

ON SOME ASPECTS OF THE MONETARY IMPROVEMENT OF ANTI-DEFLATIONARY REGULATION IN BULGARIA

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Abstract:

The article attempts to examine deflation from the perspective of global risk management. Some elements of the external and internal impacts leading to the realization of the bilateral risk of inflation and deflation are investigated. A conclusion is made about the need to complement the complex approach to the management of these risks.

Key words: risk management inflation, deflation, macroeconomic risks, bilateral monetary and credit and budget policy, price dynamics, aggregate monetary demand, aggregate monetary supply.

INTRODUCTION

One of the most problematic issues of economic policy in our country is the management of the relationship between inflation and deflation. The methods of its management are ambiguous and contradictory in their consequences. Managing deflation involves the use of a range of measures that help to some extent to combine rising prices with stabilizing incomes. Process supervision tools used in Bulgaria vary depending on the nature and level of deflation, the characteristics of the economic situation and the specifics of the economic mechanism.

METHODS

The negative social and economic consequences of deflation force the Bulgarian government to implement a certain economic policy. Antideflationary policy includes a wide range of different monetary and budgetary measures, tax measures, stabilization programs and actions to regulate and distribute income. A very important condition for the antideflation policy is the independence of the Bulgarian government from pressure groups. Antideflationary measures must be conducted consistently and carefully, considering the systemic relationship with monetary and fiscal policy.

MATERIALS

It is significant to note that the main way to fight deflation must be to fight its root causes. The objectives of the anti-deflationary policy should be above all:

- increasing inflationary potential,
- predictability of inflation dynamics,
- increase in inflation rates,
- price stabilization.

The strategic goal of Bulgaria's anti-deflation policy is to align the growth rate of the money supply with the growth rate of the commodity supply (or the real gross domestic product) in the short term, and the volume and structure of the aggregate supply with the volume and structure of aggregate demand in the long run. To solve these difficulties, a set of measures should be implemented aimed at limiting and regulating the three components of deflation of demand,

expenditure and expectations. Assessing the nature of the anti-deflationary policy, we can distinguish two general approaches:

- Policies aimed at increasing the budget deficit, increasing credit expansion and limiting money creation.

In accordance with Keynesian recipes, targeting is not used - regulation of the growth rate of the money supply within certain limits (in accordance with the growth rate of gross domestic product).

- A policy that regulates prices and incomes and aims to tie rising wages to rising prices.

One of the means is the indexation of incomes, determined by the level of the subsistence minimum or the standard consumer basket and in accordance with the dynamics of the price index. In order to limit undesirable phenomena, limits can be established on the increase or freeze of wages, the issuance of loans can be restricted, etc.

If deflation rises as a result of falling production costs, then investment should be encouraged by all means. The governments of Bulgaria, unfortunately, cannot use strict methods of direct price targeting, they again have to resort to methods such as increasing tax rates.

With the stabilization program, which includes a set of interrelated measures in the area of fiscal and monetary policy, it helps to reduce deflation in a short time. As a rule, it is performed as a single complex. The main objectives of the stabilization program are:

- reducing government spending, including reducing subsidies;
- tax increase;
- reduction of lending volumes of commercial banks;
- increasing the issuance of treasury bonds and the volume of external loans;
- increase in social spending for the needs of low-income segments of the population;

In the implementation of stabilization measures, along with economic logic, political foresight is also necessary. It is known that raising taxes is an extremely unpopular step of any Bulgarian government. And this measure does not find support among the population. Therefore, it must be compensated by increased spending on social needs. But since the stabilization package is primarily aimed at reducing the budget deficit, external loans can help the Bulgarian government pay for socially significant programs.

Designing a stabilization program and getting it started is quite difficult. The main task is to get it to work. Because of this, many Bulgarian governments are simultaneously trying to make changes in economic legislation while simultaneously reducing government spending. This applies, for example, to a law prohibiting the Bulgarian National Bank from granting loans to the Bulgarian government or commercial banks.

Experience shows that it is very difficult to stop deflation with organizational measures alone. This requires a structural reform aimed at overcoming the emerging imbalances in the economy.

