Comment on Mayer on Monetarism*

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Prolonged and serious academic discussion of such concepts as "monetarism" is a potentially dangerous endeavour, for two reasons. The first is that, while *Mayer*[1] gives the credit for popularization of the term to a 1968 article by *Brunner* and a 1970 article by *Fand*, there is some reason to think that the popular use of the term owes more to the desire of newspaper columnists and other fringe personnel to encapsulate scientific controversy into sloganized "schools"; and second, at the very least the encapsulation of the processes of scholarly scientific research and discovery in an "adversary procedure" or "democratic election" paradigm is misleadingly oversimplified. Derived in the context of American economic policy, the rapid popularization of the term "monetarism" reflected the policy problems and the debates over monetary versus fiscal policy that ensued on the political success of the "new economics" of Walter *Heller* and the subsequent "new, new economics" of the first *Nixon* Administration. And consequently, the concept of monetarism is saddled with the dead weight of the historical luggage and political passions of that period. This danger is particularly evident in policy discussions and debates in countries other than the United States — and particularly in the United Kingdom, where such contemporarily illiterate monetary policy amateurs as Nicholas *Kaldor* and J. R. *Hicks* use the term "monetarism" to describe any and all views at variance with their own view of British policy problems. (In Britain, in fact, the majority view bases itself on the axiom "monetarism" = Milton *Friedman* = "The Treasury View" = utter nonsense; in the same circles, incidentally, the corollary is "Keynesianism" = incomes policy.)

Such risks of intellectual stereotyping and historical fossilization unfortunately must be courted if some sense and intelligibility is to be

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made of issues that really divide active researchers and writers in the field; and on that understanding Thomas *Mayer* has successfully carried out a careful effort to list the main "monetarist" propositions and determine which are "essential" to the monetarist position and which are "optional" but convenient to or aesthetically harmonious with it.

The key proposition, from the point of view of differentiating monetarism from its contemporary alternative, is the first one. It is also the subtlest. Unfortunately, it is the one that *Mayer* states initially in an ambiguous form, and in the discussion of which he concentrates very narrowly on the post-war II, or "contemporary" literature (excluding the very early post-war literature such as that on liquidity preference versus loanable funds that merely carried on the 1930s debates). The ambiguity referred to lies in the use in the initial list of the undefined term "monetary factors", or "the impact of monetary factors", which could mean either factors leading to change in the demand for money, or factors leading to change in the supply, as the main causes of changes in nominal income. It turns out, however, that *Mayer* means "monetary factors" in the specific sense of (changes in) the supply of money, on the assumption of a stable demand for money; and it is this specification that differentiates monetarism from both the broader stream of the quantity theory of money tradition — in which *Keynes* and the Keynesians also belong — and the older pre-war II generation of quantity theorists, and also requires supplementation of the first proposition by the rest of the first four, six, eight, or whole dozen propositions listed. In a subtle sense, it is the proposition that there is a stable demand for money that differentiates monetarism from the classical quantity theory of money tradition, and "monetarism" from its Keynesian rival. (Both views are differentiable from a third view, or more accurately a mixture of two inconsistent views: that money is in perfectly elastic supply from the private economic system in response to demand for it so that the demand does not matter, and is not worth analysing; and that the monetary authority makes the money supply elastic in response to demand in order to control interest rates, and relies on credit control of some kind to control the economy at these interest rates, with the same implication of the irrelevance of moneary theory.)

In elaboration of this point, it is convenient to digress into a brief and impressionistic account of the development of monetary theory and its purpose in economic analysis. The classical quantity theory, in its equation of exchange formulation, had the useful and necessary purpose of separating the theory of real equilibrium (relative prices and quantities) as determined by factor quantities, technology, and preferences, from the determination of money wages and prices — establishing what came to be known as "the classical dichotomy" or "the neutrality of money" or "the homogeneity postulate". This permitted concentration on "real" analysis, itself difficult when the main problem was to establish the systematic interrelationship of the separate parts of the aggregate of economic activity, while leaving vague the question of the mechanism by which the position of monetary neutrality was established, and the time it would take to establish it (the classical non-calendar-time "long run").

