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## STATE INTERVENTION AND MACROECONOMIC MANAGEMENT

### DRŽAVNI INTERVENCIONIZAM I MAKROEKONOMSKI MENADŽMENT

**Summary:** *The monetarists are opponents of government intervention and supporters of free market processes. Keynesians are, conversely, supporters and advocates of government intervention and opponents of uncontrolled operation of the market mechanism. As opponents of government intervention, the monetarists do not agree that it should take countercyclical fiscal policy which can cause greater increase in expenditures of the public sector during the recession, but spending cuts in the period of expansion and that, consequently, the public expenditures continue to increase. However, Tobin, indicating a negative attitude, claims that inflation cannot be used as a reason to reduce the budget, if fiscal policy has little or no effect on income. Undesirability of countercyclical fiscal policy is a logical consequence of the monetarist views on the stability of the sector and better performance of the free market of government intervention in social reproduction.*

*Rule on a constant rate of monetary expansion eliminates the need for conducting discretionary policy, as the Phillips curve, previously defined, does not allow an optimal combination of inflation and unemployment. Therefore, the use of money (and interest rates and bank loans), as the goal of monetary policy provides economic policy makers to focus on managing variability (i.e. concentrate to money supply), which is beyond the scope of operation of the market, on the one hand, and to let determining the interest rates of bank loans and the free market, on the other hand. Finally, monetarists are extremely concerned about the multiple connections between inflation and expansion of the public sector, for three reasons: first, inflation increases the share of the public sector (and exacts an increase in public expenditure), if a progressive tax system is functioning; second, combating inflation can only indirectly limit the expenditure of the public sector, as the government expenditures partly increase by inflationary financing; and third, financing the budget deficit with the primary issues typically involves inflationary effect, which, if it continues, initiates the process prices and wages control. The paper is based on theoretical analysis of the impact of state intervention in the sphere of stimulating economic recovery, growth and development.*

**Key words:** *state intervention, economic efficiency, macroeconomic policy, interest rate*

**JEL classification:** *E44, E6*

**Rezime:** *Monetaristi su protivnici intervencije vlade i pristalice slobodnog tržišnog procesa. kejnzijanci su, nasuprot tome, pristalice i zagovornici državne intervencije i protivnici nekontrolisanog rada tržišnog mehanizma. Kao protivnici vladine intervencije, monetaristi se ne slažu da bi trebalo voditi kontracikličnu fiskalnu politiku koja može izazvati veći porast troškova u javnom sektoru tokom recesije, nego smanjenje potrošnje u periodu ekspanzije. Međutim, Tobin ima negativan stav, tvrdi da inflacija ne može da se koristi kao razlog da se smanji budžet, ako fiskalna politika ima mali ili nikakav uticaj na dohodak. Nepoželjnost kontraciklične fiskalne politike je logična posledica monetarističke pogleda na stabilnost sektora i bolje performanse na slobodnom tržištu od državne intervencije. Pravilo o konstantnoj stopi monetarne ekspanzije eliminiše potrebu za vođenjem diskrecione politike, jer prethodno definisana Filipsova kriva ne dozvoljava optimalnu kombinaciju inflacije i nezaposlenosti. Zbog toga, korišćenje novca (novčane mase), a ne kamatnih stopa i bankarskih kredita kao cilj monetarne politike obezbeđuje kreatorima ekonomske politike da se usredsrede na upravljanje varijablom (tj. posvete se novčanoj masi) koja je izvan opsega tržišta, s jedne strane, i da se prepusti određivanje kamatne stope i bankarskih kredita slobodnom tržištu, s druge strane. Konačno, monetaristi su izuzetno zabrinuti zbog višestrukih veza između inflacije i proširenja javnog sektora, iz tri razloga: prvo, inflacija povećava učešće javnog sektora ukoliko funkcioniše progresivan poreski sistem, drugo, suzbijanje inflacije može samo posredno da ograniči rashode javnog sektora, budući da se državni rashodi delimično povećavaju inflacionim finansiranjem, i treće, finansiranje budžetskog deficita primarnom emisijom, po pravilu, involvira inflaciono dejstvo koje, ako duže traje, pokreće proces kontrole cena i nadnica. Rad je utemeljen na teorijskoj analizi uticaja državnog intervencionizma u sferi podsticanja privrednog oporavka, rasta i razvoja.*