The most often pursued goal of monetary policy, by Linnemann (2020), is to fight inflation and stimulate economic growth. But in times of crisis, when the possibility of deflation arises, the struggle against the fall in the general price level comes to the fore. The most dangerous consequence of deflation for economic growth is the possibility of a „recession-price reduction” spiral, from which the exit is possible only after the intervention of the government, or more

precisely after the involvement of the printing press. As a result of the contraction in the money supply, consumption falls.

Specific methods to limit deflation should be developed after determining the nature of deflation and identifying the main and related factors that stimulate the development of deflationary processes. Each deflation is specific and requires the use of a set of measures that correspond to this specificity.

Deflation can be monetary or primarily structural in nature; its sources can be excessive demand (demand deflation) or rapid growth in wages and prices of materials and components (cost deflation). Deflation can be stimulated by an unreasonably low exchange rate of the national currency or an unjustified removal of restrictions on the regulated prices of the so-called price-forming goods (fuels, agricultural raw materials). Deflation is fueled by the government budget deficit and the monopoly of suppliers and manufacturers.

Deflation in Bulgaria cannot be called harmful because banks are the result of legal requirements of depositors to receive money entrusted to the bank on the basis of a contract. The fact that no bank can handle a huge influx of customers is not reason enough to fear deflation.

First, in long-term deflation, the assessment of risks and the lending process itself fundamentally changes, and the probability of a bubble inflating in various markets goes to zero if the central bank does not provide inflationary fuel to the economy.

And secondly, even in the most difficult crisis periods there are banks and financial organizations that maintain solvency and sufficient reserves. Proper risk management of these organizations allows them to subsequently acquire less wary competitors and expand their business. In this case, deflation reflects the recovery of the economy after a critical mass of errors by market agents and the government has accumulated.

In practice, there is not only one cause, but a complex of causes and interrelated factors. Therefore, the methods of combating the deflationary process are usually complex in nature, constantly being refined and adjusted.

The negative social and economic consequences of deflation force the governments of Bulgaria to follow certain economic policies. At the same time, first of all, economists are trying to find an answer to such an important question: to eliminate deflation through radical measures or to adapt to it. This dilemma is resolved by considering a number of specific circumstances.

Assessing the nature of the anti - deflationary policy, we can distinguish two approaches. The first approach (developed by representatives of modern Keynesianism) envisages an active fiscal policy - maneuvering government spending and taxes in order to influence effective demand.

RESULTS

With deflationary policy, excessive demand, the Bulgarian government limits its spending and increases taxes. As a result, demand decreases, deflation rates decrease, but at the same time production growth is limited, which can lead to stagnation and even crisis phenomena in the economy and to the expansion of unemployment, for example:

- Changes in actual output. An increase in real output increases real income from all major sources of tax revenue. At the same time, the increase in real production reduces the real costs of the Bulgarian government for transfer payments.
- Changes in price levels. At a constant level of real output, an increase in prices increases nominal tax revenue.

- Changes in interest rates. An increase in nominal interest rates increases the real cost of servicing the government debt.

- Automatic stabilization. Because the mechanisms built into the fiscal system are necessary to offset changes in the overall volume and structure of planned spending and investment, budget components such as income taxes and unemployment benefits are called automatic stabilizers.

Monetary policy uses tight monetary policy to limit the money supply to reduce spending and limit deflationary pressures. Its purpose is to reduce bank reserves. This is done as follows:

- The Bulgarian National Bank should sell government bonds on the open market to reduce the reserves of commercial banks.

- Increasing reserve ratios automatically relieves commercial banks of excess reserves and reduces the size of the money multiplier.

- The increase in the discount rate reduces the interest of commercial banks to increase their reserves through loans from the Bulgarian National Bank.

In the short term, the consequences of restrictive monetary policy actions are as follows:

- Increase in interest rates.
- A decrease in the level of real output.
- A decrease in the price level.

The policy of expensive money control deflation leads to a decrease in net exports. A policy of expensive money - higher interest rate, increased demand for the national currency abroad, the value of the national currency increases, net exports decrease, aggregate demand decreases.

