/3 of its primary buying capacity at the beginning of the forties since the time of its monetary reform (June 1948). Price index of means of living tripled at this time, while the rate of price increase amounted 2.7% a year on an average. During the first three decades the rate of money devaluation was 1.1% a year in the years 1950—59, then in the next decades in amount-

Tab. 1a. Consumer prices  
Ceny konsumentckie

	1971/80	1981/90	1986/90	1988	1989	1990	1991
B	7.4	4.5	2.1	1.2	3.1	3.5	3.2
D	5.1	2.6	3.9	1.3	2.8	2.7	3.5
DK	9.8	5.9	1.4	4.6	4.8	2.6	2.4
E	15.3	9.3	6.5	4.8	6.8	6.7	6.0
F	9.7	6.3	3.1	2.7	3.6	3.4	3.2
GB	13.7	6.6	5.9	4.9	7.8	9.5	5.9
GR	14.3	19.0	17.4	13.5	13.7	20.4	19.5
I	13.8	9.6	5.7	5.0	6.3	6.5	6.4
IRL	13.7	7.7	3.3	2.1	4.0	3.4	3.2
L	6.6	4.4	1.7	1.4	3.4	3.7	3.1
NL	7.1	2.5	0.8	0.9	1.1	2.6	4.0
P	18.6	17.1	11.3	9.6	12.6	13.4	11.3
A	6.3	3.5	2.2	2.0	2.5	3.3	3.3
CH	5.0	3.4	2.5	1.9	3.2	5.4	5.9
IS	32.8	33.7	20.2	25.4	21.1	14.8	6.8
N	8.4	7.6	6.2	6.7	4.6	4.1	3.4
S	9.2	7.6	6.2	5.8	6.5	10.4	9.7
SF	11.2	6.7	4.9	5.1	6.6	6.1	4.2
CDN	8.0	5.9	4.5	4.1	5.0	4.8	5.6
J	9.0	4.7	1.4	0.7	2.3	3.1	3.3
USA	7.8	2.0	4.0	4.1	4.8	5.4	4.2

Percentage changes: annual averages.

Source: Federal Statistical Office.

Tab. 1b. Inflation  
Inflacja

	1988	1989	1990	1991	1992
BG	25	6.1	26.3	334	90
CS	0.2	1.4	10.0	58	11
H	15.5	17.1	28.4	35	21
PL	60.2	251.1	585.8	70	40
RO	2.6	0.9	4.2	161	200
FSU	0.6	2.0	5.3	91	2000

Percentage change over previous year. 1992. Projection.

Source: OECD.

ted respectively: 2.4% and 4.9%, in the eighties that rate decreased again to 2.6%. In the years 1990 and 1991 the discussed rate increased respectively to: 2.7% and 3.5%.<sup>4</sup>

In Poland in 1951—93 prices of food articles and nominal payments increased by estimation about 2,000 (two thousand) times. Prices and payments — parameters defining standard of social life were settled by the Polish government. These parameters were quite stable for a long time. Central authorities gave in the payment pressure fearing social disturbances. Payments increased quicker than technical equipment, production and work capability. Further maintaining of stable prices was impossible because there was not enough means for subsidizing all consumption and extra-production spheres. Hyperinflation in Poland in the eighties is characterized by two features: very fast increase of prices, decrease of level of production and services, consequently general tendency to exchange money for goods, gold, currency, pictures, realties (drawing 1, Table 2). The motive of storing goods is foreseeing of quick increase of prices. Continuous adapting of nominal prices to a higher level of prices results in further price increase and decrease of real payments, what is closely connected with decrease of money value. The programme of Leszek Balcerowicz realized since January 1, 1990, more precisely programme of International Money Found quite effectively limited rate of inflation increased from almost three-figure to one-figure monthly value; but increased number of unemployed to about 16% people professionally active in production age (state in February 1994). A negative and unplanned feature of that programme is two-figure decrease of level of national profit and devaluation of value of Polish zloty from 9500 zloties for 1\$ (1.01.1990) to about 22,000 zloties for 1\$ (II quarter of 1994).

Decrease in value of Polish zloty caused:

- decrease in value of our national profit, national property, national wealth valued in US\$ of about 65%; the level of Polish Gross Domestic Product amounted to 63.8 milliard US\$<sup>5</sup> in 1990 according to the World Bank, and in 1994 about 50 milliard US\$;
- increase in import costs and quantity of exported goods and circa services of 60%; worsening of the indicator Terms of Trade;
- increase in inflation rate, of prices of goods and home services;
- increase in service costs of our foreign debts;
- sudden impoverishment of millions of small money-grabbers of dollars, valours, etc. (January 1990).

<sup>4</sup> O. Issing: Geldwertstabilität. "Aus Politik und Zeitgeschichte". Beilage zur Wochenzeitung Das Parlament, B 18090 27 April 1990, and Intitut der Deutschen Wirtschaft, Köln 1993. International Economic Indicators, tab. 56.

