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ETELBERTO ORTIZ CRUZ

Pricing in a small open monetary economy: a Post Keynesian model

Abstract: Pricing is conceived within the framework of a monetary economy with fully endogenous money. Agents react to the basic tools of monetary policy, the rate of interest, and the rate of exchange, forming prices and quantities. But the maximization of the profit rate leads to a bifurcated price behavior, which, as it is shown, can be neither neutral nor stable. The implications for monetary policy highlight that the conditions for macroeconomic stability cannot be reduced to zero inflation nor a nil public deficit. Furthermore, such policies may turn contradictory if they do not consider the non-neutrality of monetary policy.

Key words: open monetary economy, pricing.

The issues

Pricing in a monetary economy constitutes an essential issue for macroeconomic modeling. It concerns not only the determination of the price level but also the stability conditions of the economy. In spite of an increasingly growing literature on the problem, no one can claim that the issue has been set. In spite of the importance that monetary relations have in Post Keynesian literature, pricing still constitutes an open issue, and this paper attempts to contribute to its discussion. The point of departure is Eichner’s (1976) view about the formation of prices, considering that firms must recover financial costs in addition to fixed and

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1 An important literature follows Patinkin’s critique (1965) on the incoherence of the IS-LM model. Other important references are in Clower (1965; 1967) and Benetti (1992).

2 A recent published set of lectures by Frederick Lee (2002) seems not to have covered the issue in a comprehensive way.
variable costs. Eichner's model is built in a partial equilibrium framework. A more general approach requires that financial costs are introduced without distorting the conditions for the formation of exchange values or real prices. Therefore, financial cost is introduced as a deduction from profits. This allows us to work first with the solution of real prices and the rate of profit, and second with the impact of monetary policy on the financial cost and prices.

The analyses of pricing, financial cost, and macroeconomic stability have advanced on different roads. Within standard IS-LM models the impact of changes in interest rates affect the real cash balance of individuals, but not the financial costs of enterprises. The introduction of financial cost—even in a limited way, as it is introduced in this paper, such as the interest payments on circulating capital—shows that it opens an important line of criticism to the standard model. The financial side in the orthodox model is considered in a rather peculiar form; it is always assumed in equilibrium, whatever happens within the "real" and "monetary" sectors. Therefore, financial cost is analyzed as a problem in partial equilibrium, with no incidence on the equilibrium price vector of the system.

This paper takes a general approach on competition from a Classical view. Competition means that capital can move to whichever economic activity is open to investment for profits. Agents would always be in a permanent striving for differentiation in their rates of profit, through their advance of investment. A model like this has been the subject of an important debate initiated by Nikaido (1983), followed by a number of important contributions. The initial proposition by Nikaido was that the model could have a general solution only within a very restricting condition, given by the structure of production. Other papers have discussed the limits to that proposition and open different ways to deal with the issue, as in Flaschel and Semmler (1987; 1988), Duménil and Lévy (1987), Benetti (1986), and Ortiz (1997). The difficulty with all of this literature is that it puts the problem in a nonmonetary framework. Benetti (1998) shows another form to deal with the construction of a pricing model in a monetary economy, and within a Classical-Marxian approach, a model in the spirits of the circuit theory.

The model here advanced follows the general idea of a Classical competitive framework, in a credit—investment circuit, which fits within the Post Keynesian approach, as in Rochon (1999). Classical competition can produce the image of a competitive process without resorting to the notion of "perfect competition." Moreover, it introduces a monetary environment according to the conditions for a small open economy. There,
monetary policy is expressed through the determination of the rate of exchange \( E \) and the rate of interest \( i \), by the monetary authority.

The paper aims to show the importance of financial costs for pricing, in a monetary economy, with the purpose to analyze the limits of monetary policy and stabilization policies in a small open economy.

**The monetary policy framework**

Overall, the approach is based on the non-neutrality of money, which will not be discussed here,\(^3\) because our purpose is to advance on the analysis of monetary policy given the non-neutrality of money. This condition is shown to be far more important in an open economy, where monetary policy has an incidence on the formation of prices.

We observe that monetary policy is defined by the monetary authority as a pair \([E, i]\), and not by a monetary quantum \( M \). The argument is that the amount of means of payment and money, \( M \), becomes completely endogenous, according to a pair \([E, i]\) determined by the monetary authority and the banking system.\(^4\) In a closed economy, the link between real and monetary magnitudes is built through credit. In an open economy, it is built through the determination of the amount of credit that can be accommodated, and, given a pair \([E', i']\), it is targeted by the monetary authority. The degree of flexibility of the rate of exchange is defined by the readiness and capability of the monetary authority to intervene for a target \([E', i']\).

