Keynes and the real world: Davidson, money, and uncertainty

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To cite this article: Virginie Monvoisin & Louis-Philipe Rochon (2009) Keynes and the real world: Davidson, money, and uncertainty, Journal of Post Keynesian Economics, 32:1, 43-58

To link to this article: https://doi.org/10.2753/PKE0160-3477320103

Published online: 08 Dec 2014.

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Keynes and the real world: Davidson, money, and uncertainty

Abstract: In this paper, we show that there are many similarities between the economics of Paul Davidson and the views expressed by the monetary circuit. This is not surprising because they both trace their roots to Keynes. Circuitists emphasize banks and uncertainty; Davidson places the focus on uncertainty, contracts, and money. We seek to show that both approaches are complementary on many levels and offer in fact simply different pieces of the same overall Post Keynesian puzzle. In the end, they both find their inspiration in Keynes, which is still relevant today, as exemplified in Davidson’s new book, John Maynard Keynes.

Key words: banks, Paul Davidson, John Maynard Keynes, monetary circuit, uncertainty.

The question of whether Keynes is still relevant to understanding the intricacies of today’s economies is certainly an important question that deserves closer scrutiny. In light of the current economic/financial crisis, or with respect to reforming the international financial architecture, WWKD (what would Keynes do?) is perhaps more relevant now than ever.

Of course, this question may not be of great interest to many of our mainstream colleagues for whom the question was decidedly answered several decades ago with the collapse of the Phillips curve. Following the stagflation of the 1970s, the profession at large has moved away and beyond Keynes, and the age of Milton Friedman began. For some, Keynes had, at best, some interesting insights, albeit relevant to the short run; for others, Keynesian economics was the cause of many of the problems

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we have encountered during—and since—the Keynesian era. As such, they argue, Keynes should best be left where he belongs—in the past. For them, the world has evolved too much in recent decades; a book written more than 70 years ago is surely irrelevant to deal with today’s contemporary and complex world.

For many heterodox economists, of course, this is akin to throwing out the baby with the bathwater. Whether the interpretation is “old” or “new,” there are fundamental errors in judgment and a profound misunderstanding about what Keynes was all about. Indeed, even though Keynesian economics may have lost its flavor with the economics profession, heterodox economists would claim that Keynesian economics, or what passed for Keynesian economics, has little to do with Keynes. It was some “bastard” version of what Keynes wrote, highly influenced by some “suggested re-interpretation,” exemplified by the perpetual misunderstanding that started with John Hicks and Paul Samuelson, as Paul Davidson (2007) accurately points out. This “synthesis” version of Keynes ignored some of the more fundamental and revolutionary aspects of the General Theory, such as the importance of uncertainty, upon which so much of Davidson’s analysis rests.

Post Keynesians have tried in vain to convince the profession at large that a proper interpretation of Keynes is required for any discussion of contemporary money-using economies. Economies may have evolved, but the underlying structure is still the same: we are still operating within what Keynes called a monetary economy of production where uncertainty is a pervasive element that influences our decisions to consume, invest, and more. In other words, Keynes’s analyses are still relevant today, and indeed perhaps even more so in light of recent events.

Recently, Davidson provided a possible answer. In his remarkable book, John Maynard Keynes, Davidson provides a clear and distinctive interpretation of Keynes and of Post Keynesian economics, which enriches and pushes forward the boundaries of our collective understanding of Keynes. Davidson provides us all, students and academics alike, with a well-written and refreshingly accessible account of Keynes’s life, work, and contribution. He provides convincing answers to a number of questions and devotes much of the book to deconstructing neoclassical theory and providing a better edifice based on the insights of Keynes. Much of Davidson’s book is devoted to debunking a number of important Keynesian myths.

It becomes clear, of course, that Davidson thinks that Keynes is still very much relevant today. Davidson achieves this by setting forth to explain “how a monetary economy really works” (ibid., p. xiii), and
he hopes that readers will see how Keynes was “so obviously correct” (ibid., p. xiii).

To most Post Keynesians, this is certainly not an extravagant statement. But Davidson goes even further. Indeed, Davidson sets himself another tall task—to convince us that Keynes was not only the most prominent economist of the twentieth century, but that he was the most important or “greatest Englishman of the 20th century” (ibid., p. 1). We will let readers reach their own conclusion, but there is certainly some merit to this statement. After all, the economic policies based on Keynes saved capitalism from its own destruction. And at the time of writing this paper, politicians seem to be rediscovering Keynes in the hope of saving capitalism once again. In that respect, perhaps Keynes was the “greatest Englishman.”