As is well known, two alternative mechanisms were developed in the course of time, the "desired cash balance" mechanism of *Walras* and the Cambridge school and the income-expenditure mechanism of *Wicksell* and *Keynes*, and these alternatives remain a central point of difference between the "monetarist" and the "Keynesian" schools of thought at the present time. Note that both, when properly formulated, involve a full simultaneous equilibrium of stock and flow markets, though this point is masked by the common practice of disregarding or minimizing the processes of accumulation of real and monetary assets in economic growth in order to make the analysis more easily applicable to the calendar-time perspective of business cycle and policy stabilization problems. But the income-expenditure approach concentrates on the effects of stock disequilibrium in setting relative prices (particularly the level of the interest rate) that produce disequilibrium between income and expenditure flows and hence change the magnitude of flows, whereas the desired-cash-balance approach concentrates directly on disequilibrium between desired and actual stocks with changes in flows ensuing incidentally.

Initially, the adumbration of a mechanism to resolve monetary disequilibrium was primarily a question of logical completeness and consistency in a theory designed to show that money was a "veil" over the real economy, and that the presence of money and the existence of a monetary economy made no essential difference to the operations of a barter economy. This formulation corresponded with the classical and neo-classical interest in the long run, and specification of the very longest possible run in terms of "the classical stationary state". With the development of economics as a professional and "practical" (as distinct from philosophical) subject of study, however, and also with the emerging recognition of the trade or business cycle as a characteristic phenomenon of the capitalist system, the focus of monetary-theoretic interest shifted gradually from the long-run demonstration of monetary neutrality to the shorter run problem of "the conditions for monetary equilibrium" — the most important landmarks being the work of *Wicksell, Robertson, Keynes* and *Hayek,* and *Wicksell's* followers in the Stockholm School.

As one heuristic formulation, monetary equilibrium over (successive periods of) time requires equality of the real saving people wish to do out of current income with the real investment they wish to undertake, and equality of changes in the quantity of money demand with changes in the quantity of money supplied by the monetary authority. (This formulation ignores certain obvious difficulties associated with the need for growth of the money supply at a constant price level in a growing economy, and changes in the desire for financial intermediation between saving in the form of monetary assets and investments in terms of real capital equipment). A statement of this problem in this way involves converting the concept of neutrality from a long-run equilibrium tendency of a monetary economy confronted by parametric changes in the nominal money supply (or in real balance demands), to a short-run dynamic policy objective, and in so doing creates the setting in which "monetarism" and "Keynesianism" appear as rival approaches. Note, incidentally, that the necessity for this change of perspective explains why *Mayer*, quite correctly, regards *Patinkin* as not belonging to the monetarist school: *Patinkin's* work has been confined largely to the first phase of interest in the evolution of the quantity theory, which concerned itself with long-run monetary neutrality, and specifically with the construction of an integrated theory of relative and absolute prices in a monetary economy, and has not been concerned with the pursuit of short-run stability as a policy objective.

As the argument has been outlined so far, the dynamic neutrality of money can be described by changes in any one of the four basic constituents of, or factors influencing the dynamic development of, the system: the desire to save (or consume), the desire to invest, the demand for money (the active component of which is "hoarding" or "liquidity preference proper" or "the assets demand" as it has been successively described chronologically), and the supply of money. Conventionally, monetary economists have tended to simplify the problem by treating consumption as passive, and this convention is adopted for simplicity here, though with the necessary warning that to do so consistently would close out some important issues involved in *Mayer's* listed propositions, especially, 3, 4, 12 and possibly 5.

With that simplification — or alternatively, by lumping changes in consumption and investment expenditure together under the general description of "real" disturbances — we can quickly arrive at a classification of approaches to monetary disturbances according to the "normal" or most common type of disturbance: disturbances involving changes in private money-holding behaviour; disturbances involving changes in official (or governmental) money supply behaviour; and disturbances involving changes in private real spending behaviour.

While *Wicksell's* analysis of the "cumulative process" in terms of a divergence of the "money" from the "natural" rate of interest could be interpreted as a case of the second type of disturbance, as could *Keynes's* occasionally expressed view that the monetary authorities were not in fact willing to use monetary policy to the extent required to offset private sector disturbance, and as would certain aspects of *Hayek's* discussion of the business cycle, it is a fair generalisation that none of the leading pre-war II monetary theorists regarded policy-introduced changes in the money supply as a (or "the") major source of monetary disturbance. Instead, either real or monetary private sector disturbances or both, on the demand side, constituted the prime source of instability — *Robertson* indeed went so far as to maintain that a competent central bank should be able to distinguish between changes in hoarding demand for money and changes in the demand for money associated with changes in expenditure.