**Ključne riječi:** *državni intervencionizam, ekonomska efikasnost, makroekonomska politika, kamatna stopa.*

**JEL klasifikacija:** *E44, E6*

## 1. INTRODUCTION

If under pure fiscalism we mean learning, then (1) economic effects of fiscal measures are independent of the method of financing, and (2) changes in the amounts of money are without affecting the level and dynamics of economic activity (provided that fiscal measures do not imply the injecting new money in the economy, or any withdrawal of money from the business sector). On the other hand, if pure monetarism is called teaching, according to which "only money is important," then (1) economic effects of changes of amounts of cash are significantly independent of the increasing inputs manner (or withdrawals) in the economy (2) effects of measures of fiscal policy on the economy are negligible, if we take their monetary consequences (*Bronfenbrenner*) (Blinder 1980, 585-614). If an expansionary fiscal measure (expansion) is followed by monetary expansion to maintain higher interest rates and prevent weakening of the multiplier, is - asks Bronfenbrenner - consequently, an increase in income the result of displacement of curve IS and shifting of curve LM, i.e. fiscal and monetary expansion. The answer depends on the elasticity of the given functions to the interest rate. Inelastic IS and/or infinitely elastic LM gives fiscal answers, and infinitely elastic IS and/or inelastic LM gives monetarist responses. But, by keeping the rise in nominal interest rates, monetary policy needs to confirm the value of expansionary fiscal policy. The definition of the budget, the nature of expenditure policy, the responsiveness of tax revenues and the assumption of mutual substitutability of different types of assets affect the formulation of various theses (Brunner): The monetarists, according to Kagan, claim that putting fiscal policy as an instrument of economic policy to mitigate economic fluctuations, represent a mistake, but do not claim that fiscal policy has no effect. Friedman once pointed out the importance of automated effects of budgetary policy on short-term stabilization, since certain fiscal measures (eg. Expenditures) can effectively be used in certain phases of the economic cycle, especially if we take into account the lag effects of monetary policy. Advocating of Friedman for the so-called non-discretionary fiscal policy is something quite different, which may not mean totally denying the potential of active discretionary fiscal policy. Monetarists, therefore, advocate for reordering of priorities of application of monetary policy in relation to fiscal policy. On the other hand, the monetarists are skeptical about the results of the applied fiscal policy, which fiscalists often glorify. Changes in the level of public expenditure, which, as a rule, late due to administrative lime lags, and changes in tax rates, to which the fiscal stabilization is over-concentrated, in practice, uncertainly reverberate on expenditures and consumption. On the other hand, changes in tax rates (which the government often increases or decreases) cannot always be controlled due to their effects on income distribution.

## 2. MONETARY AND FISCAL POLICY: ECONOMIC ANALYSIS

It is not either possible to control the budget deficit due to the inability of solid linking of changes in public expenditures and fiscal revenues, changes in fiscal and economic trends and changes in non inflationary financing of fiscal measures. As a result, the monetarists believe that discretionary fiscal changes are not needed as an instrument of economic stabilization in the course of many years of application of stable monetary growth. Does a stable money supply affect the stabilization of the economy, is the question essential to the monetarists, who are always ready to claim that stabilization policy should be avoided, even when balanced scaling up the money supply does not contribute to the creation of stable conditions in the economy (Modigliani 1975, 234). This claim stems from the fact that the unpredictably changeable effects of deferred variable and unpredictably followed disturbances hinder the formulation of appropriate policies of stabilization. As a result, stabilization policies in practice act destabilizing. Many monetarists, said Melzer, consider that in practice an expansive fiscal policy displaces real capital, reduces the long-term value of output per worker, encourages the development of the public sector and restricts economic freedom. Melzer's study of countercyclical policies reflects the differences in the empirical estimate of long-term as well as short-term Keynesian effects. However, the monetarists and Keynesians differently explicate unemployment, give a different meaning to unemployment and differently estimate the role of government policies in their removal, differently explain fluctuations in employment and the functioning of the labor market, and have different views on economic policy and stabilization. Modern monetarism, considers Melzer, does not basically negate short-term real effects of fiscal policy on relative prices and real demand, but question

the durability and reliability of the fiscal effects and long-term cost of achieving short-term increase in production through fiscal expansion (Blinder 1976, 501-510). Certain models show that the real effects of fiscal policy exhaust after a relatively short period. Conference about monetarism at Brown University (materials and comments of which are systematized in his book "Monetarism") did not dispute the importance of money although the fiscalists pointed out that the main econometric models show a significant effect of changes of public expenditures and fiscal rates (Ristić et al. 2014). However, with constant money supply, the fiscal effects on the theoretical level depend on the elasticity of demand about the changes in interest rates (after the effect of deficits on interest rates is needed to support the growth of expenditures) and respecting the future tax rates considering interest on bonds (considering that the indebtedness of the public sector can be compensated by increasing of savings of tax payers). But despite that, all this makes the size of the long-term effects of fiscal policy independent, because different fiscal effects in terms of assets are completely uncertain. The initial impact of changes in public expenditures occurs before compensation (related to the funding date fiscal measures) in spending. Therefore, the effect in the short term seems much larger.