The objectives of this paper are not to review John Maynard Keynes or to provide an appraisal of every aspect of Keynes’s writings, as discussed by Davidson, but rather to take a narrower view of credit, money, and the endogeneity of money. Others in this symposium discuss other aspects of Keynes’s and Davidson’s work. As we will see, Davidson’s interpretation of Keynes offers us key insights into the workings of a money-using economy in which uncertainty is prevalent.

We set ourselves another, perhaps more controversial, task. Writing from the perspective of the monetary circuit, we wish to show that there exists a natural parallel between Davidson and the monetary circuit, because both approaches trace their roots to Keynes. Not everyone would agree, of course. But we think that even though both approaches focus on very different aspects of money, they are nonetheless complementary inasmuch as they each provide a different piece of the overall heterodox puzzle. In that sense, much of the difference is a matter of emphasis and can be reconciled within an overall theory of a monetary economy of production.

This paper is divided into two sections. First we discuss the Post Keynesian theory of endogenous money. We present the main arguments of the theory of the monetary circuit and of horizontalism, as these represent the consensus among post Keynesians. Then we look at Davidson’s views and how, in fact, they are linked in many respects to the discussion of the monetary circuit. Here, we will be examining closely his contribution to monetary theory and policy, as presented in his John Maynard Keynes.

Post Keynesians, credit, and the monetary circuit

The endogenous nature of credit-money is the anchor of Post Keynesian economics, as it carefully brings together the monetary and the real sides
of economic analysis. This is an important first step in understanding the working of economic systems and of capitalism in particular. In mainstream economic analysis, real and monetary sides are independent from one another. This is the meaning of the neutrality of money: it allows us to discuss economic growth, investment, unemployment, and production without referring to credit, money, or a banking system, which are added at a later stage to give semblance of a more realistic economic model. Nevertheless, the analysis of money is simply some afterthought and is not integrated into the main neoclassical model of exchange.

For Post Keynesians, of course, money is integrated into the discussion of production through a careful sequential analysis of economic events in historical time. We cannot discuss output, production, unemployment, or real analysis in general without first discussing the banking system, monetary debt contracts, or credit. But it is more than simply suggesting that the real and monetary analyses are interdependent—they are rather integrated with one another in such a way that the analysis of one side of the economy requires the simultaneous analysis of the other.

The endogeneity of money contains two arguments. The first deals with the nature of money—that is, how it is created and the role played by institutions. We argue here that money is indeed a social institution resulting from debt and double-entry accounting, but its endogeneity does not depend on the existence of a central bank. In other words, as we will see below, money is endogenous, irrespective of the existence of a central bank or the historical period. As Parguez and Seccareccia argue, “the neoclassical scarcity principle can never be applied to the creation of money” (2000, p. 106).

The second issue deals with the exogeneity of the benchmark rate of interest. Here, the central bank is important because it alone has the authority to set the rate of interest, at least at the very short end of the spectrum, which in turn will have some influence on a number of other rates of interest. It is true that economic events may influence the central bank to vary the rate of interest, such as in Taylor rules. But this does not negate the exogeneity property of the rate of interest. At the end of the day, it is still an administrative decision to change the rate. In other words, the central bank is confronted with contradictory information regarding the performance of the economy, and it must decide whether to increase, decrease, or maintain the rate of interest. In this context, the rate of interest is best described as an administered price.

Interestingly enough, the central bank appears in this discussion in an asymmetrical way: it is important for the setting of the rate of interest but not for the endogeneity of money, per se. This asymmetry, as we ar-
gue later, stems naturally from the simple question of “what is money?” (Smithin, 2000), which is developed below.

**Keynes and money’s endogeneity**

In discussing the endogeneity of money, Post Keynesians find inspiration in a number of writers, such as Knut Wicksell and Nicholas Kaldor, to name but a few. Keynes, of course, is a central figure, too, as are some of his followers, such as Richard Kahn and Joan Robinson. Yet Keynes seemed to have given some conflicting messages on the endogeneity of money. For instance, in the *General Theory*, there can be no doubt that money is exogenous and under the control of the central bank. Yet, in the *Treatise on Money*, and certainly after the publication of the *General Theory*, money appears to be endogenous (Rochon, 1999). This apparent contradiction has generated some concern over Keynes’s actual views on money and some great debates. How then can we explain this confusion?

