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BOOK REVIEW

YUJI SATO AND SUSUMU TAKENAGA (eds), *Ricardo on Money and Finance. A Bicentenary Reappraisal*, London, Routledge, 2013, pp. 220.

Despite a flurry of statements about the need to rethink monetary theory in the light of the events that started in 2007 with the financial crisis, the mainstream academic program seems to have simply been to 'lock the door and wait until this storm is over: business as usual'. Seven years since, the storm is not over (even with some tapering, the Fed is still buying $65 billion per month), and the door stays closed. The deepest rethinking the mainstream has granted itself, in fact, is the attempt to show how the principles that support the autonomy of the central bank and the policy of inflation targeting, can provide—with some minor modifications—a satisfactory explanation for the current state of things. Admittedly, this is not easy to achieve. The policy of inflation targeting is based on two relations: the relation between the interest rate and the output level, and the relation between the output level and inflation. An interest rate lower than the natural rate of interest would push production beyond its potential level. The inflation thereby generated would signal to the central bank the otherwise inscrutable level of the natural rate of interest, thus enabling it to adjust its policy instrument, the market rate (the analogous thing would happen in the opposite case). The practical result of this is that the central bank has only to worry about inflation: keeping it stable is equivalent to fixing production to its full potential. Everything is based on inflation being a measure of the degree of utilization of resources, and the rate of interest a tool that can vary the degree of utilization. Both these assumptions have proved incorrect: during the last five years the interest rate has dropped, but the gap between actual output and potential output has greatly increased; on the other hand, the inflation rate has remained relatively high, compared with the output gap. Following the precepts of inflation targeting, the central bank would not have to change interest rates, despite the collapse of production. As a matter of fact, the rates have instead been reduced, but this has not caused a significant recovery in production, nor has it generate rising inflation. The only way to match these developments with the theory of inflation targeting would seem to be that offered by Wicksell—based, essentially, on the argument that the reduction in the market rate of interest has been slower than the reduction in the natural rate of interest. It would thus be possible to reconcile declining rates of interest and lowering levels of capacity utilization. However, since market rates of interest have reached levels close to zero, this argument leads to the conclusion that the natural rate has become negative—a conclusion hardly acceptable to the neoclassical theory of distribution and output levels. And it is ultimately for this reason that mainstream explanations have often emphasized the unlikely possibility that an abrupt reduction has taken place not only in actual production, but also in potential production.

These brief remarks may help clarify that there is no way to rethink monetary policy but to reconsider the links between monetary theory and the theory of output and its distribution among social classes. The only grounds on which it is possible to make progress without focussing on this connection is the management of the financial emergency. Indeed, it is not a coincidence that almost all the post-crisis debate has been monopolized by this issue: in addition to being of obvious immediate practical relevance, it stresses that recent years have been an exception to the rule, and that what has happened has basically nothing to teach us about the regular course of business in the longer term. As a result, instead of a theory that explains the facts, we have a theory that is 'right' *in spite* of the facts, and we do not have a single rule for central banking, but two: one to be used in normal circumstances, the other in exceptional circumstances. What are the connections between these two dimensions does not appear to be of particular interest, despite the fact that these 'exceptional circumstances' have persisted for almost a decade now. And of course, since few feel the need to deal with the actual facts, almost nobody compares the 'latest developments' in monetary theory to older monetary debates. The more mainstream economics realizes it rests on shaky ground, the more it tries to appear as authentic cutting-edge science, with no need to look back at the past.

The Ricardo Society, founded in 2000 by a group of Japanese scholars keeping contacts with interested scholars in the rest of the world, celebrated the bicentenary of Ricardo's *début* as an economist in 1811, with two conferences on Ricardo's monetary thought and policy in September 2011 (Tokyo), and in March 2012 (Kyoto). The contributions to these conferences are published in the book under review. This collection of essays presents many points of interest to both the reader who wants to become familiar with classical monetary theory, and the scholars in the field. The volume contains nine essays, aimed at investigating the theoretical and historical context within which the work of Ricardo on money should be placed (Part I), some aspects of the connections between Ricardo's theory of money and finance and the labour theory of value (Part II), and the influence of the Ricardian tradition in the ensuing debate (Part III).