In the pricing model discussed in the second section, we advance a model for real and money prices and the exchange value of money, and thus for price level, determined by \([E, i]\). Therefore, it becomes a model for monetary prices, since both variables express: either the exchange value in terms of purchasing power, given \( E \); or the future exchange value or dated purchasing power, given the interest rate, \( i \). This approximation allows us to work out the impacts of monetary policy without resorting to the quantity theory of money. This is so because, once domestic prices are linked to external prices, all domestic real and monetary prices are established for a determined \([E, i]\).

**Pricing in a monetary open model**

The model of production sets a framework of interdependence through technological and productive linkages, but in an open economy, it also

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\(^3\) This is an important issue on which we take the discussion as in Davidson (1994) or Snowdon et al. (1996).

\(^4\) See Blinder (1998) and Davidson (1994).
has to specify the production of commodities for exports in order to pay for its imported inputs.

The production model is:

\[ X_1 P_1 = [X_{11} P_1 + X_{21} P_1 + X_{31} P_1] + D_1 P_1 \]
\[ X_2 P_2 = [X_{12} P_2 + X_{22} P_2 + X_{32} P_2] + D_2 P_2 \]
\[ X_3 P_3 = [X_{13} P_3 + X_{23} P_3 + X_{33} P_3] + D_3 P_3, \]

where \( X_{ij} \) denotes inputs in the production of \( X_j \), and \( P_i \) is prices of commodities. \( D_1 P_1 \) represents net demand for wage goods and \( D_2 P_2 \) represents net demand for capital goods produced in the economy. Sector 3 corresponds to the sector of "tradables," that is, goods that can be imported and exported, although they are not quite the same thing nor perfect substitutes. Therefore \( D_3 P_3 \) represents exports. The trade balance restriction works as the fourth quantity equation and is:

\[ D_3 P_3 = [X_{1m} P^m E + X_{2m} P^m E + X_{3m} P^m E], \]

where \( E \) is the nominal exchange rate, and assuming no imports of final demand commodities. Only one import commodity is considered at the external price \( P^m \), which in domestic currency is: \( P^m S = P^m E \).

The economy also uses labor and a financial cost for the use of financial resources external to the firm. Financial costs are only on circulating capital, because the introduction of fixed capital would demand a joint production model that would unnecessarily make the problem considerably more complicated.

Consequently, the pricing model is expressed as

\[ P_1 = [a_{11} P_1 + a_{12} P_2 + a_{13} P_3 + a_{1m} P^m E + l_1 w] (1 + r_1) + k_1 (i) \]
\[ P_2 = [a_{21} P_1 + a_{22} P_2 + a_{23} P_3 + a_{2m} P^m E + l_2 w] (1 + r_2) + k_2 (i) \]
\[ P_3 = [a_{31} P_1 + a_{32} P_2 + a_{33} P_3 + a_{3m} P^m E + l_3 w] (1 + r_3) + k_3 (i). \]

The total value of production is: \( Y_0 = X_1 P_1 + X_2 P_2 + [X_3 P_3 E - \Sigma_i X_i P^m E] \). The lowercase letters \( a \) denote the coefficients of the respective input products, \( w \) is the wage rate, \( l \) are the labor coefficients, and \( r \) is the profits rate. Net income is the sum of total wages plus total profits minus imported inputs: \( \Sigma_i l_i w + \Sigma_i \pi_i - \Sigma_i X_i P^m E \). The price of exports in domestic currency is \( P_3 = P_3^x E \). If we take the import price \( P^m \) as the numéraire, real prices can be expressed based on it. Given the trade balance restriction \([D_3 P_3 - \Sigma_i X_i P^m E] \), since \( P^m \) and \( P_3^x \) are given and \( E \) is determined by the monetary authority, therefore the price level is automatically determined as an index. composed by production coefficients, and the rates of exchange and interest.
Thus, the $E$ equation, $E = P^m/P_m$, is considered as a fourth equation of the price model. This notion stresses the usual view in small open economies that domestic prices are strongly related to import prices and the rate of exchange.

Pricing considers one part associated with real costs, and a second part associated with financial costs. Therefore price equations determine the homogeneous part for real prices and the rate of profit, given the wage rate and the exchange rate. The second considers the rate of interest on external funds used by firms. Financial cost appears as a deduction from profits, because it is considered that it does not add up value to the commodities.