Partly at least, because monetary theory at that time contained no adequate theory of demand for a stock and of demand influenced heavily by expectations about the future, the possibility of changes in hoarding demand was expressed, not as contemporary theory would tend to express it, in terms of a *stable* function of the values of *expected* independent variables in the function, but in terms of *instability* of the demand for money or instability of velocity, an instability which had to be offset by discretionary monetary management or, for some writers, a monetary rule of conducting monetary policy to achieve price stability. This characterisation, in turn, lent itself easily to ridicule at the hands of *Keynes* and the Keynesians, once *Keynes* had used the multiplier relationship and the propensity to consume to tie changes in aggregate expenditure to changes in investment, themselves partially (but not completely) controllable by the influence of monetary policy on the interest rate.

The modern quantity theory, and the monetarist school based on it, makes several fundamental departures from the neo-classical quantity theory, partly as a broadly political response to Keynesianism and partly as a reflection of improved basic theory largely attributable to the impact of The General Theory itself. (There is, however, one basic difference between the new quantity theory approach and the Keynesian approach, which consists in the explicit incorporation in the demand for money function of the expected rate of change of the price level as a determinant of the relative yield on money, which in turn provides the foundation for the distinctions relevant to monetary policy between real and nominal interest rates and between changes in real and in nominal cash balances.) The most direct departure, whose major constituent is the assumption of a stable demand for money, is the assumption that disturbances originate primarily not in the instability of the private sector's behaviour, either in spending or in cash-demanding behaviour, but in the instability of the behaviour of the monetary authorities. This is associated directly or indirectly with most of the other propositions, specifically 2 - 6, which broadly amount to maintaining that the private sector will look after itself if let alone and does not require detailed specification, analysis or control in the process of monetary analysis and policy stabilization; 7 - 9, which aim at making monetary policy as little amenable to discretionary action and semantic obfuscation as possible, and 12, which is a natural corollary of the assumption that governmental action is the prime cause of monetary disturbance. Note, incidentally, that concentration on the demand for money as the key relationship, and nominal income as the determinate that follows from the determinant of the quantity of money through that relationship, releases the quantity theory from the great incubus imposed on it by Keynesian criticism, that it "assumed" full employment and consequently was irretrievably inconsistent with the observed fact of mass unemployment.

The foregoing paragraph omits reference to items 10 and 11 on *Mayer's* list. As regards the *Phillips* curve trade-off, I would regard this piece of apparatus as a long-post-*Keynes,* and only peripherally Keynesian, piece of apparatus relevant to a particular stage in the breakdown of the Keynesian assumption of rigid or exogenously determined wages, and hence not crucial to the Keynesian-monetarism debate. Further, the expectations-augmented *Phillips* curve (with a trade-off in the short but not the long run following a monetary disturbance) has become an integral tool of frontier theorizing on monetarist lines. As regards inflation, *Mayer's* statement is somewhat imprecise, but I would myself say that monetarists are less concerned about both inflation and unemployment than other economists, partly because they regard both as logical consequence of monetary disequilibrium rather than of inexplicable malfunctionings of the private sector, and partly because they are more apt to subject the alleged social costs to economic analysis.

These two propositions being left aside, as either having a more specific context and reference content than their statement implies or as embodying a general judgment based on *Mayer's* extensive reading of the literature, one must accept *Mayer's* general thesis that the listed propositions do constitute an intercorrelated set, sufficiently so to form a coherent approach to a view of monetary policy, but that it is possible to accept or reject some of them while remaining broadly a monetarist, or a non-monetarist, as the case may be. It remains to add only that (as Mayer himself observes) some combinations of selections from the bill of fare would make a pretty indigestible intellectual meal, whereas there are some eccentric tastes (e. g., the love of large models, or distrust of government) that demand "ketchup with everything".