<sup>5</sup> Op. Lit. International Economic Indicators, tab. 20.

Tab. 2. Price index of rate of living  
Cenowy wskaźnik stopy życiowej

Year	All households	4-person family of workers with average income	4-person family of clerks with average income	2-person family of pensioners and annual income
West		1985=100		
1950		33.0		
1955		36.3		
1960		39.7		37.9
1965	44.7	45.6	44.1	44.5
1970	50.4	52.1	50.1	50.6
1975	67.9	68.4	67.4	68.2
1980	82.8	82.8	82.4	82.6
1985	100	100	100	100
1986	99.9	99.8	100.1	100.3
1987	100.1	99.9	100.6	100.0
1988	101.4	101.0	102.1	101.0
1989	104.2	103.9	104.9	104.0
1990	110.7	106.7	107.6	107.0
1991	107.0	110.5	111.3	110.8
1992	115.1	114.9	115.8	115.2
West		Changes in relation to previous year in %		
1951/55		1.9		
1956/60		1.8		
1961/65		2.8		3.3
1966/70	6.1	2.3	2.6	2.6
1971/75	2.4	6.0	6.1	6.2
1976/80	4.0	3.9	4.1	3.9
1981/85	3.8	3.8	3.9	3.9
1986/90	1.4	1.3	1.5	1.4
1980	5.5	5.2	5.5	5.4
1981	6.3	6.4	6.6	6.1
1982	5.2	5.2	5.4	5.6
1983	3.3	3.3	3.4	3.5
1984	2.4	2.3	2.4	2.5
1985	2.0	2.0	2.1	1.9
1986	-0.1	-0.2	0.1	0.3
1987	0.2	0.1	0.5	1.0
1988	1.3	1.1	1.5	-0.3
1989	2.8	2.9	2.7	3.0
1990	2.7	2.7	2.6	2.9
1991	3.5	3.6	3.4	3.6
1992	4.0	4.0	4.0	4.0
East <sup>1</sup>				
1991	14.2	14.4	11.2	15.8
1992	11.2	10.5	10.5	11.7

1 — 1990/1991 = 100.

Source: Federal Statistical Office.

It is proper to remind that before World War II Poland had the stable currency. In the years 1928—1932 1\$ cost 8.90 zloties, while in 1935—38 only 5.30 zloties.<sup>6</sup>

<sup>6</sup> Concise Statistical Year-Book of Poland, September 1939 — June 1941 London 1941, p. 103.



Existence of two currencies at the home market: US dollar and Polish zloty having two different interest rates of investments and credits (2—8% for a year and about 30—80% for zloty a year), enabled all those who had legal or illegal access to million sums of dollar loans to become rich in a flash in a way not always consistent with law, democracy and tolerance.

In Poland at the turn of the eighties over 60% of national business was "ill", ineffective because of: 1) the process of limiting or liquidation of budget endowments, 2) the process of equalization of home prices to the world prices, 3) subjugating of state firms by the progressive compensatory tax on overnormative payment increase, 4) the breakdown of the traditional eastern market.

In Poland in 1993 the national income increased by 4%; private firms composed about 55% of all firms; 2/3 of international exchange made connections with western countries.

The privatisation process of state firms, mass media, banks, etc., should be treated as the basic source of internal home accumulation. Meanwhile the Polish state called upon to secure the state property gains little profit on selling of those possessions. *Exempla docent.* Art-"B" Company with the incoming capital of 100 US\$ "multiplied" its capital in one year to over 4 billion zloties (i.e. about 500 million US\$). Ministry of Ownership Transformations sold several hundred of state firms for about 500 million US\$ in a few years. Sold property, bank stock and stock of economic units in many cases are priced beyond their real value, i.e. in limits of 5—15% of their factual value. Buying of those economic units and stock has rather a political, protective character than free-market, competitive character. Privatisation in Poland is in odds with the rule of freedom, equality and competition to quite a large extent. Comparisons of buying power of dollar and zloty are often made and untrue conclusions are drawn from those. For example, one can buy less than 1 litre of milk for 1\$ in the USA, in Germany a half loaf of bread. In Poland in 1994 one can buy about 3.5 litres of milk and 3 loaves of bread for 1\$ counted into zloties. Other examples may show something simply opposite. There is no such a system of parameters, rates, which would enable comparing two countries, two systems, two economies with each other. Everything which economy can now is to compare two national economies in one currency, e.g. in dollars, roubles or zloties. However, one cannot draw any serious conclusions on that basis. In each of those countries we have to deal with another structure of production, investment, employment and education, payments, prices, resources, export, import, etc.

Taking the above into consideration, the following questions impose directly:

- what rank should be given to the aim of stabilization of money value?
- what causes give unsatisfactory results?
- what actions result from destabilization, i.e. from depriving money of its value?