Monetarists see the money supply as the only factor determining the level of output, employment, and prices. The theoretical reasoning of monetarists stems from the fact that an expansion of the money supply increases the demand for all types of assets as well as current production. Therefore, under conditions of full employment, the prices of all factors will rise.

The natural rate hypothesis states that the economy is sustainable in the long run at the natural rate of unemployment. The natural rate hypothesis has two variants, by Стоичкова (2016):

- Adaptive Expectations Theory.

The simplest version of adaptive expectations theory boils down to the fact that individuals imagine the future as similar to the recent past, starting from which they firms expect the same deflation this year as last.

- In more sophisticated economic models, expectations are often assumed to be based on some weighted average of deflation rates over several previous years.

Adaptive expectations theory basically involves the use of an aggregate supply curve that is positively sloped in the short run and upward sloping in the long run.

Financial policy is also followed to expand demand during a recession. If demand is insufficient, government investment and other spending programs are implemented and taxes are cut. Low taxes are established primarily in relation to middle- and low-income earners, who usually immediately realize the benefits.

This is believed to increase the demand for consumer goods and services. Stimulating demand with budget funds, however, can increase deflation. In addition, large budget deficits limit the Bulgarian government's ability to maneuver with taxes and spending.

The second approach is advocated by neoclassical economists who emphasize monetary regulation that indirectly and flexibly affects the economic situation.

This type of regulation is carried out by the Bulgarian National Bank, formally not controlled by the Bulgarian government, which changes the amount of money in circulation and the interest rate, thus influencing the economy. In other words, the Bulgarian government must take deflationary measures to limit effective demand, because stimulating economic growth and artificially maintaining employment by reducing the natural rate of unemployment leads to a loss of control over deflation.

The modern market economy sometimes has a deflationary character, since it is impossible to eliminate all factors of deflation (budget deficit, monopolies, imbalances in the national economy, deflationary expectations of the population and entrepreneurs, transfer of deflation through foreign economic channels, etc.).

In this regard, it is obvious that the task of completely eliminating deflation is unrealistic. Apparently, that is why many countries are aiming to make it moderate, controlled and prevent its destructive scale.

Economic policy is the manipulation of government budgets (government spending and taxes) to achieve stated goals of increasing output and employment or reducing deflation. Discretionary contractionary economic policy, which refers to the deliberate manipulation of taxes and government spending to control deflation, includes:

- reducing government spending
- increase taxes
- a combination of the first and second measure.

In all these cases, there is a decrease in the equilibrium net national product.

Liberal economists, by Gerald, (2021), who believe that the public sector should expand to compensate for the various pitfalls of the market system, may recommend limiting aggregate spending during periods of rising deflation by cutting taxes. Conservative economists who believe that the public sector is too bloated and inefficient may advocate reducing aggregate spending during periods of rising deflation by cutting government spending. An active economic policy aimed at stabilizing the economy can rely on both an expanding and a contracting public sector.

To some extent, the necessary changes in the relative levels of government spending and taxes are introduced automatically. This so-called automatic or built-in stability is not included in the discussion of discretionary economic policy.

If tax revenues vary in the same direction as the net national product, then budget surpluses, which tend to occur automatically during economic booms, will help to overcome possible deflation.

Automatic economic policy is this type of fiscal policy - changing orders related to government purchases and orders, tax structure and transfer payments in order to increase or decrease aggregate demand is called discretionary fiscal policy.

DISCUSSION

In practice, however, the level of government procurement, as well as the level of net taxes, can change even in the absence of changes in the laws that regulate them. This is because many laws regarding the tax structure and spending mechanisms are designed in such a way that the parameters of economic policy automatically change as economic conditions change. These

changes in government purchases and orders and net taxes, called automatic economic policy, are most closely related to changes in the actual output of goods and services, price levels, and interest rates.

The increase in the price level affects both parts of the state budget - revenue and expenditure. At a constant level of real output, a reduction in prices reduces nominal prices tax revenue. Where tax rates are not indexed, ie. do not automatically change when the rate of deflation changes, deflation can also cause tax revenues to decrease.