Some have attempted to reconcile this contradiction by claiming outright that money is endogenous in the *General Theory*, but that it is taken as “given,” rather than exogenous. Dow (1997) argues that Keynes was implicitly aware of the endogeneity of money and assumed it so in the *General Theory*. This, of course, is wishful thinking at best. After all, the endogeneity of money implies that the quantity of money grows with production and output. Because the *General Theory* is about explaining “the forces which determine changes in the scale of output and employment as a whole”—in Keynes’s own words—how then can money simply be “given”? If there are changes in output and employment, these must be financed by credit, and this implies a growing money supply. The money supply can therefore not be taken as given.1

We could argue that this represents a gross mistake or inconsistency in Keynes’s thinking, and perhaps it does. After all, Keynes claimed to be “struggling,” and still had “vestigial traces” of neoclassical theory. Maybe he did not “get everything right” in his mind. But we do not think that it questions Keynes’s understanding of endogenous money. Rather, we would argue that the purpose of the *General Theory* was never to explain the endogeneity of money, but rather effective demand. In order to “get a better hearing,” Keynes dispensed with the endogeneity of money (Robinson, 1970) and placed monetary factors “into the background.”

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1 Although in Dow and Dow (1989), the authors recognize that the money supply was exogenous in the *General Theory*, and that Keynes had made a “tactical” decision.
Keynes surely realized this was a poor strategy altogether, an argument he set forth in a number of articles in the *Economics Journal* clarifying his position and where he introduced the finance motive, which is analogous to the demand for bank credit. We argue that the endogeneity of money is now made evident when Keynes discusses the importance of banks in financing the production needs of private agents—notably, firms. In introducing this “fourth motive,” Keynes now brings together the creation of money (the finance motive) with the uses of money once created (transactions, precautionary, and speculative motives).

But the finance motive creates a bridge with Keynes’s pre-*General Theory* thinking in an important way. Keynes returns to an original idea of placing the importance of the banking system at the very heart of economic expansions. For Keynes, banks “hold the key” to economic growth (1973, pp. 216–223), whenever we wish to move from “a lower to a higher scale of activity” (ibid., p. 222), by financing this expansion with bank credit, independent of prior savings or bank deposits.

These are themes that Keynes had touched on before the *General Theory*. In the *Treatise on Money*, for instance, Keynes argues precisely that “by the scale and the terms on which it is prepared to grant loans, the banking system is in a position . . . to determine—broadly speaking—the rate of investment by the business world” (1930, p. 138). Credit is needed for the production of both consumption and investment goods: “production of consumption goods require the prior provision of funds just as much as does he production of capital goods” (Keynes, 1973, p. 282). Money is therefore endogenous and is tied to bank credit.

With respect to the rate of interest, we believe that Keynes comes to argue that the rate of interest may not rise during an expansion provided the money supply is adjusted appropriately (ibid., p. 80). If we accept the idea that Keynes defended the notion of endogenous money after the *General Theory*, then this would necessarily imply that the rate of interest “need not rise” because money is created endogenously as investment is financed. It is therefore a reasonable assumption to argue that Keynes accepted the administered-price view of the rate of interest.

What is money? *credit and debt*

Based on the insights of Keynes and his followers, among others, Post Keynesians and circuit writers have developed a theory of endogenous money which centers on the ability of banks to finance the production needs of firms. The Post Keynesian theory of endogenous money therefore builds on Keynes by developing his views on the finance motive and the rate of interest as an exogenous variable.
Yet, among Post Keynesians, there has been considerable debate on the precise meaning of endogeneity, or more precisely the mechanisms by which money is made endogenous, and considerable debate as to the role of functions of central banks, both among Post Keynesians and between Post Keynesians and circuit writers.

