RECAPTURING OR REMODELLING
THE PAST?

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The Quantity Theory of Money: From Locke to Keynes and Friedman
By M. Blaug.

This collection of essays by M. Blaug, W. Eltis, D. O'Brien, D. Patinkin, R. Skidelsky, and G. Wood focuses on the quantity theory of money, historically reconsidered. In his introduction, Blaug asks: "Can we ever achieve that Nirvana in which the past is truly recaptured?" It is not inappropriate, therefore, to assess the way in which the six contributors to this volume have coped with the task of "recapturing the past." Anticipating here what I will argue in my review, I think that the authors of this book manage to "recapture" the past by "remodelling" it, namely by making the past conform to the present framework of economic analysis. Recapturing the past, I will argue, is quite a different intellectual exercise.

In the first essay, "John Locke, the Quantity Theory of Money and the Establishment of a Sound Currency," W. Eltis claims that Locke set out "a detailed account of the transactions demand for money, and in this he was almost two centuries ahead of what later became generally known and understood" (p. 24). Here
we can see clearly epitomized that distinctive (and widely accepted) approach to the history of economic analysis, whereby the study of the past is seen as hunting ground for predecessors and inventors of economic propositions whose truth or precise formulation is given by contemporary wisdom. The exercise of the historian of economic analysis is understood as making sense of quaint language and conceptualization by translating them into modern terms and assigning priorities or merits according to the vicinity to or remoteness from the present state of the art. Thus, Eltis can state that “the French Physiocrats, Adam Smith, Thomas Malthus and David Ricardo all similarly failed to go as far as Locke” (p. 24) in giving us something that is close to what we now mean by the transactions demand for money, because the purpose of the historical investigation is to assess the past on the basis of the knowledge gained ex post. An alternative to this methodological stance would be that of searching the past for what has been lost in the present state of the art in economics, looking not for similarities but for differences arising on account of the different contexts.

This leads me to a point raised in the second essay, “Why Is the Quantity Theory of Money the Oldest Surviving Theory in Economics?”, where Blaug gives us a solution of what he sees as a fundamental contradiction in Ricardo’s monetary theory. I quote: “Ricardo continued to expound a labour theory of value of the monetary metal while at the same time espousing a hard-line version of the quantity theory. He might have reconciled the two by reserving the quantity theory for short-run problems and for inconvertible paper, while maintaining the cost of production theory for the long run and for specie money and convertible paper only. In fact, however, he left the two doctrines standing in an unresolved relationship to each other” (p. 31). I would like to argue that this contradiction (and its proposed solution) are the outcome of the methodological position taken by Blaug—making sense of past doctrines through the lenses of the contemporary accepted body of knowledge—rather than the necessary result of an investigation mindful of the context peculiar to that individual theory.

I have argued elsewhere (see, for instance, Marcuzzo-Rosselli 1994) that the role of gold in Ricardo’s theory is not as money, but as the standard of money, that is, the means to measure the value of money. His analysis pivots on the distinction between the value of gold and the value of money: while the former is determined by its cost of production, the value of money depends upon its quantity and is measured by the purchasing power of money over gold, which is the standard. According to this interpretation, it is therefore immaterial whether the circulating medium is made up of full bodied gold coins or of debased coins or paper money (whether convertible or inconvertible): the value of money is always determined by the quantity of gold bullion that one unit of currency can buy on the domestic and foreign markets, according to the prices of gold and the exchange rate. In fact, the gold content of coins does not necessarily play any role in determining the value of money. Debased or clipped coins can circulate at the same value as full-weight coins as long as their quantity has not been increased beyond what Ricardo calls
its "natural" level. Therefore, although the gold content of a unit of currencies decreases, the value of money may not decrease since the price of gold may not increase. And the value of money depends only upon the quantity of gold bullion which money can buy on the market and not on the number of coins (and of units of currency) necessary to make up a given weight of gold (Marcuzzo-Rosselli 1994: 1253-1254).