At the same time, an increase in the price level reduces nominal spending. This happens in part because most transfer programs are not indexed to the rising cost of living and in part because deflation raises the prices of goods and services purchased by government agencies as part of government procurement. Some types of government of Bulgaria, procurement „pass“ through the budget pens in nominal terms.

This state of affairs leads to the fact that the nominal reduction in expenditure will be less than necessary when the price level rises, so that real expenditure will fall. If all items in the budget are indexed, then the increase in the price level in no way affects the real budget deficit. In practice, the budget is far from fully indexed, with the result that the nominal amounts of taxes, both in absolute and percentage terms, grow faster than the nominal amounts of government purchases and expenditures. Thus, the increase in the price level, other things being equal, reduces the nominal volume of the state budget deficit, and in real variables this reduction is even more significant.

Rising nominal interest rates increase the real cost of servicing government debt. This increase was only partially offset by the increase in the nominal income of government agencies from increases in interest rates and bank discount rates. So, in general, increases in nominal interest rates increase both the real and nominal budget deficits. Antideflationary policy is a set of government regulatory instruments aimed at reducing deflation.

The negative social and economic consequences of deflation are forcing the Bulgarian government to follow certain economic policies:

- Policies aimed at reducing the budget deficit, limiting credit expansion and limiting the monetary mission. In accordance with monetarist recipes, targeting is used - regulation of the growth rate of the money supply within certain limits (in accordance with the growth rate of gross domestic product). A radical variant of this policy is deflationary policy.
- A policy that regulates prices and incomes and aims to tie rising wages to rising prices. One of the means is the indexation of incomes, determined by the level of the minimum living wage or the standard consumer basket and consistent with the dynamics of the price index. In order to limit undesirable phenomena, limits can be established on the increase or freeze of wages, the issuance of loans can be restricted, etc.

Evaluating the nature of antideflationary policy, we can distinguish two approaches. The first approach (developed by representatives of modern Keynesianism, by Beckworth (2020), envisages an active economic policy - maneuvering government spending and taxes in order to influence effective demand. Economic policy is also followed to expand demand during a recession. If demand is insufficient, government investment and other spending programs are implemented and taxes are cut. Low taxes are established primarily in relation to middle- and low-income earners, who usually immediately realize the benefits. This is believed to reduce the demand for consumer goods and services.

The second approach is recommended by neoclassical economists, by Humphrey (2021), who emphasize monetary regulation that indirectly and flexibly affects the economic situation. This type of regulation is carried out by the Bulgarian National Bank, formally not controlled by the Bulgarian government, which changes the amount of money in circulation and the interest rate, thus influencing the economy.

The modern market economy sometimes also has a deflationary character, since it is impossible to eliminate all factors of inflation (budget deficit, monopolies, imbalances in the national economy, deflationary expectations of the population and entrepreneurs, transfer of deflation through foreign economic channels, etc.).

The consequences of deflation are highly ambiguous and represent complex, multidimensional phenomena. Among the consequences of deflation, the most important role is played by socio-economic results.

The negative consequences of high deflation are:

- decrease in the real income of the population;
- redistribution of income and wealth to a small part of the population;
- increased risk for entrepreneurs;
- reducing incentives for monetary savings;
- increase in speculative forms of trade;
- the appearance of the effect of deflation and spiral of wages and prices;
- escape from money; purchase of any goods;
- shift to barter trade;
- diversion of capital from the sphere of production and its movement into the sphere of circulation;
- hindering the possibility of regulatory impact on the economy by the state.

What is also importantly, economic growth rates will be more sustainable, and crises less likely. It can even be argued that crises of the modern type will not take place in a deflationary economy at all. Yes, firms will not overload capacity, but then the economy is not threatened by a crisis of overproduction. Yes, the availability of credit resources will decrease, but this will exclude various bubbles in the real estate market, the stock market, etc. Yes, investment activity will decrease, but primarily due to erroneous and unjustified risky investments made only in an effort to protect at any cost from devalued savings. As a result, company collapses and long-term strategic failures become less likely and less dangerous.

Deflation in the long-term period and with a stable money supply is possible with economic growth, but if there is a decline in economic activity, then the overall price level will rise and there will be the usual inflation today. Depreciation of money stimulates more active investment and growth in consumption due to a decrease in passive savings (cash, demand deposits, etc.)