Financial costs behavior might be represented by the following expression: $k_i(i) = \varphi_i (F/K^*, i)$, where $F/K^*$ expresses the share financed through external funds to the firm.

The financial constraint has an important consequence for the operation of the model, as it can be observed in the condition that $dr_i/di$ is negative and that $\partial k_i/\partial i$ is positive.

Keeping in mind that

$$\frac{dr_i}{dk} = -\frac{c_{ii}k'_i}{c_{ii}a_{im}P^mE} < 0; \text{ given that } \frac{\partial k_i}{\partial i} > 0.$$  

Therefore, financial cost has an impact on profit rates and the demand for external funds, as is described by Figure 1.

The shape of $k_i(i)$ reflects that $(dk/dr_i) < 0$, and therefore is upper-bounded. It shows that up to a rate of interest like $i'$, firms will be able to cover the financial costs with their profits. The condition for realization of investment is to have rates of interest well below that rate; otherwise it would be impossible for firms to fulfill their commitments with banks.

The solution to the price system can be observed in two components, one with the homogeneous part of the problem; the second, giving way to one of many particular solutions. The first provides the solution for the structure of prices, exchange values, and the rate of profit. The particular solution analyzed here addresses the alternative possibilities of the monetary policy solution. Given the purpose of this paper, we will assume for the moment the existence and stability of a dynamic process.

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5 In Eichner (1976; 1984), financial costs appear as interest charges on fixed costs that affect prices because they are subject to the same markup as any other input.
of formation of real prices, converging to production prices, which will act as "centers of gravity" for the price system.\(^6\)

Generally, the price equations have the following form:

\[
\begin{bmatrix}
P_1 \\
P_2 \\
P_3
\end{bmatrix} = \begin{bmatrix} a_{ij} \end{bmatrix} \begin{bmatrix} P_1 \\
P_2 \\
P_3
\end{bmatrix} (1 + r) + \left\{ [a_{im}] P^m E + l_iw \right\} (1 + r) + k_i(i),
\]

for which the general solution will be of the form:

\[
\begin{bmatrix}
P_1 \\
P_2 \\
P_3
\end{bmatrix} = \left[ I - A (1 + r) \right]^{-1} \left\{ [a_{im}] P^m E + l_iw \right\} (1 + r) + \left[ I - A (1 + r) \right]^{-1} k_i(i).
\]

$P_i$ is a function of the productive structure, of $w$ the wage rate, $E$ is the exchange rate, and $i$ is the interest rate. Accordingly, the effect of these variables on the price level is a complex relationship given by the Leontief matrix: $[I - A(1 + r)]^{-1}$.

We can observe that if workers’ consumption is equal to their total salary, $W = wI$, the consumption of workers is reduced to the production of sector 2, given a rate of distribution $w$. Then, the previous expression can be simplified as

$$
\begin{bmatrix}
P_1 \\
P_2 \\
P_3
\end{bmatrix} = \left[ I - B(1 + r) \right]^{-1} \left\{ [a_{im}] P^m E \right\} (1 + r) + \left[ I - B(1 + r) \right]^{-1} k_i (i),
$$

where the $B$ matrix is the extended matrix of circulating productive inputs and workers’ consumption:

$$
[B] = \begin{bmatrix}
b_{11} & b_{12} & b_{13} \\
b_{21} & b_{22} & b_{23} \\
b_{31} & b_{32} & b_{33}
\end{bmatrix}.
$$

Accordingly, the total amount of wages can be introduced as an equation that allows for the normalization of the system, where $w$ will be the proportion in which salaries participate in the product and $P_1$ will be the price of wage goods, or $W = \sum_i I_i w = D_1 P_1$. The general form is given by the Leontieff matrix, that is, $[c_{ij}] = [I - B(1 + r)]^{-1}$.

Evidently, this system presents more unknowns, seven, than equations, four. Therefore, any solution rests on considering that the wage rate and $[E, i]$ are exogenously determined to the price system by monetary policy. Consequently, the latter will determine the price level, and the rate of real profits, at a given wage rate.

