“Taking Money Seriously”

Workshop: Real analysis versus monetary analysis: Does it matter and what are its main implications for macroeconomic theory and policy?

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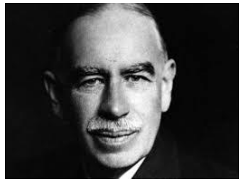
The *General Theory* in essence



- Labor and capital markets do *not* work in neoclassical ways
  - Wage-price flexibility for supposedly ‘automatic’ labor market adjustment highly risky and unreliable
    - Micro analysis of labor market (focus on substitution) does not extend to macro economy; ‘classics’ commit fallacy of composition
  - Interest rate mechanism in the capital market does not even exist
    - Loanable funds theory flawed; ‘classics’ confuse money and saving
- Some implications
  - Stability not flexibility of national wage-price levels key to economic stability and effectiveness of domestic economic policies
  - Under fundamental uncertainty liquidity is valuable; price & availability of liquidity set for real economy by CB & financial system without any real anchor
    - And there goes Wicksell’s ‘natural rate of interest’ … neoclassical world turned upside down!

The neoclassical struggle with money

- Early & lasting response to Keynes' challenge
  - Stable money wages seen as a problem
  - LP and LF seen as equivalent
  - Real balance effect seen as guarantor of systemic stability ("deflation to the rescue")

- The modern RBC-DSGE culmination of futility
  - (representative) agent free to choose (macro) labor supply
    - Micro hegemony restored
  - Intertemporal consumption choice determines the rest
    - No uncertainty/liquidity/finance/banks/default etc.

- Add "frictions" for more "Keynesian" flavor, then focus policy debate on "structural reform" to enhance market "flexibility" (=neoliberal embrace)

Workshop contributions

- Bofinger/Ries – monetary analysis vs. real analysis
  - Building on Keynes' TM framework, show that mainstream 'real analysis' (LFT) not really about this planet and irreconcilable with Keynes' monetary analysis (LPT)
  - 'economics profession has stepped back and de facto reestablished the old paradigm instead of developing the Keynesian framework further.
- Werner – banks and credit creation need to be controlled
  - Keynes' banks control credit *and their asset purchases*
  - Central bank has tough time controlling bank credit by short rates only
- Adam – (pace Friedman) optimal inflation rate may be positive
  - Tobin on inflationary bias in economy with structural change
  - Monetary policy scope for rate cuts; Blanchard (raise inflation target) vs. Rogoff (abolish cash)
- Terzi – fiscal policy needs to be flexible & counteract private sector
  - Rejects 'real analysis' narrative about saving being a source of funds for investment and proposes 'savings-debt identity' instead, with actual and desired stock of financial assets of private sector driving changes in aggregate demand

Quest for taking money seriously is on

- Instead of trying to squeeze pseudo-money into parallel universe of real analysis start with acknowledging that, in this world, it takes money to make anything real ever happening
  - ‘The idea that it is comparatively easy to adapt the hypothetical conclusions of a real wage economics to the real world of monetary economics is a mistake” (Keynes CW XIV, 411).’
  - ‘one could regard the rate of interest as being determined by the interplay of the terms on which the public desires to become more or less liquid and those on which the banking system is ready to become more or less unliquid. This is, I think, an illuminating way of expressing the liquidity preference theory of the rate of interest’ (JMK 14, p. 219).
  - ‘in general banks hold the key position in the transition from a lower to a higher level of activity.’
  - ‘… the rate of interest on money plays a peculiar part in setting a limit to the level of employment, since it sets a standard to which the marginal efficiency of a capital-asset must attain if it is to be newly produced … it ‘rules the roost’ (Keynes 1936, 222-3).
  - ‘It’s liquidity [as provided by the financial system, at a price, – or not!] that is driving the world’ (Alan Greenspan, Jun 07).