But short-term effect of the tax cuts due to its temporary nature is uncertain due to the effect of public expenditure multiplier in the short term, the rate of compensation and time lag. Monetarist policies, which do not depend on the effects of the asset, are appealing to the opposite image of the schedule of activities, which cumulate in a long-term effect (despite short lag). In the long term, changes in the money supply cause a tendency of producing proportional changes in total expenditures without major compensations of the monetary effects on demand.

Changes in money demand due to changes in interest rates represent only short-term compensation. Monetarists do not deny possible endogenous character of money, though they claim that properly controlled money can control aggregate demand. And by the conclusions of Friedman-Schwartz tandem, money can still be a potential source of disturbance in the economy of the US, if not properly controlled. Brunner-Meltzer analysis ascribes different roles to fiscal policy in the short and long term. It does not deny the impact of fiscal policy on production and price levels, but indicates to the different and varying effect of fiscal measures in the observation period. In the short term, an increase in expenditures of the public sector increases the production of the sector inversely related to price response to changes in production, which depends on the changes of forecasting caused by fiscal expansionism. If the predictions of prices and wages are lined with fiscal policy, then the price level neutralizes the increasing in demand of products and labor from the public sector, without provoking changes in levels of production of the economic sector. But the increase in demand of the public sector induces the so-called crowding out of private demand (economic) sector and reduces the absorption of the production sector. Brunner-Meltzer analysis is, therefore, contrary to the ISLM system in which the position of the LM curve is a sufficient condition for short-term displacement of demand. The analysis highlights the importance of the slope of the demand of goods in response to prediction of nominal wages and prices in fiscal measures, rather than the significance of the LM curve slope which nominates moving directions of money demand. The effect of fiscal policy on production in the short term implies the relatively low elasticity of price formation in relation to production (i.e. the flat curve of production offer). Negative displacement of economic sector demand and the multiplier effect appears only in the case of flat curves of demand and retroactive effect through the financial markets, while the positive displacement of demand in given sector occurs only in the case of disturbed conditions. In the medium-term observations, retroactive effect through budgetary relations implicates consequences with measures of fiscal policy, where the short-term effect of fiscal measures supplements with the effect of increase of financial resources (Brunner and Meltzer 1976, 150-182). Total fiscal effect, therefore, is equal to short-term effect of fiscal measures and financial effect. Factors of short-term effects of fiscal measures on the level of production and the price level, determine the degree of medium-term reaction of fiscal policy. In the medium term, it comes to a balance of financial funds with the state of fiscal policy. But going to the longer term, imbalance of extrusion of business sector demand increases depending on whether the current level of production is below or above the level of normal production.

In case of deviation of production below or above normal production, fiscal expansion accelerates process of convergence of points of normal production, or causes only a temporary increase in production volume, because, fiscal measures work only in the short and medium volume of production of the private sector. However, modern fiscal analysis shows that the problem does not arise only in the short squeezing out of private sector demand. Specifically, Brunner and Meltzer analytically showed that for each combination of fiscal measures there is a long-term amount of

financial resources and long-term price levels, but with every possible combination of fiscal measures is linked the nominal level of production, which is defined by long-term capital intensity, the normal rate of unemployment and the normal range of the workforce in the private sector. The final measures, in that context, work on the determinants of normal production, since the increase in real spending of fiscal sector reduces the level of normal production. Public sector expenditures, therefore, reduce the level of normal production, considering they cause long-term crowding out of private sector demand (Brunner and Meltzer 1976, 150-182). The problem of long-term crowding out of private sector demand occurs in conditions of domination of budgetary policy, even when a real short-term multiplier effect exists. Contrary to the Brunner-Meltzer analysis, Tobin, Buitter, Modigliani and Ando negate short-term and long-term displacement of private sector demand and show that the growth in real public sector expenditures increased long-term production and long-term supplies of real capital. Mayer, according to Frisch, neglects the so-called "Crowding out" effect (i.e. the effect of crowding out of private sector demand), which Stein considers as the main difference between monetarists and neo-Keynesians. Crowding out effect shows that public sector spending is not financed by creating money but by raising taxes and/or increasing of borrowing have resulted in reduction in private sector spending, which partially or fully compensates for the increased costs of the public sector. Ignoring crowding out effect expresses optimism in relation to the stabilization policy of the public sector, while its highlighting withdraws opposition. Moreover, this effect is the criterion for distinguishing between monetarists and neo-Keynesians. Crowding out, as a relatively new phenomenon, indicates the effect of crowding out of private investment from financial flows in conditions of growing public debt and interest rates on the capital markets. This so-called Crowding out effect arises from the expansion of the public sector, as the share of the money intended for transactions, rising along with income, and leads to a reduction in the share of money intended for the preservation of liquidity and, consequently, also to an increase in interest rates, which breaks the level of private investments. The effect of crowding can be avoided only in conditions when the demand for cash transactions is low, the function of liquidity preference is elastic and the investment function is inelastic.

