

JEL Classification Numbers
D59, P22, P23

Summary of
WP/92/69

"A Simple Monetary Model of a Shortage Economy"
by Shoukang Lin

In the transition from centrally planned economies to market economies, many countries have experienced some degree of macroeconomic instability. This paper attempts to provide a theoretical explanation of the phenomenon.

The paper develops a simple monetary model and shows how macroeconomic stability can be achieved in a rigid centrally planned economy despite structural imbalances and an irrational price system. The study also shows, however, that structural imbalances and an irrational price system may frustrate structural reform efforts. For example, price decontrol may benefit some firms at the expense of others, and, in the presence of soft budget constraints on enterprises, these benefits may translate into wage pressures that could lead to persistent budget deficits and high inflation.

The paper also analyzes household savings and money demand in a shortage economy and suggests that the notion of "forced savings" or "monetary overhang" remains a concept in search of a rationale. The analysis shows that as long as some goods are in surplus or black markets exist, there are no involuntary money holdings. Households reserve money for official transactions, savings, or black market activities.