#### BASIC CONCEPTS AND DEFINITIONS

Money value depends on quantity of goods and services which can be bought for a given sum of money today, in a month, in several years. Thus money has value in that sense that people trust in it, accept it, believe in it. That is why concepts "money value" and "buying power" are used as synonyms. The higher money value and buying power, the lower are prices of goods, and the lower they are the higher are prices of goods.

Zloty, mark, dollar banknotes do not have any value in themselves. Dollars on bank accounts are numbers written on computer tape. Buying power of zloty, mark or dollar is a lot higher than value of paper used for printing them. Similarly, value of coins is lower than nominal value of coins. Nowadays money is not based on gold. Several dozens years ago one could get 1000 pounds in gold for 1000 pounds in banknotes in Egypt, which brought to London had value of 3000 pounds in banknotes. The US government does not keep gold in Fort Knox in order to maintain 1\$ equal to 0.25 in gold for each 1\$ in circulation. Even then gold did not represent value of money, because \$=0.25 in gold did not equal the value of 1\$.<sup>7</sup> Thanks to its economic power the USA imposed the world value of one ounce of gold of 32\$ after the World War II for a long time. Actual cost of one ounce of gold was above 100\$.

Prices of single commodities may generally develop quite differently. It that relation it is important to differentiate price level among relative and absolute prices. Prices may be freely created at the market, namely it refers to the conduct of prices of particular goods, which exist on the market in a limited quantity.<sup>8</sup>

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<sup>7</sup> E. Drabowski: *Pieniądz międzynarodowy*, Warszawa 1988; W. Hagemeyer, W. Przelaskowski: *Problemy siły nabywczej pieniądza*, Warszawa 1968.

<sup>8</sup> F. Młynarski: *Siła nabywcza pieniądza*, Warszawa 1918; J. A. Szwa-grzyk: *Pieniądz na ziemiach polskich X—XX w.* Ossolineum 1990.

Price of using a flat (rent) increases quicker than other prices, that relative price increase signalizes a certain limit, a certain rarity of house goods at the building market. Tenants have a choice: reduce consumption of other goods at a given income, or reduce, limit size of a house used now, which has gone up in price, i.e. to find another place to live (smaller, in not so good, wealthy quarter, having worse technical equipment, etc.). It means better, more attractive building conditions for potential building firms, so in a longer time supply of houses will increase and rents will relatively decrease. Changes in relative prices fulfill in the market economy an important information role (beside cost and income functions), but only if the process of controlling the market is not disturbed by limits, e.g. in 1992 in Germany the maximum rate of rent was 8 German marks for 1 square meter, while rate increase from year to year could not be higher than 5%. In Poland metric area of a family house was such a limit which at the beginning was 85 sq. metres, then it was increased to 110 sq. metres. Rents of tenement houses were also limited.

In market economy relative prices are constantly changing, i.e. prices of some goods increase relatively in relation to other goods, prices of which decrease relatively under the necessity. Being relative not all prices can simultaneously increase or decrease. It is different when average prices are settled. That average may increase very much or decrease. Buying capacity of money and average prices behave inversely proportionally: the higher average prices, the lower buying capacity of money, and vice versa.

Development of buying capacity of money can be read in changes by adequately prepared price index. In this order the average value of prices of a limited group of goods is settled (basket of goods). Choice of particular goods and their importance result from consumers' customs of representative households. Changes of those average values in time inform then about average percent changes of all prices which were taken into calculations. For example, about 160 various goods is contained<sup>1</sup> in the Polish price basket of articles of the first need. In the USA, Germany and other countries many such price indexes are calculated, for example index of production prices, of agricultural goods, export and import prices, houses, etc. Changes of creating of money value represented by changes of price index of food articles, will affect city workmen's households of 4 people (index of costs of living).<sup>9</sup>

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<sup>9</sup> Zahlen zur wirtschaftlichen Entwicklung der Bundesrepublik Deutschland. Ausgabe 1993 Institut der Deutschen Wirtschaft, Köln 1993.

Such an index of prices distorts development of prices of "a basket of goods", which is based on average consumers' customs of chosen types of households. For a given household change of its buying capacity may draw off from the average more or less. For example a given increase of turnover tax of alcohol and tobacco need not affect an abstinent, while a consumer of these will be affected very much. Similarly, in a case when a household saves money for building of an own house. Ruling of prices of building materials and lots, particularly change of buying capacity of its savings for that purpose are decisive.

Particular difficulties at calculating price indexes of costs of living are caused by qualitative changes and transfers in consumers' customs and imitation. The basket of goods must be adopted by replacing old goods by new ones (e.g. black-white TV sets by color ones) and by changes of expense structure (e.g. lower share of expenses for food in Germany from 40 to 21%). In Poland we observe quite a different trend in the last few years: increase of expenses for food dominates in general expenses of a household. A new basic year for index of prices is introduced every 5th—7th year which is bound with that revision of data.