We can present the $[E, i]$ relationship more clearly as

$$
k_i (i) = \left[ I - B(1 + r_i) \right] \begin{bmatrix}
P_1 \\
P_2 \\
P_3
\end{bmatrix} - \left\{ [a_{im}] P^m E \right\} (1 + r)
$$

$$
= \left[ I - B(1 + r_i) \right] \frac{P_i}{P^m} - [a_{im}] E (1 + r_i).
$$
The relationship between \([E, i]\) and prices cannot be lineal, except in a case in which all sectors were to present the same structure of coefficients.\(^7\)

The price equations consider that for each pair \([E, i]\), the rate of profit necessarily changes, because the structure of costs change; therefore, the structure of prices and rates of profit change. We assume that terms of trade remain constant in the short run, in order to identify the trajectories of price equations.

Total derivatives on these last equations provide the basic insight about the impact of a devaluation in the structure of prices and the accompanying change in the rate of interest.

From the price equations we can derive for sector 1:

\[
dP_1 = c_{11}a_{1m}P^m(1 + r_1)dE + c_{11}a_{1m}P^mEdr_1 + c_{11}\left(\frac{\partial k_1}{\partial i}\right)di.
\]

Rearranging terms, for the three sectors:

\[
dP_1 = c_{11}a_{1m}P^m dE \left(1 + r_1\right) + c_{11}a_{1m}P^m Edr_1 + c_{11}\left(\frac{\partial k_1}{\partial i}\right)\left(di\right)
\]

\[
dP_2 = c_{22}a_{2m}P^m dE \left(1 + r_2\right) + c_{22}a_{2m}P^m Edr_2 + c_{22}\left(\frac{\partial k_2}{\partial i}\right)\left(di\right)
\]

\[
dP_3 = c_{33}a_{3m}P^m dE \left(1 + r_3\right) + c_{33}a_{3m}P^m Edr_3 + c_{33}\left(\frac{\partial k_3}{\partial i}\right)\left(di\right).
\]

Extending the equation, for example, for sector 1:

\[
dP_1 = \left[c_{11}\right]a_{1m}P^m dE \left(1 + r_1\right) + \left[c_{11}\right]a_{1m}P^m Edr_1 + \left[c_{11}\right]\left(\frac{\partial k_1}{\partial i}\right)di.
\]

Putting together terms and clearing for \(di\), we have:

\(^7\)The general case for a lineal relationship between \([E, i]\) corresponds to the IS-LM model, as in the standard Mundell-Fleming model (Pentecost, 1993). A more general criticism would be addressed to models that rest on the assumption that an open economy is isomorphic to a closed economy.
The relationship between \( E, i \) and prices cannot be linear, except in a case in which all sectors were to present the same structure of coefficients.\(^7\) The price equations consider that for each pair \( E, i \), the rate of profit necessarily changes, because the structure of costs change; therefore, the structure of prices and rates of profit change. We assume that terms of trade remain constant in the short run, in order to identify the trajectories of price equations.

Total derivatives on these last equations provide the basic insight about the impact of a devaluation in the structure of prices and the accompanying change in the rate of interest.

Prom the price equations we can derive for sector 1:

\[
di = \frac{dP_1}{\left( \frac{\partial k_1}{\partial i} \right) c_{11}} - \frac{a_{1m} P^m}{\left( \frac{\partial k_1}{\partial i} \right) c_{11}} \left( (1 + r_1) dE + Edr_1 \right), \text{ for sector 1,}
\]

\[
di = \frac{dP_2}{\left( \frac{\partial k_2}{\partial i} \right) c_{22}} - \frac{a_{2m} P^m}{\left( \frac{\partial k_2}{\partial i} \right) c_{22}} \left( (1 + r_2) dE + Edr_2 \right), \text{ for sector 2,}
\]

\[
di = \frac{dP_3}{\left( \frac{\partial k_3}{\partial i} \right) c_{33}} - \frac{a_{3m} P^m}{\left( \frac{\partial k_3}{\partial i} \right) c_{33}} \left( (1 + r_3) dE + Edr_3 \right), \text{ for sector 3,}
\]

Consequently, a devaluation \( dE > 0 \), will impact the rate of interest and the rate of profit. Real and monetary prices will show the adjustment capabilities given the sign of \( \left( \frac{\partial k_i}{\partial i} \right) \). Nevertheless, we have different trajectories for each price line, because prices react to different financial elasticity coefficients, and the impact on the first sector might be higher or smaller than on the second, or even following a different path. Consequently, for each sector, we might have different conditions on \( Edr_i > dE \) or \( Edr_i < dE \). But \( Edr_i < dE \) would be a necessary condition to make effective the devaluation. Although this result partly depends on \( dP_i \) not overreacting (overshooting) to the initial impact.