References

1. J. R. *Hicks*, The Crisis in Keynesian Economics, Oxford: Clarendon Press, 1974. — 2. J. R. *Hicks*, What Is Wrong With Monetarism, Lloyd's Bank Review, No. 118, October 1975, pp. 1—13. — 3. N. *Kaldor*, The New Monetarism, Lloyd's Bank Review, July 1970, pp. 1—18.

Zusammenfassung

Anmerkungen zu Mayers Aufsatz über Monetarismus

Diskussionen über Monetarismus gehören zu einer jüngst beendeten Phase der geldpolitischen Auseinandersetzung in den Vereinigten Staaten und laufen Gefahr, zur bloßen Formsache zu werden. Unter den von *Mayer** aufgezählten Lehrsätzen ist die Annahme einer stabilen Nachfrage nach Geld der grundlegende. Er unterscheidet den Monetarismus sowohl von *Keynes* als auch von

* 8. Jg. (1975) S. 191 ff. und 293 ff.

der alten Quantitätstheorie (unstabile Umlaufgeschwindigkeit), die *Keynes* attackierte. Die klassische Quantitätstheorie durchlief zwei Phasen: 1. Die Phase des „neutralen Geldes“, die sich durch den Versuch auszeichnete, den Weg zu einer Analyse eines allgemeinen realen Gleichgewichts aufzuzeigen. 2. Die „Analyse der Bedingungen für ein monetäres Gleichgewicht“, d. h. Analyse von Störungen zwischen realem und monetärem Gleichgewicht in einer modernen (Geld-)Wirtschaft. Vor dem zweiten Weltkrieg hielten Theoretiker geldpolitisch verursachte Veränderungen der Geldmenge niemals für destabilisierend. Sie gingen davon aus, daß allfällige Änderungen der Geldnachfrage mit der Unstabilität der Umlaufgeschwindigkeit zusammenhingen und man sie durch Geldpolitik ausgleichen müßte. Moderne Quantitätstheoretiker sehen dagegen gerade in der Geldpolitik den wichtigsten Störungsfaktor für das Gleichgewicht — bei einer stabilen Nachfrage nach Geld.

Summary

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Discussion of monetarism belongs to a recently passed era of U.S. policy debates and runs the danger of formalization. Of *Mayer's** propositions, the crucial one is the assumption of a stable demand for money which differentiates monetarism from both Keynesian theory and the old quantity theory (unstable velocity) that *Keynes* attacked. Classical quantity theory went through two phases; the "neutrality of money" phase, designed to clear the way for real general equilibrium analysis; and "the conditions for money equilibrium analysis", of disturbances to real and monetary equilibrium in a monetary economy. Prewar II theorists never regarded policy changes in money supply as a destabilizing factor, and treated expectational change in money demand as involving instability of velocity; to be offset by policy. Modern quantity theorists instead make policy a chief disturber of equilibrium, in the face of a stable demand for money.

Résumé

Annotations sur l'article de Mayer relatif au monétarisme

Les débats sur le monétarisme appartiennent à une période à peine achevée des discussions portant sur la politique monétaire aux Etats-Unis et risquent d'être vidés de leur contenu. Parmi les thèses énumérées par *Mayer***, la plus mondamentale est l'hypothèse de la stabilité de la demande monétaire. Il écarte le monétarisme aussi bien de la théorie de *Keynes* que de l'ancienne théorie de la quantité (instabilité de la vitesse de rotation) réfutée par *Keynes*. La théorie

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quantitative classique connut deux phases: 1. La phase de la « monnaie neutre », qui se caractérisait par la tentative de montrer la voie d'une analyse d'un équilibre réel général. 2. L'« analyse des conditions d'un équilibre monétaire », c. à. d. l'analyse des distorsions entre l'équilibre réel et l'équilibre monétaire dans une économie (monétaire) moderne. Avant la deuxième guerre mondiale, les théoriciens n'avaient jamais accusé de déstabilisatrices les variations du volume monétaire occasionnées par la politique monétaire. Ils estimaient que tout changement dans la demande monétaire était à mettre en relation avec l'instabilité de la vitesse de rotation et que cette instabilité devait être corrigée par la politique monétaire. Les théoriciens modernes de la quantité voient précisément au contraire dans la politique monétaire le facteur principal de perturbation de l'équilibre — lorsque la demande monétaire demeure stable.