Fixing, finding out buying capacity of money and its changes entails a lot of difficulties. If the price index of costs of living increases below 2% a year, one will be able to say not about the last quality improvement, which could not be fixed in numbers, but one will carefully say about a small decrease of money value. The higher decrease in rate of prices exceeds the above limit and the longer such a tendency will remain, the purpose of money stabilization is more struck — inflation simply rules.

#### PRIORITY OF STABILIZATION OF MONEY VALUE

Money fulfills important tasks in the national economy: serves as an exchange unit and a measure of store of value and as an account unit. Only stable money can fulfill these functions. So when a credit is paid off a creditor obtains back the same amount, which he gave before as a credit only when money has a stable real value, i.e. calculated in buying capacity. If on the contrary, the price level has risen in the meantime, a debtor clears his debt with worse money, having less value, without additional agreement concerning compensation in the form of e.g. re-compense. The debtors profits in this way to the creditor's disadvantage.<sup>10</sup>

<sup>10</sup> E. Taylor: *Druga inflacja polska*, Warszawa 1926; H. R. Varian: *Grundzüge der Mikroökonomik*, Internationale Standardlehrbücher der Wirtschafts- und Sozialwissenschaften. Oldenbourg. Verlag München 1990; P. A. Samuelson, W. D. Nordhaus: *Economics*. McGraw-Hill International Editions. 1989, p. II&III.

Expressing the value in terms of money, calculating in money prices is possible only while doing economic calculations in contemporary meaning. It concerns single economic units (a home, an enterprise) as well as the whole national economy. Calculations of losses and profits, balance, turnover, margin of profit, also social product and balance of payment are expressed in calculations in terms of money. Only stable money can fulfill that function satisfactorily. If the money value changes then the value is not measured in real, stable units but in internally changed units of measure. The basis of economic calculations is not longer powerful, a standard measure of values, but — as we can say — stretching rubber rope.

First of all, in times of high inflation rate it is becoming obvious that money loses its everyday function. Money is more often rejected as a means of exchange, other goods replace it (therefore e.g. the expression — cigarette currency). As a result of fast loss of money value less and less savers want to locate credits for nominal values. Instead of that the escape to material values is observed. As a calculation unit money is at the same time replaced by various kinds of substitute calculation units, with the help of which nominal predominance of increased prices is corrected.

Pathological state of hyperinflation shows clearly economic costs of nonstability of money value — saying in another way: advantages of the stable money value lie in confidence in exchange, in keeping the value and counting on the monetary unit having the stable buying capacity. The rule of nominalism, "zloty = zloty", "dollar = dollar", "mark = mark", which lies at the basis of numerous agreements and decisions, will get its right of citizenship only on condition of the stable money value.

Expectations of forming of money value are included in almost all economic decisions concerning the future. It concerns investment plans of businesses as well as considerations on securing the future of private households. Confidence in the basis of the rule of nominalism is secured only if citizens may count on stable money value in the future. The Act of July 28 1990 (Journal of Acts No. 55, item 321) amending the Civil Code, introduced normalization reflecting changes being carried out in Poland and regaining by Civil Law a function of a regulator of property and turnover relations.

One of significant innovations included in the above mentioned act is introducing article 357<sup>1</sup> into the Civil Code, enacting the clause *rebus sic stantibus* in the state of a general rule. That rule, in case of exceptional circumstances, enables courts to modify obligations and adapt them to changed economic conditions, in such a way that services of both sides of obligations relation were in relation of mutual balance, reserved at

the date of entering into an engagement. New entered rule enables courts to pass decisions conforming to the idea of adjudging *ex bobo et aequo*.

Article 358<sup>1</sup> C.C., also entered by the above mentioned act, remains in relation to art. 367<sup>1</sup> of C.C. That rule enacting the rule of nominalism in § 1, foreseeing simultaneously the possibility of renouncing it when particular regulations state differently. It admits in § 2 and 3 novum in the existing Civil Code — valorization of money services, § 2 of art. 358<sup>1</sup> enacts the so-called conditional valorization clauses, and § 3 admits court valorization.

The above legal normalization brings conditional relations to real, fair ground, supplementing in this way the rule of *pacta sunt servanda*.<sup>11</sup> Thus the stability of money value constitutes the centre of order of market economy. Walter Eucken raises it to the central rule: "All aims for realizing of competing order (rivalry, competition — M. M.) are vain until defined stable money value is secured"<sup>12</sup>. That's why primacy to monetary policy should be given.

#### STABILITY OF MONEY VALUE IN CONFLICT WITH OTHER SOCIAL-ECONOMIC AIMS

Relation of stability of money value to other general economic aims should be considered in relation to economic policy. For analytical reasons relation among assumed aims will be considered each time separately; in this situation the aim of fair partition should also be considered.

##### A. HIGHER ECONOMIC GROWTH BY INFLATION

In the first two decades after World War II particularly developing countries, but not only them, were advised to obtain real economic growth by moderate inflation. The background of those advices constituted conviction that the value of money was reduced, which would be under control and belief that all-economic savings could be raised, thus investment activity would be raised beyond measure, at voluntary giving up consumer aspirations.