In other words, eliminating the negative effects of the budget deficit to increase national income through higher interest rates, which displaces economic sector in the capital market, requires a complementary fiscal policy with an expansionary monetary policy that prevents an increase in interest rates. However, expansionary monetary policy in coexistence with budget deficits amplifier would only strengthen inflationary tensions, while the growing inflation rate would introduce a growing trend of nominal interest rates. In general terms, the increase in public debt is followed by the high rate growth, so between these phenomena there is a close relationship in the short term. Acceleration of public borrowing in the financial markets accompanied by restrictive monetary policy supports the relatively high level of real interest rates. However, the necessary resources to finance budget deficits are pushing the financial markets, since the restrictive monetary policies prevent the use of the primary issue instead of public debt. State, basically, can avoid it in two ways: (a) by resorting to monetary creations and/or (b) by resorting to external borrowing. In that way, the state hinders interest rates. Italy is usually distinguished by the use of the primary issue to cover the budget deficit independently of rising inflation, while Denmark stands out for its use of foreign loans. But in terms of the restrictive course, other OECD countries are also increasingly resorting to foreign indebtedness to finance the budget deficit (when Germany and Japan are in the foreground). Borrowing from international capital flows contributes to the stabilization of interest rates on domestic markets, as money supply increases through conversion of foreign currency into domestic currency.

### **3. STATE INTERVENTION IN THE FUNCTION OF ECONOMIC EFFICIENCY**

Whether fiscal policy represents means of economic policy for positive effects on employment levels is essentially a question that is enriched by a discussion of crowding out of private sector demand (crowding out). But in discussing crowding out there must be made a difference between real crowding out and financial effects of crowding, because in discussions on suppressing means for transactional purposes and effects of repression portfolio significance of budgetary restrictions enters into the first plan, although it is also possible to have the so-called crowding (i.e. promotion of private sector demand). At the same time, the fiscal multiplier must be a long-term positive, although the

stability of the economic phenomenon does not necessarily lead to positive multiplier as in Blinder Solow's theory. But the real crowding out is more relevant than the financial crowding out, because in real model state budget restrictions do not play an important role any more. Now, the investment multiplier increases state expenditure and develops as an important factor. And, if it is positive, the more there is a price increasing the more it guarantees real growth. However, more funds of state with stimulant curb of inflation have dampening effect on employment levels and can even lead to a decline in real income and thus to an increase in unemployment. Methods of financing the budget deficit regularly induce inflationary or non-inflationary filling of the public finance deficit. With the financing of the budget deficit by creating money there exists inflationary pressure, while with creating money by nature there exists inflationary pressure, while financing deficit of public sector loans of non-financial sector has the pressure onto increasing of interest rates. At one time, the creators of the econometric model of St. Louis highlighting crowding out effect stressed the fact that public sector spending, which are not financed through tax increases and government loans, and not accompanied by an increase in the money supply, causes crowding out of private sector spending. Namely, if the state reduces taxes and feeds into, the budget deficit by selling government bonds, the more it increases the structure of financial assets and the ratio of bond /money supply. The bond market, in this case can be balanced only if the market interest rate increases. Increased market interest in the commodity market involves opposite effects, namely: a positive effect of asset on the function of asset allocation and negative crowding out effect. In this context, crowding out effect may be greater or smaller than the effect of assets and, eventually be compensated. However, the adverse effects are essential for the formulation of the differences between monetarist and neo-Keynesian school because accepting or refusing crowding out effect distances monetarists from fiscalists. Indeed, if the effect of the budget deficit (funded loans of non-financial sector) does not show positive, then the given model must be considered monetarist and vice versa, if it proves positive, then it must be considered fiscalist. (Ristic 1998, 345)

Recently, Modigliani and Ando tried to assess the effect of crowdingout effect. Within the empirical tests and the simulation model, these authors showed that crowdingout effect, as a result of the monetary impulse, is just one of many effects, which occur in the process of financing the increase in public sector expenditure by placing of bonds: a direct effect on real income, the induced effect of consumption the effect of acceleration, the effect of prices, the effect of asset, crowding out effect and the effect of real amount of money (Patinkin Pigou effect). Modigliani and Ando proved, in this context especially, that crowding out effect is restrictive, so that the real income, which initially increases under the effect of monetary impulses, returns to the starting position. For these reasons, neo-Keynesians tend to neglect crowding out effect because of the optimistic views on the policy of stabilization of public sector with the aim to countering Mayer monetarist setting of the rejection of government intervention in economic politics. In the controversy of monetarists and fiscalists, theoretical positions in the last decade have so converged in the process of treatment of individual problems, so it is difficult to identify what is more monetarist, and what is more Keynesian. (Ristic 1998, 567-568)

