

Mr. Milton Friedman  
Hoover Institution  
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Dear Mr. Friedman:

Thank you for your candid response.

You are in the right. I am not persuaded by your comments.

In my opinion, the fundamental defect in your reasoning, and in reasoning the traditional economics in whole, is the failure to recognize that the surplus of utility in no way can be derived from costs. A distinction between the sum of costs and the sum of utilities (you say the sum of value!?) I do not make "somehow or other" but in thermodynamic manner. The thermodynamic approach is the fundament of modern scientific research.

Thermodynamically observed, the cost (as an economically relevant energy spent in production of a commodity) and utility (as the economically relevant energy absorbed from consumption of same commodity), incorporated in commodity, are equivalent only in case of thermodynamic equilibrium, i.e. in a static economic system of general equilibrium with maximal entropy. Thermodynamically defined - each global equilibrium is the system with maximal entropy. Unfortunately, such are all analytic models of traditional economics, and your analytic model too. In reality, such a system-model corresponds to stagnation in the growth of economic rationality.

The analytic model of my economic paradigm is a system of dissipated structure (inspired by I. Prigogine, the winner of Nobel prize for chemistry, 1977.), i.e. a non-equilibrium system but with diminished entropy. In such a system, organized and ordered, the utility is greater than the cost, per definitionem. A progress in economic rationality (i.e. a diminution of entropy) leads to diminishing the costs and to augmenting the utilities. How the cost and utility can be equivalent in a dynamic economy with increasing economic rationality? The people permanently attempts to diminish the costs and to augment the utilities. Wherefrom the progress of mankind, if these attempts are not successful?

A money in general originally is a measure of utility, and monetary income also is derived from it. As the global utility is greater than the global costs, the total quantity of money must be greater than the total quantum of credit money (which originally is derived from costs) and the total monetary income must be greater than the monetary income derived from costs. This surplus of money, as a monetary expression of the global surplus of utility, consequently, must be emitted as a noncredit money, and, as an income derived from the global surplus of utility, must be distributed to nonproductive individuals.

The growth rate of global economic rationality (which constitutes the global surplus of utility and, accordingly, is a measure of quantitative difference between the global sum of costs and the global sum of utilities) is maybe 2-5% per annum, and is being

composed by the progress both in labour productivity (which, by unvaried costs, results in augmenting the production and supply) and in consumption rationality (which, by unvaried monetary income, results in diminishing purchasings, i.e. in retarding the monetary velocity, all as a result of prolonging the commodity utilization period, i.e. of creating the surplus of utility).

Both for realizing the increased production and for compensating the retarded monetary velocity, an additional quantum of incredit money is necessary sure enough.

You are also constatad a secular trend of retarding the monetary velocity. This rate of retarding, in fact the rate of deflation, can be compensated only by identical rate of inflation, i.e. by identical rate of noncredit money emission. This money must be distributed to nonproductive individuals because just productive, although produce, insufficiently purchase.

Consequently, if the growth in global economic rationality amounts 5% per annum (e.g. 3% in labour productivity and 2% in consumption rationality), the newly-created (emitted) quantum of noncredit money must amount also 5% per annum and in no way can generate inflation. It only compensates deflation, i.e. ensures normal realization of national production. In fact, I am inspired by your program for monetary stability. I plead also for constant modest annual growth in the quantity of money, but I think that this quantity must be emitted as a noncredit money. In your mental experiments a helicopter launches money from sky. This money, as well as gold, is also a noncredit money. Today, in reality, all paper-money is emitted as a kind of credit. However, the laws of noncredit and credit money cannot be identical.

As the incredit money is the only original money, in stated example, the 5% -emission of incredit money per annum must be sufficiently for normal reproduction without inflation, while the 5% -emission of credit money in the same period cannot be sufficiently.

Why? If the credit money is emitted in the form of credits to producers, these credits cannot be paid off (returned) in whole, because the monetary velocity is retarded (i.e. a demande of consumers whose incomes result from costs in which the credits are incorporated is ~~diminished~~ diminished). If the credit money is emitted in the form of credit to state (i.e. as an income of nonproductive consumers), the prices must automatically increase for equivalent amount of taxes. It is the taxes then which automatically augment the prices, no money in itself. If the problem of deflation already exists it cannot be solved, the volume of real transactions cannot be augmented because as much as incomes of consumers are augmented so much also the prices are done.

Thence appears the need for always new and new emission of credit money. Therefrom modern inflation. Therefrom the budget deficit. However, in terms of inflation nobody pays off its real debt in whole - it is the net emission of noncredit money, and by budget deficit, the state expenditures (as consumers incomes) are greater than the state takings (i.e. taxes as producers costs) - it is also the net emission of noncredit money. For what reason nobody can eliminate modern inflation and budget deficit? I think that with organized emission of noncredit money both deflation and inflation must disappear. Please, read repeatedly my article.

Sincerely yours

Stojan Nenadović  
dipl. jurist