A trial of experimental test of that hypothesis may be recognized as unsuccessful. The real state is too controversial. The high speed of real growth at moderately stable money value can be stated the same as however the low increase rate together with differential development of the

<sup>11</sup> Z. G a w l i k: Klauzula *rebus sic stantibus* w znowelizowanym kodeksie cywilnym, „Nowe Prawo” 1990, 10—12, s. 36—53.

<sup>12</sup> W. E u c k e n: Grundsätze der Wirtschaftspolitik. Tübingen 1990.

price level. One thing does not unquestionably arouse any reservations: by heating up inflation it is possible to obtain a longer or shorter period of illusory rise. The side effect of that period is distortion in the scope of production structure, which must be corrected later. Semi-finished and empty tenement houses (ruins of houses) testify significantly about inflationary faulty guiding of production factors. If the above is balanced in further perspective it turns out that the real economic growth is more often lower than at the starting moment.

At the time of hyperinflation the possibility of calculability of economizing is largely hindered, and sometimes even impossible. The national economy in principle after hyperinflation is ended by reform of currency and requires an adequate time to overcome the breakdown of the economic growth.

#### B. EXTERNAL SURROUNDING OF ECONOMY

In inflation surrounding a given country may maintain the stability of money if it protects externally from "infection" by the elastic exchange rate or by revaluation of its own currency at the right time. At the stable exchange rate the growth of prices at the world market is imported by import of goods; enabling home exporters to sell their products abroad at more expensive prices will also result in the increase of home prices. Salaries will follow that trend and inflation pressure will be stimulated. The development of home prices being left behind the development of prices abroad and the export surplus resulting from that will make the bank of issue intervene at the currency market. Buying of currency by the bank of issue enlarges the quantity of money of the central bank; if that quantity is also supplemented by the import of capital, probably reinforced by expectations of revaluation of home currency, then the bank of issue will completely lose control over the quantity of home money, and thus the control of the development of the price level. Until the free exchange of mark to dollar in March 1973 the Federal German Republic had to experience constantly that there are practically no defensive possibilities against the mechanism of transferring of imported inflation, unless a decision of revaluation of its own currency. Besides, the instrument of periodical revaluation turned out to be too slow to protect sufficiently foreign economic aspects of stabilization of money value in Federal Republic.

As long as inflationary tendencies will dominate in the world currency system only the elastic external value of home currency will enable the adequate protection against influences of foreign economy. Although even at the elastic exchange rate it is not totally possible to avoid the consequences of high price increase of important imported goods, e.g. oil

by OPEC. However, in such a way a given country may isolate itself from inflationary tendencies in the world. Resuming, it is the easier to maintain the stability of money value, the more the most important trade partners aim at the same purpose with success.

#### C. FULL EMPLOYMENT OR STABILIZATION OF MONEY VALUE

Widely spread and probably true is the opinion that there is a conflict between the aim of full employment and the stabilization of money value. The known saying of a famous politician may be quoted here: "five per cent of inflation is nicer to me than five per cent of unemployment". These beliefs lose largely to empirical studies on relations between changes in nominal payments and the unemployment in England in the years 1861—1957 made by the English economist A. W. Philips. In works of other authors that dependence was transformed by taking into account the growth of productivity in relation between the inflation rate and the unemployment.

The drawing no. 2 shows the so-called Philips's curve, which represents the conflict between the full employment and the stabilization of money value. If the national economy gains the stability of money value in point A, it must pay for it with 8 per cent unemployment. The expansive course of financial policy and monetary policy may limit the unemployment, however the price of that achievement is simultaneously higher rate of price increase. For example point B is defined by 3 percent unemployment and 5 per cent inflation rate of coming out of that situation. Depending on result of a choice one should consider higher unemployment or higher inflation.

The opinion that there was stable exchange rate between inflation and unemployment, as shown by the drawing no. 2 was criticized by E. Phelps and M. Friedman, who argued in the following way: enterprises of the expansive economy assume that employment will increase by price increase at the assumption that prices will increase faster than nominal payments. The employment increase results from decrease of real payments. Trade unions will not want to agree with decrease of real payment for good. It should be expected that sooner or later they will demand the inflation compensation, by which the increase of employment conditioned by inflation will be lost. Unemployment will again come back to its initial value, whereas the inflation increase will remain at the higher level. A trial to renew increase of employment assumes the reinforced expansion of money quantity, subsequently the repeated compensation of payments will result, etc. The Philip's curve moves up in the course of that development and thus it is unnecessary to increase prices higher and higher in order to induce the employment increase, which however will



remain temporary. After each new cycle, "circulation", the inflation rate increases, however employment is fixed on the old level (Friedman says about "natural number of unemployed"). It should be foreseen sooner or later.