The views are extremely approximated within the analysis of the facts in the short term, because short-term oriented measures of stabilization policy concept do not significantly diverge. In conditions of high inflation rate and high unemployment rate, the reduction of the unemployment problem without intervening help of the public sector requires a long time, and the problem of rapid reduction rate of reductions over the binding of the money supply for the monetarist policies induce further increase of the binding of the money supply for the monetarist policies, which induces a further rise in unemployment. For these reasons, the monetarists believe that fiscally oriented stabilization policies are more efficient, and therefore more acceptable and desirable. Unlike the theoretical positions, the concepts of economic policy of monetarist and fiscalists are much sharply sketched and polarized. Diverging understandings of economic concepts in particular come to the fore in the field of economic policy of priorities regulation of stabilization policies and the implementation of monetary policy. In terms of regulatory policy, monetarists differ from fiscalists precisely because they do not favor state intervention (but free market and the private sector is left to itself), while others believe in the necessity of a global policy of stabilization by which economic process is controlled for global policy of stabilization by which economic process is controlled in order to achieve certain goals. From the standpoint of the priorities in the stabilization objectives, monetarists attach greater importance to inflation than employment, since they are more concerned about harmful consequences of non-anticipated inflation in relation to the negative effects of unemployment than the Keynesians. Between

two evils (i.e. between inflation and unemployment) monetarists select the inflation for priority in stabilization policy by consequent activation of roles of growth of money supply with mediation with rising unemployment rate (due to assumptions of realistic Phillips curve about the impossibility of reducing unemployment rate at the expense of inflation) (Markovic et al. 236-237). Contrary to the monetarists, Keynesians, concerned about rising unemployment, reject the regulation of the money supply based on monetarist policies, push for interventionist fiscal policy (to stabilize employment levels) and reconcile with increasing price; therefore, as the priority in stabilization economic policy they choose unemployment rather than inflation. Perhaps, therefore, the British monetarists and fiscalists are more right, considering the inflation, i.e. unemployment as the aim of macroeconomic or microeconomic policy (monetarism) and vice versa inflation or unemployment as microeconomic or macroeconomic policy objectives. From the standpoint of the rules of implementing monetary policy, fiscalists reject the binding of the money supply to the established rules, but do not deny the influence of monetary policy on demand through interest rate control. Actually Keynesians believe that the economic process is unstable and that with discretionary economic policy a greater degree of stability can be achieved. Attributing the increasing importance to fiscal policy, Keynesians say that it should be used for immediate action on the demand over variations of expenditure and indirect action on demand through variations in interest rates.

#### 4. MACROECONOMIC STABILIZATION CONTROL

As a rule, monetarists do not advocate control of money creation by the central bank, although some monetarist requirements in Bronfenbrenner interpretation tend to regulate the supply of the economy with money instruments of the central bank.

Even, once, Nausk rightly raised the question: is it possible to achieve non inflation economy supply with money in the banking system organized on a competitive basis, with no central institutions. However, from Mayer's thesis 9 (binding of the money supply to the monetarist policies) stems request for the use of base money as an indicator of policy and money supply as a temporary parameter. And since the creation of money of the Federal Reserve System in the United States relies almost exclusively on fiscal components which the issuing bank can control relatively easily through open market policy (as opposed to the dominant foreign economic components of refinancing in the mechanism of money creation in Germany), it is difficult to assume that monetary policy is not controlled according to plan in accordance with the monetarist propositions. Keynesians are not only for control of supplying of the economy with money, due to their endogenous determination of the money supply, but are committed to influencing the movement of interest rates. Keynes once noted the need for stabilization policies, while his followers (Hicks, Modigliani and Hansen) empirically verified the necessity based on coordinated action of liquidity preference and the inelasticity of wages going down. The change in aggregate demand due to liquidity preference, which affects the change of equilibrium prices and equilibrium interest rates, causes a corresponding change in the real demand for money and (or speed of circulation, and the actual amount of money that is needed in the period of full employment. At constant nominal offer, full employment could take place by changing wages and price (which should provoke the necessary changes in money supply in real terms, provided that wages are quite elastic. But then, the stability of the price level engulfed anti-cyclical monetary policy. In the case of the Keynesian assumptions in terms of wages - considers Modigliani - classic alignment by price is realized only under conditions of increased demand. However, in terms of reduction of demand, inelasticity of wages just prevents the need to increase the money supply in real terms and lowering of interest rates. Therefore, if the money supply in nominal terms is constant starting balance, it should give way to a new stable equilibrium, which is characterized by reduced production and coerced by reducing employment, which does not come from change of scheme of supply and demand, but from insufficient money supply in real terms and is elegantly captured with J.Hicks's model IS/LM, concludes Modigliani. Immutability of the money supply does not ensure the stability of prices and production, as considered by classics. Reducing of instability mainly depends on exogenous disturbances of demand and the impact of changes of IS on the reduction of interest rates, and consequently on the change in income. The economy is generally unstable, if the elasticity of demand for money is higher in terms of interest, if the response of demand to interest rate is lower and if the multiplier is higher (Ristic 1998, 789).

