10 Post-Keynesian Monetary Theory

Official postwar Keynesianism largely ignored Keynes’ original emphasis on uncertainty, the capitalist entrepreneur’s ‘animal spirits’ and the psychological elements of money holding. In Britain, where the radical milieu in which Keynes had moved remained much in evidence, it became common practice to differentiate between the economics of Keynes and official Keynesianism. Moreover the tradition of the banking school had also retained a strong influence in British policy-making and academic life. These strands of economic thought were instrumental to the emergence of post-Keynesianism.

Post-Keynesianism has become a significant current of economic thought since the mid-1970s, with a varied intellectual output. It has attracted economists who see themselves as the true heirs of Keynes, as well as the more radical followers of Kalecki’s approach to macroeconomics, Sraffa’s neo-Ricardianism and Marxism. The range of post-Keynesian analysis has become very wide, including the analysis of economic methodology, the theory of investment and saving and the theory of distribution. The disparate nature of the components of the current, however, has prevented the emergence of coherent and clearly recognisable post-Keynesian policy proposals. Post-Keynesianism has remained mostly a critique, reflecting the profound disillusionment of many economists with the formalism and conservatism of mainstream economics. However, despite the relative paucity of alternative proposals regarding the future of the capitalist economy, post-Keynesianism has provided vital breathing space for various radical currents of thought and alternative economic analyses of capitalism in the Anglo-Saxon world.

Post-Keynesianism first made its mark in monetary theory in the 1970s and 1980s, at the time when Nicholas Kaldor clashed with Milton Friedman’s ascendant monetarism. In his seminal contributions, Kaldor (1970, 1980, 1982, 1985), one of the leading lights of the Radcliffe Report (1959) in Britain, explicitly associated monetarism with the tradition of the currency school. The present chapter examines post-Keynesianism as a distinctive critique of mainstream monetary theory, concentrating particularly on the points of similarity with
and difference from Marxist monetary theory. The theoretical underpinnings of the post-Keynesian treatment of money and credit are considered first, followed by a discussion of the post-Keynesian claim that the money supply is endogenous.

10.1 UNCERTAINTY, TIME AND MONEY

10.1.1 The Critique of General Equilibrium Theory

In the first of his three well-known lectures on money and inflation, Hahn (1982, p. 1) claimed that:

The most serious challenge that the existence of money poses to the theorist is this: the best developed model of the economy cannot find room for it. The best developed model is, of course, the Arrow–Debreu version of a Walrasian general equilibrium. A world in which all conceivable contingent future contracts are possible neither needs nor wants intrinsically worthless money.

Hahn further argued that a minimum requirement for modelling a monetary economy is that there should be trading at every date. The model should be one of a ‘sequence’ economy rather than of a Walrasian economy in which all transactions are completed at one point in time. This in turn implies the need to have a theory of how price expectations are formed. In such a model, money can find a place as a store of value, functioning as a link between the present and the future. As Hahn also pointed out, however, even under these conditions a unique equilibrium is not guaranteed. The theorist may further allow for uncertainty, positing money as a precaution against uncertainty and a store of value, but a unique equilibrium is still not guaranteed. No firm place for money can be found in general equilibrium models, as long as it is not theoretically established that money possesses some special property relative to other goods.

The problem of logically incorporating a medium of exchange in formal general equilibrium analysis is particularly intractable, as Menger (1892) recognised a long time ago. A solution was proposed by Clower (1967), namely to impose the special property that only money buys goods, that is, that goods do not buy goods. However it is not at all clear how this postulate can be included within the confines of general equilibrium analysis. Hahn’s (1982, p. 21) preferred solution