The point is not that the outline sketched above is a better interpretation of Ricardo's monetary theory, but rather that it is an interpretation that accepts Ricardo's framework of analysis and explores its conceptual content in its own terms, not according to definitions and terms from a posterior conceptual environment, which also happens to be thought of better economic analysis.

The third essay by D. O'Brien, "Long-run Equilibrium and Cyclic Disturbances: The Currency and Banking Controversy over Monetary Control," raises an interesting point about the long-run and short-run distinction, which—once again—cannot be made independent from the conceptual environment considered. He writes: "although there are long-run equilibrium values of monetary variables and of price and income levels, the existence of these in no way justifies ignoring the analysis of the correct response to short-run disturbances which move these variables away from their long-run values" (p. 51). Ricardo is said to be the best example of an approach, which focuses "on conditions of long-run equilibrium, and ignore[s] the nature and amplitude of disturbances around that long-run equilibrium" (p. 67).

There are two issues here. First, O'Brien has in mind a distinction between short run and long run values, based on the length of time required for different causes to work out their effects. However, Ricardian justification for the perception that certain effects persist longer than others is based on the nature of the causes, not on the duration of the effects; only long-period positions—Ricardo would argue—can be made the object of economic theory, because they are the outcome of permanent as opposed to temporary forces. The question in Ricardo's theory is, then, not one of measuring "for how long" or "to what extent" an observed consequence follows from a given cause, before deciding whether it is a short or a long-run effect. The distinction between short and long run pertains to the question of which causes are eligible to become part of a theory, and not to the question of which effects endure or fail to endure.

There is then the other issue of whether this approach is best suited to analyze a monetary economy, which is precisely what Keynes questioned. Since uncertainty prevents the economy from ever getting into long-run equilibrium, the short period is the only relevant period to explain decisions taken in an uncertain environment. Economic theory is not, then, asked to provide an explanation of "permanent causes," but of "motives, expectations, and psychological uncertainties" (Keynes 1973, p. 300). It follows that the short period is not a situation where causes have not fully worked out their effects or where expectations are not fulfilled, but a situation in which expectations generate "a state of things" which con-
forms to it. The distinction between long-run equilibrium values of monetary variables and short-run disturbances is therefore rooted in the context in which the theory is framed. In the Classical case, short period does not matter much because temporary causes cannot be made part of the theory, because their effects are uncertain and volatile and can be offset by more certain and permanent ones. In the Keynesian case, long period is made irrelevant because there is no grounds for ascribing necessity and generality to the distinction between causes, this distinction being contingent on particular, ever-changing circumstances.

The role of the distinction between short period and long period, in particular for issues related to the acceptance or rejection of the quantity theory of money, also turns up in the fourth essay, "J.M. Keynes and the Quantity of Money." In this paper Skidelsky argues that at a certain point "Keynes abandoned the attempt to use the quantity theory to analyse short-run employment and production problems. But he continued to believe that it must form part of any theory of macro-economic stabilization. So his escape from the quantity theory was evidently not complete" (p. 83).

The word "escape," of course, reminds us of the Preface to the French edition of the General Theory, dated February 1939, where Keynes wrote: "The following analysis registers my final escape from the confusions of the Quantity Theory, which once entangled me" (Keynes 1973, p. xxxiv).

In Chapter 21 Keynes discusses the conditions under which the result of the strict quantity theory—a proportional increase in prices as consequence of an increase in the quantity of money—actually hold. We are asked to consider first the effect of a change in the quantity of money on effective demand, and then how the change in effective demand spends itself in increasing output and prices. In other words the elasticity of changes in prices with respect to a change in the quantity of money is given by the elasticity of changes in effective demand with respect to changes in the quantity of money times the elasticity of changes in prices with respect to changes in effective demand. In fact, an increase in the quantity of money may not generate a proportional increase in effective demand; the increase in effective demand may not give rise to a predictable rise in wages, and the rise in output and employment and prices may occur in various combinations so that there is not only one possible outcome.