In that context, the instability can be counteracted by monetary and fiscal policy for economic stabilization. Fiscal policy can (through spending and taxes) neutralize disturbances bringing full employment in accordance with the initial amount of money in nominal terms, while monetary policy can act on changes in the real money supply in the direction of its adaptation to changes in real demand that is induced with disturbances in aggregate demand. However, the uncertainty from the point of reaction of demand to changes in interest rates and changes related to the so-called liquidity trap led to giving preferences to fiscal policy in relation to monetary policy. Early supporters of the Keynesian revolution felt that the money demand is very elastic with respect to interest, that interest rates affect the demand of long-term investments in fixed assets, that the interest elasticity is small and that the investment demand is a significant source of disorder. Not distinguishing between short-term and long-term marginal propensity to save, led the mentioned followers to overestimation of long-term savings rate, to underestimating of the short-term tendency to save and to justifying demands for an active policy tendency to save and to justifying demands for active stabilization policies centered with care, focused on fiscal policy (as the main instrument for maintaining the economy near full employment) rather than monetary policy. Finally, the requirement of monetarist to Keynesian theory, and Modigliani, was not only directed at the very Keynesian model, more challenging is the fact that the given model incorporates the need for stabilization. Explicit monetarist request went in the direction of reducing of the practical significance of Keynesian model independently of its analytical value. Different empirical assessment of the value of parameters and duration of response to disturbances in the conditions of constant growth of money supply had the function to reduce the stabilizing power of Hicks mechanism. According to monetarists, liquidity preference represented a modest contribution to monetary theory; search of money reaction and the velocity of money in relation to interest rates could not be empirically detected, and the impact of interest rates on demand was generally harmful. However, after the Keynesians, the impact of interest rates on demand was significantly large (though it was not just limited to the usual investments in fixed assets), while the reaction of money demand and the velocity of money with respect to interest rates was small in practice. Friedman's contribution to the theory of the consumption function and Modigliani - Brumberg hypothesis about lifecycle included the high marginal propensity to save in relation to short-term disruptions in terms of income and a small short-term multiplier. This just led Modigliani to the following conclusions: (1) qualitative impairments in demand can act in ways that Keynes described in detail (2) Hicks mechanism is so quantitatively efficient that effects of the disorder in demand become small and short-term (assuming always the same increase in the money supply, (3) fiscal policy measures have short-term impact on demand in relation to the long-term impact of changes in the money supply to nominal wages, (4) instability of the economy is most likely a consequence of unstable increase in money supply (due to misallocation of efforts to stabilize income or achieve the objectives of the balance of payments).

However, the monetarists are always ready to argue that it is necessary to avoid a policy of stabilization, even when scaling up the money supply does not contribute to the stability of the sector. Monetarist claim is based on the fact that in the process of policy formulation for stabilization, it is not possible to take into account the unpredictability of future disorders and unpredictable variable deferred effects nor is it possible to conceive adequate stabilization policy and its timely implementation. As a result, the monetarists believe that the policy of stabilization is destabilizing. Monetarists actually claim that instability in the past is consequence of sinful-oriented actions of stabilization policy, primarily due to monetary policy over reliance on the Keynesian stabilization policy. Problem of success or failure of stabilization policy is of course extremely difficult to verify empirically. Even tests of Ardy (which are based on comparing the variability of income with the variability of runoff velocity of money), Starleat Floyd (about the effectiveness of stabilization by comparing the stability of monetary growth with stability of increase income) and Modigliani do not go completely in favor of Keynesian stabilization policy, but also do not confirm impressive results of monetary policy. It is indisputable, therefore, that in certain conditions it acted in destabilizing way. However, the thesis of monetarists that the state policy is the only source of attacks against inherently stable mechanism of private economy is not sustainable (Ristic 1998, 456). Since the Keynesian analysis was in fact the analysis of unemployment, contemporary post Keynesian economic analysis extends straight research facilities of output, while the level of employment is seen as the other side of the same process, bringing focus to the analysis of inflation that is on other side of the cyclic movement. However, Galbraith, coming to the conclusion that the neoclassical and Keynesian model was reprobate turned to control prices policy and wages, as the only solution that can stabilize the general price level and that this does not result in a reduction of output and employment (Ristic 1998,