Yuji Sato's essay (Chapter 3: Old and new interpretations of classical monetary theory) can be read as an introduction to the whole volume. It analyses the relationship between the quantity theory of money (QTM) and classical monetary theory. According to Yuji Sato, 'old' interpretations of classical monetary theory tended to assimilate the position of all the classical economists to that of Hume. Since the early 1980s, 'new' interpretations have instead highlighted the differences between classical authors and Hume, thus putting into question the relationship between classical monetary theory and QTM. The author pushes this position to the extremes, arguing that 'the classical monetary theorists denied *all* of the Quantity Theory of Money *sine qua nons*' (p. 55). According to him, these '*sine qua nons*' are: (i) the premise that the money stock is an exogenous variable to which prices should adjust; (ii) the premise that there is a stable velocity of circulation of money; (iii) the premise that real output is determined by real forces independent of both the quantity of money and the level of prices; (iv) the price-specie flow mechanism. He discusses the reasons why the major classical economists did not strictly adhere to these four premises, pointing out the merits of the new interpretation in having shown that the endogenous creation of money, the instability of its velocity of circulation, and adjustments of the external accounts alternative to the price-specie mechanism are extensively analysed by Smith, Thornton, and Ricardo (just to mention some of the main authors) with a wealth of insights—both practical and theoretical—whose relevance is paramount. His essay, however, leaves in the background the question why these departures from the QTM in its purest form lead to a denial of the basic point of this theory, namely that the level of money stock is neutral to the level of real output. In fact, to admit that money is not exogenous in the strong sense, or that the external adjustment mechanism is not the price-specie flow mechanism, does not, by itself, imply that money is not neutral. Suffice to think of Wicksell, who would not accept points (i) and (ii), but who certainly cannot be considered an opponent of the QTM, and the neutrality of money. From this perspective, not only an author like Ricardo, but even an 'eclectic' author as Thornton, can hardly be seen as denying the neutrality proposition.

According to Yuji Sato the central underpinning of the view that Ricardo does not accept the neutrality proposition is that the classical price-level determination implies that gold is a product with its own value. This leads to the essay by Susumu Takenaga (Chapter 4: The value of money: labour theory of value and quantity theory in Ricardo's economic theory), which is devoted to a discussion of the relationship between the labour theory of value and the QTM in Ricardo's writings. The author points out that in Ricardo 'money is gold as a commodity, and gold has its proper value ("intrinsic value") just like any other commodity' (p. 79). This is a fundamental premise of Ricardo's monetary theory that will always remain at the centre of his work, though he makes a number of changes and clarifications to the concept of the value of a commodity. Being a commodity, money is exchanged according to its value. This notion is at odds with a pillar of the QTM, i.e. the idea that money is not a commodity, and only acquires value in circulation. Susumu Takenaga discusses the problematic coexistence of the QTM and the Labour Cost Theory of Money, arguing that in Ricardo these two theories can coexist to the extent that for the commodity 'gold', the convergence of the market price towards the natural price does not operate in the same way as it does for other commodities: '[f]rom the point of view of Ricardo's 'principles of political economy', such a situation could be interpreted as an extremely special case of the deviation between the value (natural price) of a commodity and its market price' (p. 90). As long as the specific conditions of the production of precious metals prevent the process of levelling the rates of profit, it is no longer true that the value of money determines the amount of money in circulation, but rather the other way around. This is undoubtedly true, according to the author, in international circulation, which is based on gold: the process of distribution of precious metals among world countries does not imply that the process of production of money moves at the same pace as that of the other commodities. He then adds that this is also true for domestic circulation, since 'the supply of precious metal does not respond to the expansion of economic activities, so that the quantity of money becomes scarce related to a larger quantity of commercial transactions, which destabilizes the value of money irrespective of the stability of the value of gold as a commodity' (p. 91). The only difference is that for domestic circulation it is possible to create a substitute for gold. Starting from this standpoint, Susumu Takenaga analyses convertible and inconvertible banknotes, finally reaching a conclusion much more nuanced than Yuji Sato's: 'it is undeniable that some aspects of Ricardo's theory of money appear as under the Quantity Theory' (p. 105). The Labour Cost Theory of Money, rather than representing the road to get away from the neutrality proposition, seems to emerge as a problematic element in the context of an approach based on 'quantitative' lines of reasoning, reaching indisputably 'neutralist' conclusions.