Trade Unions will add an expected amount of price increase to their payment demands. The positive response to employment is possible in that situation only if the really realized inflation rate exceeds also the expected inflation rate. If the government chooses the described method of employment policy in these circumstances, fast acceleration of inflation speed will threaten. If a given national economy reaches such a state once some time — in western industrial countries there is no need, according to all experience, for numerous repetitions — then it will not be possible to increase employment gained in that way even in a short time. Thereby the conflict between the aim of employment and the stabilization of money value is solved.

Practice testifies these considerations. Even in England where Philips's thesis was considered to be a credo of the official economic policy, the then Prime Minister Callaghan said farewell to that policy in his speech at the yearly conference of Labour Party on September 28, 1976 saying: "We once thought that we might come out of recession by cutting taxes and increasing government expenses and setting employment going (increasing it). I declare frankly that such an option does not exist, and that it — if it ever existed — did not result in anything else but clinging inflation to economy. And each time it happened the average quantity of unemployment increased. Higher inflation and in consequence higher unemployment — that is the history of the last twenty years".

#### D. RESULTS OF DIVISION

The influence of inflation on employment and the economic growth assumes unquestionably also the results of division among social groups which are partly diametrically opposed to traditional purposes of division:

— people getting payment lose, they are in unadvantageous position and a businessman gets profit, i.e. they are in unadvantageous position when prices of goods increase faster than payments;

— pensioners and others receiving other services are stricken with inflation to such an extent in which the services received by them are not adapted to the level of increased prices with delay;

— savers lose if interest or their property in money is not adapted or only partly adapted to inflation;

— a country may not get profit by inflation only as a debtor having funds, at the expense of savers, but also in a way of "cold progression",

which consists in the fact that nominal profits increase (unite) in inflation conditions into higher levels of tax progression. At the end inflation acts as a tax for a joint quantity of money, which is transferred to the Treasury by bringing profits from the bank of issue.

#### DEFENSIVE MECHANISMS AGAINST INFLATION

Each economic system develops by principle the stronger defensive mechanisms against inflation the longer it lasts and the higher is money devaluation. They consist in adding allowance in the sum of the expected inflation interest to nominal values agreed in contract. Thus the expected predictable interest of price increase in a validity period of the entered tariff contract falls into e.g. the agreed payment increase beside productivity increase. In a similar way an adequate allowance, resulting from inflation, contains interest for all kinds of credits. In such a way of shaping matters we can see the aim for settling such agreed relations that changes conditioned by inflation eliminated tendentious acting for one or the other partner of the agreement. In national economies having constant high inflation, that defensive mechanism is in fact automatized by all kinds of factors or clauses securing the value; nominal payments, interests, etc. are adapted schematically to each shaping of prices.

That theoretical model descends from the economy in which inflation is fully anticipated, adopted. Even in that fictitious extreme case there remains the inflation tax, which concerns maintaining banks without interest; because costs of adopting, maintaining banks (emergency fund) are higher on account of inflation, the state of banks does not gain all-economic optimum. Moreover, protection against inflation cannot be obtained without any costs, because of constant, permanent re-counting, current adopting of adjustments, etc., which require quite a large outlay from weak sources, which are lost for the productive activity.

Even in the most advantageous theoretical case, inflation entails costs, which do not exist when the money value is stable. However, in reality adopting to inflation is a success only conditionally. The greater the success obtained by single groups, the higher results of inflation for the other social groups, which cannot sufficiently protect themselves, because they cannot understand relationships or they have not the penetrating force. In general, the weakest social groups lose most by inflation, because they do not adopt their profits to price increases quite quickly or do not do it at all. They have little funds (property) and thus there are only very limited possibilities of inflation protection.

We cannot omit considerable costs which will occur if policy overcoming inflation must be entered, which constitutes the unavoidable ending of each inflation. The longer the inflation period, the more adequate expectations have grown in various kinds of contracts. However, if such inflation expectations were agreed in form of allowances for the period of the contract validity and the real price increase is behind the formerly expected price increase (thanks to entering of means of overcoming inflation), then finally the unintended real interest and real payments will increase. Decreased investment activity, insolvency of enterprises and regress in employment are by all rules the result of the disinflation process. In principle the most important are costs, which were caused by formerly existing inflation. Thus it would be more advantageous if we could stop inflation, rather than to be forced to overcome it later at large economic costs.

#### CONSTITUTIONAL ASSUMPTIONS FOR PROTECTION OF STABLE MONEY VALUE

Each inflation entails costs and has admittedly antisocial influence. Therefore one may at first consider surprising the fact that there are lower or larger price increases everyday in the whole world, and the stabilization of money value appears locally and is a temporarily limited exception for a long time. The political economy explains that state: the stabilization of money value constitutes the public good; everybody is interested in it as a principle, but for a particular person it "does not count" so much and he does not want to fight for it (that good) or make a sacrifice. Rather single groups profit from activities which are against the stability of money value, and they profit all the more, the more other society members aim at gaining the purpose of the money stability.