679). However, this policy within the Keynesian concept has also proven to be ineffective. Noting that the Keynesian policy rather made worse than alleviated unemployment, neoliberals have started to push Smith's ideas and return to the original principles of the market. At the same time, the return to Smith is linked with the search for new theoretical arguments of neoconservatives and the doctrine of the new realism with the imperative of reducing of state intervention in the economy, reductions in public expenditure and tax revenue and balancing the budget at the expense of social programs. Ineffectiveness of Keynesian therapy, intensifying the problem of unemployment and inflation, favored the neo-liberals and neo-monetarists appearance with the aim to "revenge" to Keynesians in terms of macroeconomic policy recommendations. However, neo-Keynesianism, neoliberalism and neomonetarism, as the main currents of modern economists and concepts on which the theory is based economic policies in the present stagflation economies do not show their empirical superiority in mutual confrontation.

Is the combination of stagnation, inflation and unemployment the result of incorrect use or non-use of monetary and fiscal policy in the period 2007-2013? What can macroeconomic stabilization policies do and in which way in these episodic disorders? Macroeconomic policy, according to theorists of the so-called *ratex* school would have to try to stabilize expectations in terms of economic activity. This is because the stabilization policies have been ineffective and useless in the process of improving the efficiency of the economy, because the hypothesis is true that prices are perfectly flexible and economic agents form their anticipations rationally. Monetarists however, believe that the rule on money supply growth is important itself to bring down inflation and success of macroeconomic stabilization policy. Keynesians and fiscalists think the opposite, arguing that fiscal policy and income are key instruments of political stabilization, which should simultaneously reduce inflation and unemployment. Finally, structuralists, disappointed in the policies of demand, consider that the new policy is the only right recipe for breaking the current stagflation trends. However, in the demand disorder, Modigliani says, there is no macroeconomic political that would support a stable level of prices and that employment would remain at its natural rate. If there is a disturbance of prices (eg. due to exogenous factors), in conditions of disturbed supply, prices can be returned to the original position of equilibrium of unemployment and inflation. Probably there are, in addition to policy regulation of demand, some other policies that would help to resolve the dilemma about the choice of possible trajectories of inflation and combined issues of unemployment. But policy of control of wages and prices is not that (because it failed expectations the most). It is, however, not a policy of constant growth of money supply, which reacts in disappointing manner to inflationary distortions and unemployment. The new policy of stabilization, therefore, is a challenge, claims Modigliani (Ristic et al. 2014, 216-217).

Modern economy, in whole, is lost, therefore, in the ocean of empty tautology by leading economic schools - monetarism, Keynesianism, neo Keynesianism, rational expectations, supply-siders in the institutional landscape of the changed economic environment, social environment and financial position, as almost all control policies failed the exam of persistent stagflation. And as known, under the current optimal control theory the three characteristic model of stabilization policy crystallized: (1) preventive policies which take into account the anticipated perturbations, (2) the retroactive policy that corresponds to unforeseen perturbations and (3) the function policy - a goal that allows comparison of different policies and measuring of the effects of frozen politics. In macroeconomic control theory, therefore, the ideas went from (1) the economic policy (line *lunin*), which by expansive or restrictive monetary policy supports the demand level of employment, over (2) macroeconomic policy, which supports stability in demand and employment and reduces fluctuations in economic activity by stabilization mechanism of variations in relative prices, the real monetary "encaisses", wealth, interest rates and exchange, (3) empirical relation between the growth rate of wages and levels of unemployment (the Phillips curve) and (4) the traditional instruments of regulation of demand (fiscal policy and income) to (5) monetarist policy and offers. Exposing analytical and empirical research of the effects that caused monetary stabilization programs in the field of prices, production, and exchange rate industrialized countries, Artis focuses on the analysis of view based on the rational predictions that the monetary authorities can stop inflation quickly, without having to pay a high price due to lost production and employment, if they reduce monetary expansion and at the same time convince the participants in the private market that the reduction of monetary growth will last longer, on the one hand, and on the analysis of view based on market funds, according to which the monetary stabilization program aims to increase the real exchange rate which speeds up the adjustment of prices in the labor market and commodity markets, by reducing the price of



imported goods, but deteriorating situation of foreign trade of the country, on the other hand. We used the free monetarist model where it is assumed that the long-term inflation expectations of participants in the private market reflex monetary policy and that interest rate and exchange rate are short-term variables determined by the financial market (Ristic et al. 2014, 485). Econometric valuation of parameters in the model provides reserved conclusions about the significance for the conduct of monetary policy. Many other authors came to the same devastating results in empirical research of stabilizing effects of fiscal policy and income policy. It is possible that the same fate befalls the "young" supply-side policies.