A devaluation would be effective to close the balance of trade deficit only if \( dP_i < dE \). Therefore, a successful adjustment demands either that \( \left( \frac{\partial k_i}{\partial i} \right) \) to be negative or \( dr < dP \). This last condition can be met if \( dr < di \), namely inducing a deterioration in profitability through the introduction of a recessive condition.

Therefore, the relationship between \( di \) and \( dE \) will generally be negative. Nevertheless, the trajectories of \( dE \) into \( di \) will generally be of different sign, because they are not excluded in, from the possibility that they might have the same direction of movement within particular tracts. This is due to the different trajectories of \( dr/di \) and \( \partial k_i/\partial i \). Therefore, the mapping of the above equations may look as is shown in Figure 2.

Price lines show that changes in nominal and relative prices will thus be the most visible impact on monetary policy. The impact on the determination of capital value and the rate of profit will be of the utmost importance. The shape of the price curves can have any form, not necessarily those traced here, and may give rise to all sorts of disequilibria.
Thus, the neutrality of monetary policy is only conceivable in a world in which not only production structures, or production functions, are totally homogenous, but also require homogeneity of inputs used, means of production and labor, as well as imported inputs. But even that would not be enough. It would also be required that firms should have the same $k_i$ that is the same financial behavior in the face of a determinate monetary policy. Neutrality of money is meaningless unless agents were to have the same pattern of reaction to whatever the pair $[E, i]$ comes from, the monetary authority, or from the market.

Consequences for the efficacy of monetary policy

Standard monetary policy prescriptions are generally expressed on:

1. purpose: to sustain "sound macroeconomic conditions," and
2. targets that become the fundamental policy instruments for that purpose: zero public deficit and zero inflation.

These are expressed as if they were necessary and sufficient conditions to attain macroeconomic stability. Our analysis on pricing in fact shows that they are, by large, insufficient conditions for stability. The reason is very simple; the standard macroeconomic model, as in any IS-LM,\(^8\) rests on a particular presumption about the form of the price lines: There is

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\(^8\) See Pentecost (1993). In a New Classical model, we have Barro (1990) or Sachs-Larrain (1994).
but one single price line for the whole economy and it is a straight line in the \([E, i]\) space. Therefore, the presumption is that monetary policy impacts work just the same way for every sector in the economy. More than that, the presumption is that the same pattern of adjustment for every sector would adhere to a particular change in policy. Our result shows that the call for standard "micro-foundations" as the basis for macroeconomic models, built on one single-sector economy and a sort of one "representative agent," becomes meaningless. It just rests on assuming away the essential issue, the reaction paths of different agents through a competitive framework.

But our result also shows that there is another possible approach to the path of adjustment. Confronted with a real shock, if competition brings again the uniformity of profit rates, the adjustment would fall entirely on the wage rate and the level of employment. This condition is of the utmost importance, as has been shown by Thirlwall (1997). Insofar as the adjustment hits the level of activity, the incidence on the wage rate is unavoidable. Then the real question for the efficacy of monetary policy is not fixed versus flexible exchange rates, but the degree of flexibility of the wage rate.

Economies going through processes of structural change, which is the case of most small open economies, continually adapting to external shocks, would necessarily show nonlinear price lines, different and changing at all times. Assuming a fully flexible competitive model, this would necessarily bring important real effects on the different levels of activity of each sector.

But the actual incidence of monetary policy comes through credit rationing. Monetary authority targeting inflation with a given \([E, i]\) very soon found itself trapped with an overvalued rate of exchange and the need for increasing amounts of external savings. The increase of the rate of interest, even if it is congenial to meet this need, can eventually turn to produce an excess of external funds over the needs of the current account deficit and the service of external debts. The usual approach will be to sterilize the flows of external capital. Congruence demands then that the amount of credit authorized to banks has to be squeezed.

Consequently, small open economies face one single rate of exchange, but, in fact, at least two sets of rates of interest: one given by the domestic financial market, and a second by the international market. Even in the case of emerging markets, we have to face that the financial market operates in oligopolistic conditions, because they can discriminate among their clients. Non-straight price lines might well be the best explanation for bifurcation in the financial market. This behavior has been associated
with financial fragility. Therefore, one particular policy, expressed in a pair \([E, i]\), might be pushing for the bifurcation of price lines.