In our view, there are two overall debates, both dealing with money’s endogeneity. First, there is the familiar debate between horizontalists and structuralists which dominated the Post Keynesian landscape for nearly two decades and has been analyzed at length (Lavoie, 1996; see Rochon, 1999, for a more detailed analysis). Many would claim that both approaches are competing explanations of the endogeneity process, but we believe that they are an explanation of a different element of the same process. In other words, they both emphasize a different relationship within the same process of monetary creation. This said, we believe this debate is largely resolved, as there has been considerable consensus in recent years over the general tenets of horizontalism. It is difficult to argue today that the rate of interest is anything but set by the central bank at its desired level, and that the accommodative nature of the central bank is well entrenched.

There is another misunderstanding we believe on the precise meaning of endogeneity, explored in some detail by Rochon and Rossi (2010), and they deal specifically with the historical roots of money’s endogeneity. Rochon and Rossi (ibid.), for instance, argue that there are the evolutionary endogenists who follow Chick’s (1986) argument that money only became endogenous over time as the banking system developed. On the other hand, there is a competing argument that they call the revolutionary endogeneity approach, according to which money was always endogenous, irrespective of the historical period or the stage of banking development (Parguez and Seccareccia, 2000). For the revolutionary endogenists, largely influenced by the insights of the theory of the monetary circuit, money’s endogeneity is not tied to any specific institutional feature but is a direct result of a debt relationship between agents (see also Innes, 1913; Wray, 1990, ch. 1). They reject barter as historically accurate and the argument that money became endogenous through time, as a direct result of the evolution of the banking system or the existence of a central bank. In fact, as Lavoie argues,

accommodation or the lack of it, liability management or the lack of it, and financial innovations or the lack of it are second-order phenomena compared to the crucial story that goes from debt creation to the supply of means of payment. (1996, p. 533)
To better understand this notion, we need to consider what Lavoie, 25 years ago, called the two poles of endogeneity (see Lavoie, 1984). According to this approach, a full explanation of money’s endogeneity requires an analysis of two specific relationships: first, the one between banks and bank customers, which deals with the demand for credit-money; second, the relationship between banks and the central bank, which emphasizes the demand for central-bank or high-powered money. In both cases, the supply adapts to the demand. In other words, the demands for credit-money and for central-bank money are endogenous. Yet the order of these relationships is crucial: the relationship between banks and borrowers arises first in the sense that the creation of money (that is, loans create deposits) precedes the second relationship (deposits create reserves).

This being said, each pole describes a different part of the endogeneity process. The first relationship explains the endogeneity of credit-money—that is, the creation of money. Bank borrowers, traditionally firms seeking to obtain funds for their production needs, will approach banks for a loan. As Keynes (1973) reminds us, banks are “specialists”: only they can supply firms with the necessary credit to pay wages and purchase other inputs used in the production of goods. Provided they are deemed creditworthy and meet the bank’s standards for borrowing (see Rochon, 2006), they will be granted credit (usually in the form of a line of credit). When firms remunerate workers, money is created and released into circulation. The creation of credit-money in this sense is synonymous with the creation of income and is the result of debt; money is the mere physical manifestation of debt, through double-entry accounting: it is a “pure token” (Parguez and Seccareccia, 2000, p. 105).

Yet, even though the money supply is credit driven and demand determined, this does not mean banks will agree to fund the production needs of all firms. Banks are governed by “sudden bursts of optimism and pessimism”—to paraphrase Keynes—and their lending behavior reflects this. In this sense, uncertainty plays a key role in the theory of endogenous money and the theory of the monetary circuit. During booms, as banks are optimistic about the ability of firms to reimburse their debt, they will tend to lower their creditworthiness standards and lend more, simply because more borrowers now qualify and are deemed worthy of credit. This credit boom will lead to higher growth and more lending. In fact, Rochon (2008), based on the insights of Kahn (1931), has tied the multiplier process to bank lending. According to Kahn, the existence of the multiplier rests on the “co-operation of the banking system” (ibid., p. 174). As they feel optimistic about the business cycle, they will validate their own optimism by lending. Sawyer (2008), in his interpretation of
Michal Kalecki, reaches a similar conclusion. Uncertainty is therefore crucial in understanding the behavior of firms and also of banks: it is a key argument in the theory of endogenous money.