The really important result achieved by Keynes is not, of course, to have claimed what any defender of the quantity theory of money would readily concede—that there are cases in which an increase in the supply of money fails to increase money prices—but to have provided us with description of a transmission mechanism in which behavioral relationships are ordered according to a clear chain of causes and effects. Keynes' generalization of the quantity theory of money in the General Theory follows a line of reasoning similar to that employed in the theory of income determination: the quantity theory of money results apply under very special conditions: far from being a general proposition it can be applied only in very special circumstances, which rarely occur in the real world.
It could be argued that the attempted reconciliation with the tradition, as in many other instances of Keynes's tactics against the orthodox view, ended up as serving its rehabilitation. Rather than stressing that the quantity theory of money results apply under very special conditions, the Neoclassical synthesis first, and the so-called Neo-Keynesian models later, swept those very special assumptions under the carpet so that the very point Keynes was making against the quantity theory of money was completely missed. The generalized statement of the quantity theory of money which Keynes elucidates provides us with a transmission mechanism from monetary to real factors that can be broken down into a series of steps, each of which may lead to a very different outcome.

This brings me to discuss an interesting point raised by Patinkin in his "Concluding Comments on the Quantity Theory" which is the sixth contribution in the volume (for continuity of exposition I prefer to review it before the fifth). Patinkin challenges—to my mind quite rightly—the contention made by Skidelsky that "Keynes's assumption of the exogeneity of money in this book [The General Theory] is an indication of his continued support" (p. 129) of the quantity theory of money. He reiterates here a point he made in Patinkin (1954), namely that the two further conditions—besides the assumption that output is at full employment level—which Keynes maintains are required for the quantity theory of money to hold, namely "that there is also no speculative demand for money and that effective demand increases in the same proportion as the quantity of money" (p. 130), are not necessary. The only important assumption, according to Patinkin, in order to invalidate the quantity theory within a Keynesian framework is the presence of money illusion in the speculative demand for money, namely the amount of money demanded for speculative purposes is not proportionate to the amount of money and the price level. This seems to me a very thin point, since it is precisely the volatility of the demand for investment goods and of the speculative demand for money (owing to changing expectations) which makes Keynes's analysis—among other things—different from the quantity theory approach. Rather than "illusion" it is "uncertainty" which, according to Keynes, is behind people's behavior in investment and speculative decisions. Here again, Keynes is "remodelled" to fit within the Neoclassical approach, in order to single out the assumptions which would make his analysis compatible with it. The logic of an alternative approach is sacrificed to the need of having one single grammar and language.

The fifth paper by Geoffrey Wood, "The Quantity Theory in the 1980s: Hume, Thornton, Friedman and the Relation between Money and Inflation," deals with a very interesting topic, namely the role of the quantity theory in policymaking. According to Wood, "at the beginning of that [1980s] decade, government after government chose to guide its policy for the economy as a whole by the behaviour of the quantity of money, and by nothing else. ...By the start of the 1990s economic policy had gone back to being guided by a range of indicators; and if central
banks were given clear instructions they were in terms of inflation rather than money supply targets" (p. 97).

In his detailed reconstruction of why this occurred, Wood quite rightly charges monetarism with having been narrow-focused, blind to the role of institutions, obsessed by the econometric approaches to monetary economics and monetary policy, and for these reasons responsible for the downfall of the quantity theory in the ensuing years. While I do not share his description of the quantity theory as a “correct, useful and important theory” (p. 98), I found his paper useful and interesting because of its awareness of the historical setting in which the quantity theory is framed and applied.

In conclusion, this is a collection which will appeal to those who think that the history of economic analysis is a method of “recapturing” past concepts and ideas, by translating them into those assumptions and functional relationships which modern economic theory works with. It will be less liked by those who, like myself, believe that history of thought is about trying to make sense of past intuitions and concepts by reconstruction of the appropriate context. There cannot be a common language from Locke to Friedman: what they share is not the same theory, but a much looser belief that changes in the quantity of money will sooner or later, more or less proportionally, but always in the same direction, affect prices. Historians of economic thought should try to bring out what substantiated this belief in different historical circumstances, and this may well prove quite a different type of theory.

REFERENCES

