Monetary Equilibrium and Economic Development
by Xenephon Zolotas, Princeton University Press,
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Reviewed by Hyman P. Minsky

In the preface the author, the Governor of the Bank of Greece, promises ". . . to synthesize general economic principles with the practical experience of applying these principles to the "real world" of a developing economy." [p. v]. Of course he does not fulfill this grand promise. What he does is to present a restatement of one of the current wisdoms about economic development, a sketch of Greek economic experience since 1950, and views of the problems and prospects of economic development.

The wise theme is that "In the longer run, . . ., the growth of real income and overall monetary equilibrium, defined to include both the domestic price level and the external sector, are mutually interdependent and both form an integral part of an adequate consistently sustained process of development" [p. 1]. Although monetary equilibrium is nowhere precisely defined, from the argument it can be taken to mean the maintenance of exchange rate stability. Governor Zolotas quite clearly recognizes that some domestic price inflation might be unavoidable and monetary ease, to the extent made possible by the exchanges, is an apparent aid to development.

Even though monetary equilibrium is a central concept in the volume, no serious analysis of how the monetary mechanism affects the development process or how internal and external monetary equilibrium are interrelated is attempted.

If, along with economic growth, exchange rate stability is a major policy objective, then the question naturally arises as to the cost of exchange rate stability. Governor Zolotas, apparently believing in the inherent compactability of his various goals, nowhere specifically addresses himself to this problem. But in a world made up of economies with different full employment growth rates, different income elasticities of demand for the various internationally traded goods and services, and different "Philips Curves" relating domestic price level changes to unemployment, there is no presumption that the set of exchange rates that is "correct" at one time will be "correct" at another. In order to maintain fixed exchange rates some flexibility has to be introduced into the system. All too often, in both developed and underdeveloped economies it is employment that is foregone in order to achieve stability. Foregone employment not only reduces income below attainable income, thus reducing imports, but it also constrains domestic wage and price increases, thus improving the "competitive" position of an economy.

Thus the balance of payments is taken as both the key indicator and the key constraint upon the adequacy of a country's development effort. Some pressure on the balance of payments is desirable to make sure ". . .. that the development effort is not falling short of the potential of the economy" [p. 15], but, on the other hand, "Monetary pressures on the balance of payments are usually a sign that the economy seeks to operate beyond its means" [p. 21]. Thus mounting balance of payment pressures call for constraint even though open or disguised unemployment may exist for ". . . employment maximization does not always coincide with output and income maximization, as it largely does in mature economies" [p. 185].

"Employment maximization" is not what an economist means when he uses the phrase full employment; what he means is the utilization of idle resources to produce useful goods and services. Whenever open or disguised unemployment exists there is a presumption that useful output can be produced, although what outputs can be produced may be constrained by the terms upon which complementary factors are available. Thus, after all suitable labor is utilized in "sophisticated" production functions, the remaining, perhaps unskilled, labor should be used in "naive" production functions. In fact, as Zolotas recognizes when he writes about emigration, work experience transforms labor suitable only to naive into labor suitable for sophisticated production functions. Thus a policy that condones open or disguised unemployment is giving up something and the only possible defense of such a policy is that these are offsetting gains.

The major gain from exchange rate stability is that it does seem to facilitate capital importation, including the repatriation of nationals' balances. In part this is so because the international banking community has a favorable view of fixed exchange. In a world where economic growth and development are the primary policy objectives, the introduction of institutions which substitute in facilitating capital movements for the employment and output sacrificing fixed exchange rate international monetary system is needed. Until such institutional changes occur it is a question of fact rather than a matter of principle whether a particular country gains more from the facilitation of capital importation under fixed exchanges than it loses from the unemployment that may be needed in order to protect the exchangss.

Two additional, quite interrelated, themes of Governor Zolotas are the inadequacy of the human factor and the limited absorptive capacity of an underdeveloped economy. The inadequacy of the human factor as a barrier to full employment or economic development seems to be a favorite theme of central bankers and other economic policy makers, especially those wedded to fixed exchanges. Nowhere in this short book is it recognized that if tomorrow the right kind of labor force existed, the generation of sufficient demand to achieve full employment will, by itself, increase pressure on the balance of payments.

Currently education is the panacea for unemployment and underemployment in both developed and underdeveloped economies. Without denying that investment in humans increases productive capacity, it is necessary to point out that productive capacity without demand does not generate income. In addition for both developed and underdeveloped economies the gestation period for an educated labor force is perhaps longer than the social fabric can tolerate either unemployment or stagnation. Thus in both situations, the correct approach is to take the labor force as it is and tailor make labor demand to conform to the available supplies. However the generation of full employment in this manner will add to the pressures as the exchange rate--especially if the increased output is neither an export nor an import substitute.

In Greece the private sector did not absorb all of the funds made available to it by the financial system. No analysis of the terms at which funds were available is presented. If the terms were not punative, then the existence of such as liquidity trap indicates that the standard devises of expansionary government spending are needed. In a country with a very limited supply of trained and technical personnel the emphasis has to be on those projects that can utilize the existing idle workers. Failure of the private sectors to respond fully to financial ease is a signal, in both a developed and an underdeveloped economy for fiscal expansion.

Incidently, Governor Zolotas recognizes that the shortage of skilled personnel and the limited capacity of the private economy to absorb available financial resources incidates that the public sector will have to initiate many projects that in time will be transformed into private operations. The choice between private and public enterprize in many development situations is a matter of convenience rather than of ideology.

One factor stands out in Greek economic experience since 1950, the rapid growth of invisible receipts--tourism, transport and emigrants remittances--in the balance of payments. [Tables 49 and 50, p. 130]. In common with many other, Governor Zolotas does not seem to feel that specialization in invisibles is a substitute for industrialization. He emphasizes that ". . . a fundamental and even widening deficit in the balance of trade still remains the central problem of commercial policy"[p. 122].

Thus deficit in the balance of trade has been achieved while the balance of payments has been improving, but to Governor Zolotas a country that specializes in invisible is apparently in a weaker position than one that specializes in visible exports.

Of course one item in the invisibles is a sign of weakness: the growth of emigrant remittances which reflects the tight labor markets of the Common Market and the slack labor markets of Greece. However, as Greece is not a continental economy, but really of the size of a region in a country such as the United States, specialization on an invisible export, such as tourism, may be the best way to exploit favorable production possibilities and income elasticities. The inferiority of tourism to industrialization in the minds of policy makers seems to be a result of not distinguishing the effect that the size of an economy has upon its potential for product diversification. Insomuch as Zolotas advocates using Central Bank powers to guide development according to a plan, the prejudice in favor of industrialization and diversification may be an explanation of the limited absorptive capacity he writes of.

Although Governor Zolotas in his title and theme emphasizes the ambigious concept of monetary equilibrium, in much of the work he reports on developments in Greece and gives his insights on the problems faced by a developing country. Wherever his views as to the nature of and benefits from monetary equilibrium do not intrude, this is a useful and valuable book.