The opposite, of course, holds true in a downturn: pessimistic about the near future—that is, the perceived inability of firms to pay back their initial loan, which could be triggered, for instance, by increased rates of interest or a general uneasiness about the business cycle (among other possible explanations)—banks may refuse to offer credit and curtail their lending. In this sense, endogenous money and the overall horizontalist position are wholly compatible with Keynes’s “fringe of unsatisfied borrowers” (Lavoie, 1996; Rochon, 1999; Wolfson, 1996). According to this view, credit crunches are periods of extreme pessimism, as we are living through now: banks are doubtful that borrowers will be able to meet their contractual agreements and simply do not lend.

One thing, however, is clear: banks are always able to lend but may simply choose not to lend given the economic situation, or borrowers may not want to borrow either. This is a fundamental difference with the more mainstream interpretation of banks as financial intermediaries. For Post Keynesians, banks are generally constrained in their willingness to lend during a contraction, and by the availability of good borrowers during a boom; they are never constrained by a lack of deposits.

These debts, of course, are extinguished when firms sell their products and reimburse banks. At that stage, money is also destroyed. The creation of money is what Graziani (2003) called “initial finance” or the efflux phase, whereas the destruction of money can be labeled “final finance” or the reflux phase. If credit money was meant to be created, it is not meant to be held: “Credit money, as a rule, is this created only to be destroyed in the circulatory process and not to be held” (Parguez and Seccareccia, 2000, p. 102). To hold money means that households are not consumers, which represent a potential problem for the closure of the circuit.

The above discussion emphasizes three important elements in the theory of money’s endogeneity. First, radical uncertainty is at the heart of the story. Because the future is unknown and unknowable, both firms and banks must make bets on the expectations of effective demand in the future. As uncertainty grows, pessimism sets in, and both firms and banks will decrease their entrepreneurial spirit (Davidson, 1972). Second, money is the result of a debt incurred for the purpose of production. The endogeneity of money, according to this first phase, is the result of a debt incurred by private agents, through the banking system. In this sense, this implies that money was always endogenous, and not the result of any stage in the development of the banking process, as suggested by
Chick (1986). The evolutionary approach to money’s endogeneity is thus invalidated as being groundless in historical facts. As Parguez and Seccareccia wrote: “Money is the by-product of a balance sheet operation of a third agent. . . . Money emerges both causally and historically as a result of prior debt and credit relations” (2000, p. 101; also see Rochon and Rossi, 2010, for a detailed critique).

Third, we can see by this analysis how money is the result of a flow or rather how money is foremost a flow. This is another fundamental difference with the mainstream analysis where money is only treated as a stock. For Post Keynesians, however, the first relationship discussed in the endogeneity of money—that is, the relationship between private agents and banks—can thus be described as alternating flows of creation and destruction of money. All three of these conclusions are present in Davidson’s analysis, although the emphasis in his new book is placed primarily on the stock analysis of money, although Davidson has written extensively in the past on the flow aspect and the finance motive.

The second pole, the one between banks and the central bank, explains the endogeneity of central bank money. This relationship was at the heart of the debates between horizontalists and structuralists and centered on whether the central bank fully accommodated the needs of the banking system. Yet whether the central bank fully accommodates or does not invalidate the endogeneity of money depends on the relationship between banks and bank borrowers.

Through the normal process of daily transactions as well as lending, banks require central bank money largely to extinguish debt among themselves. Just like before, a third agent’s liabilities must be used to extinguish debt and guarantee payment finality. Banks therefore need central bank money to do so (Rochon and Rossi, 2007). In fact, the central bank has little choice but to validate the banks’ demand for reserves or settlement balances. Otherwise, it would simply place the banking system at risk. In fact, central banks not only are lenders of last resort, but they intervene on a daily basis to guarantee the stability of the overnight market and to keep the benchmark rate at its desired target. This is what Eichner (1987) called the defensive nature of central bank operations.

Last, it is evident that monetary policy is not concerned with the control of monetary aggregates. As we previously claimed, money is endogenous. Yet central banks do exert control over the rate of interest, which they set exogenously at a level consistent with their overall economic objectives, usually inflation. As Lavoie (2005) explores, central banks have great control over interest rates and can hit their benchmark target with aplomb, as further explained in great detail by Fullwiler (2003). There
is no more doubt that the exogenous control of central banks over the rate of interest is complete.