For policy it is each time easier to submit oneself to pressure of interested groups and satisfy their demands by additional expenses, which finally will be financed by forming (printing) money by the bank of issue. It happens particularly in such countries where the government has direct access to currency printing-houses, e.g. in the form of credits issued by the bank of issue. Not in vain all hyperinflations in history have their decisive cause in here. Not less harmful for the stabilization of money value is situation when the management of the bank of issue is submitted to instructions of the government and must execute its monetary policy responding to aims resulting in inflation. Therefore the unquestionable assumption for the functioning economy should be the demand of independence of the bank of issue, which is bound with the obligation of

caring for the stable money value as a superior purpose. Not without motivation in the centre of discussion and promotion there is e.g. the status of future European Bank of Issue, which is to be created by 1998 in Frankfurt on Men. The legal position of German Federal Bank, whose political and monetary decisions are independent of instructions of the government, is considered to be a model.

In order to maintain the stable money value the independence of the bank of issue is not sufficient, naturally. The experience teaches us that independent banks of issue admit to greater probability of lower inflation rates, however they do not bring the stabilization of money value. The above would be guaranteed forever in such a monetary system which would exclude each margin, the least freedom in issuing money!

There are historical models (gold currency) and theoretically biased propositions (index currency, goods-reserve currency, etc.). However, completely independently of in what degree institutional propositions of solutions endure the trial of practice, time, criticism, readiness to carry out such propositions and to protect them constitutionally was nowhere found. In these general limits one cannot wait for the stability of money but such an inflation level, i.e. decrease of money value, which will be consistent with each conception of the political majority. In the project of the country budget, worked out by the government of Prime Minister J. Olszewski a deficit of 65 bln zloties was accepted. The government coalition supported the program, President L. Wałęsa, President of the U.S.A. G. Bush, the International Currency Fund, the World Bank and Z. Brzeziński, whereas the opposition found the support for its critical comments to the economic programme of the government for the year 1992 in a magazine of American financiers.

#### STABILIZATION OF BUYING POWER, PROTECTION OF ZLOTY IN 1992

In "assumptions of monetary policy" worked out by the National Bank of Poland it is anticipated that the supply of money will increase during 1992 in fact by about 6.2% (in 1991 it really decreased by 8.1%), while the increase in credit for the economy and people will in fact amount to 3.6% i.e. 80 bln zloties (in 1991 such a credit increased really by 1.2%).<sup>13</sup>

Monetary projections anticipate among others that:

- foreign net reserves will increase to 666 mln \$;
- zloty deposits will really increase during 1992 by 8.6%, i.e. nominally by 77 bln zloties, in which people's deposits to the amount of

<sup>13</sup> „Rzeczpospolita”, 1992, 73 (3111).

68 bln zloties. It is assumed that the price increase at the period from December 1991 till December 1992 will amount to 3.6%. Last year the real increase in zloty deposits was 8.5%, and nominal amounted to 67.7 bln zloties;

— currency deposits will increase by 480 mln \$ (last year they decreased by 322 mln \$);

— the quantity of cash money in circulation will decrease in real categories by 1%.

The basic aims of monetary policy are continuation of anti-inflation policy, so that at the end of the year the stabilization of buying capacity of zloty is obtained at the home market, and the protection of position of home currency in relation to foreign currency.

The basic interest rate of the central bank will be the rediscount rate agreed in the year relation, so that a positive interest rate of credit is maintained in at least several periods of time.

The increase of refinanced credit will be maintained in particular reasonable cases only in relation to financing of continued central investments and supporting of restructural processes undertaken by the government.

In relation to firms which do not promise regaining of credit capacity banks will be encouraged to withdraw credits. It is foreseen that the credit increase of bank system for net budget (country budget and budget of communities) will be 51.3 bln zloties. The Polish National Bank will buy Treasury bills at the primary market, using them to control availability of banks. The project of budget act authorizes the Minister of Finance to increase liabilities of the Treasury during 1992 because the Polish National Bank bought Treasury bills in the sum of 20 bln zloties, and sold securities having the repurchase period under 1 year and credits in commercial banks in the sum of 50 bln zloties.

The president of the Polish National Bank and the Minister of Finance will undertake the conversion of credit, drawn in the bank in 1982—1991, into Treasury bills and bonds till June 30, 1992.

Criteria of giving licences to new banks being founded will be sharpened. Starting from the second term of 1992 the required level of a bank own capital will be raised to 70 mld zloties, and moreover that level will be corrected during the year.

The obligatory mechanism of the stepping devaluation of zloty is a form of maintaining of competitiveness of home production at the home and foreign markets. It is not excluded that the rate of liquid stabilized foreign money will be entered, which will more fully meet the state of demand and supply.

## ENDING

In all countries the stabilization of money value is proclaimed as an object of the economic policy. Experience, however, shows quite a different picture in the world. High inflation rates dominate more or less. The stabilization of money value is a local and temporarily limited exception. It is defined as the stabilization of the buying power of money; it is given, certain. A representative rate (index) of prices does not change with the passage of time. The stability of price level does not mean, however, the stability of all prices. Changes of relative prices fulfill important functions in free-market economy. If the purpose of stabilization of money value is spoiled, inflation will prevail. Money may fulfil its all-economic important tasks only in incompetent, incomplete way. At hyperinflation the monetary economy slumps completely<sup>16</sup>.

