MONEY AND MONETARY POLICY IN THE VIEW OF KALECKI

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Monetary theory is an unusually changeful part of economics ...

'Gladstone, speaking in a parliamentary debate on Sir Robert Peel's Bank Act of 1844 and 1845, observed that even love has not turned more men into fools than has meditation upon the meaning of money.' Marx 1970, p.64

A rapid succession of monetary theories

Credit controls, 1940s to 1970s

Monetarism, 1980s

New Consensus (inflation-targeting) 1990s-2008

Since 2008 ??? (Unconventional measures).

Keynes & Kalecki on monetary process

Keynes: monetary circulation driven by lending decisions of commercial banks where monetary policy plays a key part;

Kalecki: monetary circulation driven by production and investment decisions of firms, where **corporate finance** plays a key part.

Why firms matter?

‘Lucas asserts that “Any economic model is going to have at its centre a collection of hypothetical consumers whose decisions, together with the technology and market structure, determine the operating characteristics of the system and whose welfare is the explicit subject of normative analysis.” This view is foreign to the vision of Schumpeter and Keynes which places entrepreneurs and bankers at the centre of the economic process.’ Minsky 1992

Firms’ investment matters

Because investment determines the business

cycle (in Kalecki, Keynes, Schumpeter).

‘The Money Market’ in *Essay on the Business Cycle Theory* (1935)

Corporations hold bank deposits.

Deposits are transferred from ‘unattached

reserves’ (savings) to ‘investment reserves’

(payment accounts).

Amount of credit is not important

- Business cycle may happen without changing the total of credit in the banking system.
- Firms just move deposits between reserves (savings) and payment accounts and make investment payments between themselves.
- Vs. conventional (and Keynesian!) view that firms have no money and need to borrow for investment & production.

The rate of interest 1

- Long-term rate of interest (yield on bonds) is rate at which firms ‘fund’ investments (issue bonds to replenish reserves run down after paying for investment or productive equipment).
- Short-term rate of interest merely affects the turnover of bank deposits (between reserve & payment accounts). A higher rate discourages holding ‘idle’ funds in payment accounts.

The rate of interest 2

- The relationship between the short-term and long-term rate –
- Long-term rate = expected future short term rates + risk premium
- Stability of long-term rate means it cannot be a determinant of investment or the business cycle.

The rate of interest 3

The Principle of Increasing Risk:

Borrowing rate of interest depends on liquidity gearing

= f(borrowing unhedged by own funds of company);

Rises with external borrowing.

Principle explains size of firms & scale of production (vs. Marshall's Average Cost Curves).

Lessons for central banking

- Interest rate cannot affect the business cycle;
- Business cycle is determined by investment, which is affected by the liquidity of corporate balance sheets;
- Unconventional measures (open market operations) may affect liquidity of the banking system;

So, in conclusion

- ‘Inflation-targeting’ makes monetary policy endogenous to the business cycle:

‘The events which I thought I was controlling were

in fact controlling me.’

Kyril Bonfiglioli *Don’t Point That Thing At Me* (1972).