Growth in consumption will increase company profits, and growth in active savings (bank deposits, trust management, etc.) increase investments and reduce the cost of borrowed funds, which together will create a favorable environment for companies to overcome the crisis. Deflation will not become a hidden form of taxation and will only reveal the presence of excessive residual money, which will decrease due to less conservative investment decisions.

However, new, more risky projects will be carried out considering the long-term deflationary trend, that is, all the investment conditions mentioned above will be preserved. Under the influence of the changed value of money, only the structure of investment portfolios will change

in favor of more profitable projects. Inflation is objectively limited by the size of the money supply, and as economic activity recovers, in an economy with a stable level of money supply, a deflationary tendency prevails and prices continue to decline, which will become an additional limitation for unreasonably risky projects.

Thus, deflation can be painful if, of course, it is a one-time process that goes against the general inflationary trend. However, if a decrease in the general level of prices has a long-term nature, economic processes and expectations of market agents change, changing the entire economic system. Most likely, the highest GDP growth rates in it will be lower than the current values, but the probability of crisis phenomena will decrease even more significantly.

Finally, it is difficult to completely rule out crises, after all, all people can sometimes make mistakes, and the possibility of the accumulation of individual mistakes in a deflationary economy exists. But stimulation through natural inflation in an economy with a fixed money supply during downturns in business activity is a good self-regulation mechanism that mitigates many possible negative consequences of crises. Therefore, the fixed money supply and the absence of the emission center, over time allow to move to a more stable and predictable economic system.

Based on the deflationary policy, economic growth points to the fact that the monetary system is an example, perhaps the only one of its kind, that part of the economy that should be completely freed from anyone's control, be it the government or individual individuals. Money serves to solve specific problems and is not a value in itself, therefore it is advisable to leave it uncontrolled and use the state apparatus only for the protection of such a situation.

Then market prices, protected from distortions by the regulated monetary system, will increase the efficiency of the economy, protect against many potential problems and create a basis for sustainable development. We have highlighted the important consequences of deflation, but in reality, they can be much more, as the entire financial sector will seriously change, along with the process of project planning and lending.

In this regard, it is obvious that the task of completely eliminating deflation is unrealistic. Bulgaria's antideflationary policies include regulation of interest rates and the money supply. If the nominal interest rate is too low, the real interest rate becomes negative in deflation. If the interest rate is too high, the increase in the cost of loans provokes an increase in the prices of goods. Keynesian doctrine is based on the regulation of interest rates, while monetarists focus on the regulation of the money supply. Friedman's famous „monetary rule“ states: „the money supply must increase at a constant rate, regardless of the dynamics and cyclical fluctuations of market conditions“, by Swann (2016), i.e. growth must be limited the money supply at a constant rate but does not decrease the money supply at all.

CONCLUSION

Deflation is realized, a certain period of time passes; moreover, the Bulgarian government does not react immediately and there is an administrative delay; there is also a time lag between when economic measures are decided upon and when those measures begin to affect the price level; political issues; the effect of crowding out some of the investment capital in the money market; net export effect.

By reducing the domestic interest rate, contractionary fiscal policy tends to reduce net exports. The result of this is reduced external demand for the national currency, devaluation of this currency and a corresponding decrease in net exports (total demand is reduced, partly counteracting the contractionary fiscal policy).

We will briefly suggest what they will be in the short- and medium-term benefits and expenses of Bulgaria's antideflationary policies:

- Possibility of resetting the nominal interest rate, equalizing the yield of money and other instruments (at zero level); future asset appreciation.
- Increase in the real price of factors for national production, deterring long-term investment and current consumption; future increase in liabilities.

The aim of the regulation is that the devaluation of the national currency does not have an adverse effect on the growth of domestic prices, i.e. prevent the emergence of a deflationary spiral: prices - costs - prices. During the implementation of state antideflationary, monetary, credit and budget policy in the Bulgarian economy must consider their systemic interrelationship. Undoubtedly, all of this has completely changed the face of the modern deflationary economy, however, a detailed description of all possible transformations associated with the emergence of long-term deflation is not possible in this paper.

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