## **5. THE NEW POST-CRISIS MACROECONOMIC MANAGEMENT IN THE FUNCTION OF ECONOMIC GROWTH AND DEVELOPMENT**

Nobel laureate Krugman managed to again reaffirm the Keynesian central premise, "The right time for saving is the time of growth, not a time of crisis". Now is "the time that the government is spending more, not less," and until "the private sector is ready to once again push the economy forward" towards an expansionary policy to create job positions, not that the government implements "austerity policies repealing jobs." The crisis, as a rule, is very damaging in the short term and leaves severe consequences in the long term, because it almost permanently lowers the rate of growth and employment. A long-term unemployment acts destructively, such as low business investment, permanently undermine the economic future.

It is common that the first line of defense against recession in the US and the EU is made up of central banks, which immediately reduce interest rates in the event of economic downturn. However, short-term interest rates were close to zero without any possibility of further lowering. Government's response nevertheless reduced to the fiscal stimulus in the form of a temporary increase in public spending and/or tax cuts to encourage overall spending and job creation - a plan for economic recovery and reinvestment.

In this context, Stiglitz and Krugman's fears have come true the moment there has been a shift in focus from employment onto the issue of deficit and debt. Then political babble produced the risk of excessive deficits and debt, pushing unemployment under the carpet. Fear of the budget deficit has produced the so-called fiscal austerity and sharp reduction in public spending. So, the political discourse shifted from employment issues to the budget deficit, although it is not a tragedy that debt continues to rise until it grows faster than overall economic growth and rising inflation.

Cuts in public spending will not reduce the future debt, since crisis economy brings lower income and higher social spending. Fixing the fiscal outlook for the economy in depression by cutting public spending may drop counterproductive, because the benefits of fiscal cutting are small and the price is high. Unfortunately, the shift from employment to the deficit brought the panic that prevailed at the makers of economic policy, to whom the fear of inflation became a phantom threat. Even the warning of conservative economists of monetarism that there will be a sharp rise in inflation (due to printing money and government deficits) fell into the water.

Economists like Krugman and Stiglitz, know that to uncontrolled inflation will not occur as long as the economy is in a state of depression, in which the trap of liquidity at low interest rates does not allow the growing spending enough to return to full employment. Mass unemployment in practice undermines society and life, because the lack of jobs means unproductiveness of system and the inefficiency of the economy. And this is crucial and extreme economic inequality and social injustice. Reducing income inequality in the long term and implementing short-term measures to create new jobs, "over and over again, consistently and persistently" until it reaches the goal of full employment, is the key to any macro-economic policy - says Krugman. "If the expansionary fiscal and monetary policy combined with a reduction in debt is the way to make economy run, then such a policy would be a wise and of national interest. Indicators that fiscal policy is important today are stronger than ever - fiscal stimulus helps the economy to create jobs, and reducing the budget deficit reduces growth at least in the coming short-term period. (Ristić 2015, 89-98)

## 6. CONCLUSION

The disappointing results of empirical researches of the effects of traditional stabilization measures and instruments of monetary and fiscal policy and income, as well as the key segments of macroeconomic policy, in stagflation economies kicked into orbit the so-called expansive economic policy to crack down the core of simultaneous coexistence of inflation expansion, the explosion of unemployment and decelerating growth. In the initial phase, the expansionary macroeconomic policy in a recession would have the task to simultaneously push down unemployment and inflation and to prepare the conditions for a stable, healthy, harmonious and humanized growth in the next stage. In this context, it is necessary to determine the revenue growth and economic social transfers, anticipate future demand and production costs, switch (proportionally) social loads from enterprises on wages and reduce interest rates (to feel actions at the level of the cost of labor and capital), increase labor productivity which generates an expansion of growth and reduces inflationary pressure, to improve resource allocation and policy amelioration distribution. In this light, the policy of public investment must play a role of engines whose externalities are at maximum for the private sector from the standpoint of reducing the cost of operation of the sector, to improve resource allocation and ameliorate policy distribution. In this light, the policy of public investment must play a role of engines whose externalities are at maximum for the private sector from the standpoint of reducing the cost of operation of the sector. Privacy income should reduce inflationary anticipation and determine desirable evolution of real rents and savings. Budget politics should form tolerant and non inflation deficits without pressure on interest and the so-called extrusion ("evicilion"). Samuelson, however, as a representative of the school of macro-micro synthesis of economic analysis and a supporter of Keynesian views on inflation and unemployment, particularly underlined that every mixed economic system must pursue a policy of income along with fiscal and monetary policy, if it wants to ensure price stability with a high level of employment.

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