The stabilization of money value should be seen in connection with other purposes of all-economic policy of a country. A chance statement about a positive influence of inflation on the production and employment increase results in partition of the national profit, which is in discrepancy with traditional conception of social justice. Philips's theorem which assumes the stable relation between inflation and employment, may be recognized to be refuted. The protection of money value in inflational external economic surrounding requires extra-economic protection by the elastic rate of exchange.<sup>15</sup>

The society in which inflation prevails for a long time, develops defensive mechanisms against the results of rises in prices, however the weakest social groups have not such opportunities, or have them only on a limited scale. The guaranty of the stabilization of money value may be secured only on the constitutional plane, however as a general rule there is no readiness for realizing of adequate solutions. The independence of the bank of issue from the government is only a kind of a conditional protection against inflation, but surely it is not any security for the stabilization of money value. The stable money value is easier gained and maintained by rich countries, it is more difficult for poor countries. The first ones are creditors, the other debtors of world financial institutions and national banks.

Stabilization and revaluation of value of Polish zloty should be the most important public welfare for Poland and for Poles because it is

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<sup>14</sup> Is inflation dead? *The Economist*, London, February 5, 1994; M. Mone. La Bundesbank deprime les marches europeens. *Le Figaro*. Paris, February 4, 1994.

<sup>15</sup> B. Jenkins: The right manifesto for Europe. *The Times*, London, February 3, 1994. Speech by the Governor of the Bank, Eddie George at the Banker's Club Annual Banquet. The Guildhall. London, January 1, 1994.

a pass to the European Economic Market. The Treaty of Maastricht set up the following criteria on the way to economic and European Monetary Union (1999):<sup>16</sup>

1. Stabilization of Price Level. The rate of price increase (at the very most) of three most stable countries cannot be exceeded more than 1.5% (point).

2. Sound Funds of a State. Budget deficit cannot be excessively high, at the most 3%. Home liabilities of a country cannot exceed 60% of Gross National Product.

3. Stable Rate of Exchange. Participation in the mechanism of exchange rate of European Common Market within the limits of normal zone of tolerance for at least two years without tension and devaluation in relation to the currency of another member state.

4. Economic Convergence. Deviation of long-term interest cannot exceed 2% (points) in relation to the average of three (at the most) most stable countries.

#### STRESZCZENIE

Stabilizację wartości pieniądza definiuje się jako stabilizację siły nabywczej pieniądza. Stabilność poziomu cen nie oznacza stałości wszystkich cen. Jeśli cel stabilizacji pieniądza zostanie naruszony, zapanuje inflacja. Pieniądz może spełnić swoje ogólnogospodarcze ważne zadanie, ale jeszcze w sposób niekompletny. Przy hiperinflacji gospodarka pieniężna załamuje się całkowicie.

Stabilizację wartości pieniądza należy widzieć w powiązaniu z pozostałymi celami ogólnogospodarczej polityki państwa. Okazyjne twierdzenie o pozytywnym oddziaływaniu inflacji na wzrost produkcji i zatrudnienia wywołuje skutki w podziale dochodu narodowego, które stoją w sprzeczności z tradycyjnymi wyobrażeniami o sprawiedliwości społecznej. Teoremat Philippsa, który zakłada stabilny stosunek między inflacją a bezrobociem, można uznać za obalony. Zabezpieczenie wartości pieniądza w inflacyjnym, zewnętrznym otoczeniu gospodarczym wymaga zabezpieczenia poprzez elastyczny kurs wymiany.

Społeczeństwo, w którym dłuższy czas panuje inflacja rozwija mechanizmy obronne przeciwko skutkom podwyżek cen, jednakże nie mają tych możliwości naj-słabsze grupy społeczne. Gwarancja stabilizacji wartości pieniądza może być zabezpieczona tylko na płaszczyźnie konstytucyjnej, jednakże z reguły brak gotowości do zrealizowania odpowiednich rozwiązań. Niezależność banku emisyjnego od rządu jest bardzo pożądana. Dla Polski, dla Polaków stabilizacja i rewaluacja wartości polskiego złotego stanowić powinna najwyższe dobro publiczne. Ono bowiem jest przepustką Polski do europejskiej unii gospodarczej. Traktat z Maastricht ustanowił na drodze do gospodarczej i walutowej unii europejskiej (1999 r.) następujące kryteria: stabilizację poziomu cen, zdrowe finanse państwa, stabilne kursy walut, konwergencję gospodarczą.

<sup>16</sup> E. Meister: Aufsichtsrechtliche Aspekte der Vierten und Fünften KMG-Novelle. Bank Information und Genossenschafts-forum. Bonn 12/1993.