More importantly, changes in the rate of interest may end up having an effect on the real economy, although this effect may not work itself through the normal channels. Rather, following Lavoie (1992), Rochon (1999), Rogers (1989), Smithin (1994), and many others, Post Keynesians see the rate of interest as a distributive variable. In this sense, changes in the rate of interest will change income distribution, which will have an effect on consumption and ultimately growth. In this sense, money is not neutral, in the sense that changes in the monetary policy stance of the central bank will have effects, and long-lasting ones indeed, on the real economy.

Finally, there is one last element that needs to be discussed, although this is not discussed much within the circuitist school, and it has to do with the demand for money. It is clear, however, that the demand for money is not the same as the demand for credit. The demand for credit, if validated by the banking system, leads to the creation of money. So the two concepts are distinct.

The demand for money therefore only applies once the money is created, and has to do with the decision by households to allocate their savings, between liquid or hoarded savings, and other assets. These decisions, highly influenced by uncertainty, will carry important consequences with respect to output, employment, and growth: increases in the demand for money imply a decision to forego consumption. So, obviously, any decision to hold on to money as a stock of liquid assets will have dire consequences on the economy: it is in this sense that money can be primarily a flow, but also a stock.

**Davidson on Keynes on money**

Circuit writers do not pay much attention to the demand for money or liquidity preference; Davidson, however, does. In this sense, both approaches can be deemed complementary, although there are certainly some areas of disagreement. Nevertheless, Davidson’s analysis provides readers with a detailed analysis of the importance of money and a different approach to Keynes’s monetary theory of production.

As stated above, many of the elements of the monetary circuit are present in Davidson’s analysis and figure prominently in *John Maynard Keynes*, with only one exception: the book says nothing on central banks. This is not surprising because Davidson and Keynes had relatively little to say on this topic. Nevertheless, from the point of view of endogenous
money, the central bank is not needed per se: money is endogenous irrespective of the presence of a central bank.

Money is an important component of Keynes’s and Davidson’s views of economic systems. Money—and decisions regarding money—plays a central role in explaining the existence of unemployment and effective demand. Many of the ideas presented in the first part regarding the theory of the monetary circuit and the endogenous creation of money are present in Davidson’s interpretation of Keynes. In this sense, there is considerable convergence between the two approaches. Both are well grounded in Keynes’s concept of a money-using economy of production where contracts are denominated in money.

In *John Maynard Keynes*, however, Davidson does not spend a lot of time dealing with the creation of money or the finance motive, surprisingly, although he does discuss it, albeit briefly, a few times. But when it is discussed, the essence of the argument is clearly spelled out, where money and debt are linked, and the creation of money through the banking system is endogenous: “in a world where money is created primarily only if someone increases their indebtedness to banks in order to purchase newly produced goods” (Davidson, 2007, p. 89).

Davidson specifies that

> investment . . . is constrained, in a money-creating banking system, solely by the expected future *monetary* (not real) cash inflow . . . upon which banks are willing to make additional working capital loans to entrepreneurs to provide the latter with sufficient liquidity, so they can meet their hiring and material-purchase contractual commitments during the production process of capital goods. (ibid., p. 89, emphasis in original)

Here, Davidson expresses clearly the endogenous theory of money and brings in an element of uncertainty. Both firms and banks are concerned by these future monetary flows that, in essence, validate the loan.

We would add, however, a caveat to Davidson’s analysis. Here, he does not discuss the bank financing of wages—loans seem to be limited to investment. Nevertheless, the link between debt and the creation of money is specified, albeit quickly, and money is made endogenous.

Davidson spends much of the chapter on money discussing the importance of uncertainty—in a nonergodic sense—and how it relates to the uses of money. His analysis begins with some strong statements on the invalidity of barter and the importance of social (human) institutions, and in particular how money is nonneutral (money matters) both in the short and the long run. Uncertainty exists, as Davidson tells us, because
our economies are moving “from an irrevocable past to an uncertain and statistically unpredictable future” (ibid., p. 77).

The production of goods takes time; the consumption of capital goods and of durable goods takes time. These production and consumption processes are, by their very nature, irreversible. Real time is therefore an asymmetrical variable, meaning, among other things, that although we may know the past, we cannot know the future. (Davidson, 1985, pp. 260–261)

There are two overall elements to Davidson’s analysis of money: one that deals with the demand for money, as discussed above, meaning an allocation of household savings (liquidity preference), and the role and nature of contracts. For Davidson, in any money-using market system, contracts denominated in money matter greatly. Contracts are widely used precisely to reduce the uncertainty inherent in production and exchange transactions. In fact, they are “the essence of the entrepreneurial system” (2007, p. 77, emphasis in original). Hence, contracts are an institution developed to better equip ourselves with the possible impact of uncertainty: “binding nominal contractual commitments are a sensible method for dealing with true uncertainty regarding future outcomes” (ibid., p. 88).

