

MODERN MONETARY THEORY

M. L. BURSTEIN

'Mais nous nous représentons l'avenir comme un reflet du présent projeté dans un espace vide, tandis qu'il est le résultat, souvent tout prochain, de causes qui nous échappent pour la plupart.'—Marcel Proust, *À la Recherche du Temps Perdu*, Vol. xii, *La Prisonnière* (Paris: Gallimard, 1923) p. 146.

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MODERN MONETARY THEORY

By the same author

MONEY

ECONOMIC THEORY: Equilibrium and Change

NEW DIRECTIONS IN ECONOMIC POLICY

THE COST OF TRUCKING: Econometric Analysis (*with others*)

RESOURCE ALLOCATION AND ECONOMIC POLICY
(editor with Michael Allingham)

**STUDIES IN BANKING THEORY, FINANCIAL HISTORY
AND VERTICAL CONTROL**

For Milka

*Why with time do I not glance aside
To new-found methods and to compounds strange?
Why write I still all one, ever the same
And keep invention in a noted weed,
That every word doth almost tell my name,
Showing their birth and where they did proceed?*

.....

*So all my best is dressing old words new,
Spending again what is already spent;
(Shakespeare, Sonnet LXXVI)*

Preface: Apologia

A living science practises creative destruction. Modern developments are recombinations of old ones, infused with drawings from expanding technical possibilities. Yesterday's economics disappears; and continues. This book is meant to supply an example.

English economics is in my bones. I began to read the *General Theory* in 1941; and will die reading it. I tried to explain in 1975 (in *Economic Inquiry*) why the book, and its author, have fixed my star. But I have not before acknowledged how much I owe to Roy Harrod and Joan Robinson for the many hours they indulged me in Evanston; I have a special feeling for the 'Circus' too.

I began to read Marshallian economics in Wisconsin forty-five years ago. When I first came up to the University of Chicago, its leading figure, for a seventeen year old, and an avid reader of the press, was Henry Simons. Simons, a fascinating and kind man, and, of course, a practitioner of Marshallian economics, gave me a lot of his time. By the time I entered Chicago's graduate-economics programme, twelve years later, Marshallian economics was being expounded there with brilliant lucidity by Milton Friedman, an exemplary teacher. The book will show that I have been as thoroughly infected by Friedman's price theory, including its applications to monetary economics, as perhaps resistant to monetarism.

The flow of the narrative must be interrupted to note the influence of a remarkable, wonderfully American, economist and philosopher, Frank Knight, the most revered of my many great teachers. Mr Knight cannot be pigeon-holed. He requires and deserves a special paragraph. (Chapter 6 displays his influence, as does Chapter 8.) To have known and loved Knight grants immunity against viruses that would transform economics into petty engineering.

It became necessary to assimilate the analytical apparatus that might be called MIT economics. I single out the work of Paul Samuelson: partly because it is colossal; partly because Samuelson, along with W. A. Mozart, S. S. van Dine, T. S. Eliot, Marcel Proust *et al.*, belongs to a gaggle of geniuses, personally unknown to me, who are exceptionally

salient in my mind. He, along with Debreu, Gale and his co-workers Dorfman and Solow (see *Linear Programming and Economic Analysis*) and, recently, Arrowsmith and Place, developed for me a sense of mechanism that in time led to a quite complete turnover of my stock of images of the macroeconomy.

Formal, more-or-less mathematised, economic theory has at least three commanding virtues.

It makes it possible to strip one's reasoning to essentials; and to find that Beauty which informs Truth.

It communicates with physics.

It supplies a language permitting efficient communication within and between generations of students of economics, incidentally making it much easier to discover Error.

Whatever its virtues *en général*, the more formal economics (which one would be tempted to call continental in inspiration if Hicks's *Value and Capital* were not so important to it) has led to paradigms that have revived the corpse of monetary theory. Inevitably, then, a discriminant identifying *modern* monetary theory is a degree of formalism. The success of the resulting synthesis owes much to James Tobin, as the book will make clear.

From the beginning, monetary theorists have quarrelled – they love to quarrel – about *What is money?* The book suggests that the question has no useful answer: monetary theory may not be about money!

The formal analysis is based on two paradigms:

(1) Statics are nested in properties of rest points of dynamic systems, e.g.

$$\dot{x} = f(x)$$

(2) Comparative statics are extracted from linear systems obtained by differentiation in neighbourhoods of equilibria:

$$A(d\bar{x}) = B(d\alpha)$$

M. L. BURSTEIN

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Part I

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