

Money, Uncertainty and Time

Giuseppe Fontana

Abingdon, Routledge, 2009, 160 pp., £75.00 hardcover, £24.95 paperback

ISBN 978-0-415-27960-4 / 978-0-415-58873-7

This concise offering showcases the results of the author's doctoral research within the wider context of his thought. Although not an *apologia pro vita sua*, the book explains where Fontana is coming from and his desire to build bridges both within Post Keynesian economics and across the divide. He defines Keynesian economics in terms that accommodate New Keynesians yet insists on the need to move beyond a theory of imperfections to a deeper engagement with Keynes's thought. He sets out a synthesis of the Horizontalist and Structuralist approaches to endogenous money and manages to find positive things to say about both Hicks and Graziani in the same volume.

Part I presents a useful analysis of the history of Post Keynesian thought including a candid assessment of the tensions and divisions that have arisen during the current 'age of uncertainty' as the school struggles to find a common methodology. Part II offers a theory of individual knowledge based on a fresh analysis of Keynes's theory of probability and finds in it a basis for both monetary circuit and liquidity preference theory. Part III draws on both approaches to create a framework for understanding the endogenous money debate.

The principal innovation in Part II is a distinction between two types of Keynesian uncertainty (as opposed to risk). Uncertainty₁ applies when a probability relation (a degree of rational belief) is perceived but carries low weight. Uncertainty₂ means no probability relation can be calculated and, therefore, no weight can be placed upon it, a state of 'pure uncertainty'. Uncertainty₁ reflects an incompleteness

of the evidential base for probable knowledge, while Uncertainty₂ reflects an inconclusiveness.

Fontana relates this distinction to the different functions of money, as means of final payment (Uncertainty₁) and as store of value (Uncertainty₂), and respectively to the Monetary Circuit and 'Non-ergodic/Monetary' strands of Post Keynesian thought. He argues that Uncertainty₁ explains the need for a means of final payment while Uncertainty₂ explains liquidity preference. Does this neat mapping work?

It is true that the possibility of default calls for a means of final payment to discharge debts and, where no credit is allowed, for the immediate settlement of any contract. The hallmark of a monetary production economy is that wage-earners must be paid in money, so that money enters into the heart of production. Yet is this solely a matter of uncertainty? Is it not more a question of the division between employers and employed and the division of labour itself? Wage-earners cannot consume their output of (say) ball-bearings and by definition do not trade in goods, or claims on goods. Furthermore, money is necessary for production, but is bank credit? Is it not sufficient that employers have capital, including or exchangeable for commodity or state money? Bank money is a secondary response to a shortage of liquidity and can be, and generally is, created other than in response to the needs of production.

The difficulty with Uncertainty₂ is its lack of gradation: 'we simply do not know'. While that is certainly one of Keynes's statements, perhaps it should not be taken at face value in this context. In his substantive treatment of the choice between money and bonds, liquidity preference is a matter of degree and fluctuates with the state of confidence. Furthermore it is hard to argue that the yield on a bond presents no basis whatsoever for a calculation of probability, however tenuous. Keynes himself does not reduce even the physical investment decision to a matter of animal spirits

alone; he merely states that reasonable calculation must be ‘supplemented and supported by animal spirits’ (Keynes, 1936, p. 162). It is therefore unclear to me how much value is added by this division of uncertainty into two categories.

The centrepiece of Part III is a four-panel diagram relating interest rate, bank lending, bank deposits and bank reserves. Fontana uses the diagram to illustrate and reconcile the differences between Horizontalist and Structuralist theories of endogenous money. He invokes Hicks to argue that Horizontalists consider a single period during which expectations are unchanged while Structuralists consider a sequence of periods over which agents react to previous outcomes. The device separates the analyses, on the one hand of a flow of new bank lending, and on the other of the impact of the consequent change in money supply on portfolio decisions and the central bank’s reaction function. It is a good example of the proper use of abstraction.

I wonder if the distinction is really about constant versus changing expectation. The problem is that we are addressing a complicated system in which different forces for adjustment operate at different speeds or at different intervals. Of course, expectations may well change, but arguably the Structuralist version of the diagram presents a static solution for a state of expectation that persists long enough for all the adjustments and interactions to take place. This is what Keynes would have called a long-period position.

There is some confusion in the discussion about banks’ liquidity preference and the credit market (pp. 102–103, 110–111), between cash reserves (= liquid assets) and capital reserves (= equity, or net worth). The Horizontalist claim is that bank lending is perfectly elastic since banks cannot become short of reserves in the first sense; the central bank must accommodate at the policy rate. The Structuralist

approach envisages a sloping (or rising, in a step function) bank credit supply curve, which Fontana states is based on the increasing debt/equity ratios of both firms and banks. The latter is not a matter of liquidity-preference but of capital adequacy. The central bank does not provide capital on demand, even in a crisis. Capital requirements are an exogenous constraint on bank lending, although recent history has demonstrated the political power of banks to push this constraint outwards. Thus it is correct to say that money supply is a matter of banking policy, including the state of the capital markets, rather than production demand alone, although policy may be more flexible and capital easier to raise during some periods than others.

In the discussion about financial markets (pp. 112–115 and Figure 8.3), the relationship between bank lending and deposits is held to be determined by the portfolio preferences of wage-earners. I should have thought it was determined by the banks: banks determine their own liability structures, the market determines the terms on which each type of funding is available.

The primary value of this book is as an exemplar in research method that any graduate student, in particular, will find helpful. Fontana reads with a good will and takes trouble to identify the positive insights of others and incorporate them into a wider schema. This is an excellent instinct, even if it serves on occasion to identify more clearly where and why the differences cannot be reconciled.

M. G. Hayes

University of Cambridge

Email: mgh37@cam.ac.uk

Reference

Keynes, J. M. (1936) *The General Theory of Employment, Interest and Money* (London: Macmillan).