Now, it is possible to show that the standard notion of “sound macro-economic” conditions for stability are incoherent. If there was an equilibrium pair \([E, i]\), evidently nil inflation and null excess demand are additional conditions to preserve equilibrium. But the argument is not reversible. An inflation rate equaling zero and a fiscal budget in equilibrium do not allow us to conclude that price lines should be at rest with some particular pair of \([E, i]\). Price stability can be conceived from a particular pair \([E, i]\) compatible with macroeconomic stability, but the proposition is not reversible. Zero public deficit and close to zero inflation cannot allow the conclusion that agents are in equilibrium, namely, on a single cross-point that would be stable for every sector.

If monetary policy privileges the reduction of inflation, it is likely to go with fixing the rate of exchange and increasing the real rate of interest. It is true that the reduction of inflation could bring nominal rates of interest down only insofar that the reduction of inflation is consistent in the long run. The difficulty is that in the meantime, the nominal rate of interest might be going up depressing the rate of profit, a policy that would endure to re-create recessive conditions. If some sectors in the economy are able to obtain financial resources at lower rates (for example, large corporations in the world financial market), they might profit by considerably better conditions and thus retain their profits and growth than does the rest of the enterprises. Therefore, their reaction paths to monetary policy should be different, opening the bifurcation of price paths.

Observing the general form of the price lines equations for any particular sector:

\[
dP_i = c_{ij}a_{im}P^m dE \left(1 + r_i \right) + \frac{Edr_i}{dE} + c_{ij} \left( \frac{\partial k_i}{\partial i} \right)(di),
\]

we have a general structure that expresses that changes in prices depend on: \([E, r, i]\) therefore on \([E, w, i] and the productivity of labor\), given a particular productive structure. This explains that for a small open economy the incidence of monetary policy on the first three terms is overwhelming, but never neutral.

All this has a significant consequence on the effectiveness of anti-inflationary policies that rest on fixing \(E\). Given an inflationary expectation, by “pegging” the rate of exchange, for example as in \(P^e = E(E^e, s)\), there is no way that at any particular exchange rate \(E\) we should expect to have a uniform reduction in prices. More than that, it is not evident that
with a particular \([E, i]\) all sectors could be in equilibrium. Accordingly, for any \(E\) we will find greater efforts for adjustment, expressed in a higher variance (\(\sigma\)) on relative prices, therefore a higher variation coefficient in relative prices. Our interpretation is that enterprises perceive different inflationary pressures, and therefore are compelled to look for a real adjustment. In an economy that has begun a process of profound structural change, the persistence of a high variation coefficient in real prices can be understood as a new variety of repressed inflation.\(^9\)

From another point of view, the condition for a devaluation to be effective, namely, \(Edr_i < dE\), might produce another result. If agents try to resist the drop in profitability after a devaluation, for some sectors the condition may be fulfilled, whereas for others may not. Inflation then could be a response of agents trying to adjust to the new price environment unsuccessfully. Therefore, the long inflationary drives that follow a devaluation, in fact can be understood as a part of the adjustment in profitability conditions for every sector. Which is the actual variable that brings some relief? Actually, it is the wage rate. A monetary policy aiming to control inflation, reducing \(M_p\) or increasing the rate of interest, may well produce conditions that disturb the possibilities of adjustment for some sectors that can have an important indirect impact all over the economy. This may well provide an additional explanation for the “inertial “ component of inflation.

The second difficulty is to observe the incidence of high rates of interest on inflationary inertia. This is particularly important for those sectors that depend more on the domestic financial market. Interest rates may also express inflationary expectations, just as much as rates of exchange. If the central bank tries to operate just on \(E\), overseeing \(i\), it may well lead to self-defeat for standard anti-inflationary policies.

We conclude that policies aimed to make feasible structural change may well be at the core of the possibilities of monetary policy to perform reasonably well. The neutrality of money then would be nothing but a veil on the eyes of monetary authorities.

\(^9\) It is not surprising that, in the Mexican experience, at least since 1990, a reduction in the inflation rate did not reduce the variation coefficient in relative prices.

\(^{10}\) The use of a notion of “repressed inflation” in this context should not be confused with a similar term frequent in orthodox literature. By repressed inflation here we mean a situation in which firms are subjected to differing cost impacts, due to exchange rates and interest rates impacts, but their capabilities to adjust differ. Consequently, they show different rates of profitability and investment. The attempts to adjust via nominal price adjustments might induce a considerable pressure for the level of prices to rise (Nasica, 2000).
REFERENCES