And while Davidson specifically relates contracts to the role of money as a store of value, nothing really prevents us from expanding this approach to include bank loans, which are in themselves a contractual agreement between banks and borrowers. Davidson writes:

In any money-using entrepreneurial economy, entrepreneurs’ decisions regarding the volume of production and the contractual hiring of labor and material inputs depend on the entrepreneurs’ uncertain expectations of receiving future money sale revenues (cash inflows) in excess of the contractual money costs of production (cash outflows) of items produced for sale. (ibid., p. 78)

This is certainly compatible with the monetary circuit where entrepreneurs’ decisions regarding these production decisions are certainly based on their expectations of sale proceeds (Rochon, 1999). These expectations must, however, also be tied to the finance motive for production to begin. In evaluating entrepreneurs’ creditworthiness, these expectations regarding the excess of inflows over outflows will certainly be considered.

Moreover, we could argue that a loan is a contract in which the “date of payment [reimbursement] is later in calendar time than the date of delivery [of the line of credit]” (Davidson, 2007, p. 80). Viewing it like
this makes both approaches perfectly compatible. In fact, Davidson al-
ludes to this:

the actual sales contract included an elemental loan contract where the
seller (or as third party intermediary such as a credit card company) is
furnishing a loan to the buyer for the period between the delivery date
and the payment date. (ibid., p. 80)

Davidson does apply this to consumption largely, but it could be applied
equally well to production and bank loans.

Uncertainty can also be applied to the demand for money, as liquid-
ity. Faced with uncertainty, agents will need to hold on to money to
meet any future monetary contractual obligations. Money is a “security
blanket” (ibid., p. 79). The higher the uncertainty, the higher will be the
demand for money. Yet, as Davidson writes, “[m]oney and the posses-
sion of liquidity affects decisions making that impact on employment
and output outcomes” (ibid., p. 76). Because of the pervasive nature of
uncertainty, agents will always hold on to more money: unemployment
is the general outcome.

This is precisely why money was not meant to be held, as Parguez and
Seccareccia (2000, p. 102) claim, because its holding will threaten the
closure of the monetary circuit. Whenever households do not spend—
that is, whenever they save—they lower economic activity and threaten
the system. And by placing banks at the heart of this analysis, we can
conclude that higher savings imply that firms will be less able to extin-
guish their debt, and may not be able to renew their debt in the future,
thereby threatening even more economic activity. In other words, “future
monetary cash inflows” will be weakened, and that will carry important
consequences.

Conclusion

Davidson has written a strong and convincing book on Keynes that is
accessible to students and faculty alike. Although there are a great many
books on Keynes, this one stands out for its ambitious objective of prov-
ing that Keynes was the greatest Englishman. The admiration Davidson
has for Keynes is evident, and rightly so. After reading this book, we are
left with a deep understanding of Keynes’s policies and how his views,
more than 70 years later, are still relevant today.

The book covers a number of themes and topics, and space limitations
prevent us from dealing with many of them, including the international
financial architecture. We limited ourselves at comparing the work of
Davidson on money with the more general ideas within the theory of the monetary circuit. There are important differences, and there are very strong similarities, which is not surprising given both approaches find their inspiration in Keynes. And even though they both emphasize different aspects of money, there are natural parallels between the two approaches. For instance, they both emphasize uncertainty in discussing money, although Davidson focuses more on uncertainty and the uses of money and money-contracts, while proponents of the monetary circuit emphasize bank lending and uncertainty.

Of course, Davidson also acknowledges bank lending and the finance motive, although too briefly. The book would have been made stronger had it taken more of a central role, rather than a few pages. Nonetheless, the discussion over future monetary flows applies quite logically to both approaches.

Finally, we leave the readers to decide whether Keynes was indeed the greatest Englishman. He was, of course, a great economist, and Davidson provides us with great proof of this. Younger readers now have to take up the Keynesian challenge, and this book is a great place to start.

REFERENCES


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