The essays of Jérome De Boyer des Roches (Chapter 2: Prices, value and seigniorage in Ricardo's monetary economics) and Ghislain Deleplace (Chapter 5: The role of the standard in Ricardo's theory of money) return to the issues discussed by Susumu Takenaga from different perspectives. De Boyer, in particular, examines the relationship between the mint and the market price of gold, on the one hand, and the value of gold in relation to other commodities, on the other. The value of gold in equilibrium is the 'natural value' of the commodity gold (independent of supply and demand). According to him, in Ricardo this value is stable both with respect to changes in nominal wages, and with respect to changes in real wages. On this basis, the author discusses the price-specie flow mechanism and seigniorage. Also Ghislain Deleplace returns to this theme, but addressing it from the point of view of the value of money in relation to the notion of an invariable standard of value.

Besides the question of the relationship between the theory of money and the theory of value, the other main topic of the book under review is Ricardo's banking theory. The credit system, because of the impossibility to regulate its operations consistently with the laws of free competition, was no doubt a thorn in the side of classical political economy. The solutions suggested by the proponents of free banking (i.e. to consider the financial sector on the same footing as all the other sectors) could not be accepted by any economist with an adequate dose of realism and minimal knowledge of the functioning of the credit market. Nonetheless, the idea that the most important market of the capitalist system would constitute an exception to the principles of free market remained hard to endorse. Ricardo is certainly the classical economist less willing to swallow this. In his view, banks represent a disturbing element of the system, while the central bank and its independence will always be considered an enemy to be fought against. Sylvie Diatkine (Chapter 6: Interest rate, banking theory and monetary policy in Ricardo's economics) addresses these issues discussing Ricardo's theory of the interest rate. For Ricardo, the rate of interest for money is regulated by the rate of profits, and is totally independent of both the quantity and the value of money. Variations in the quantity of money can only lead to temporary deviations of the market rate from its natural level. Ricardo's QTM reappears here, to the extent that he locates in the interest rate the connecting link between changes in the quantity of money and changes in prices. The latter, reabsorbing money in excess supply, brings the market interest rate back to its natural level. The QTM and the proposition that the rate of interest on money is not ultimately regulated by the rate at which the bank lends, but by the profit rate, are for Ricardo closely related to one another. Sylvie Diatkine notes that Ricardo has a very clear view of the fact that the aid of a 'moneyed class' engaged in no trade is essential to allow the employers of stock to withdraw their capital from less profitable trades in order to invest it in the more profitable ones. However, in Ricardo's view 'it is always possible to borrow on the market (and not from banks) if borrowers want to pay the market rate' (p. 129). According to Diatkine, Ricardo considers banks a danger because their activity is not mere financial intermediation: it is interlinked with the power to issue paper money. Hence the possibility of diverting the market rate from the natural rate of interest, starting price changes and generating redistributive effects that, albeit temporary, are harmful to industry and trade. This theory of the rate of interest is the basis of all Ricardo's policy proposals, at the centre of which there is the idea that the central bank should not lend, issuing notes against securities, but should only create money—issuing notes against gold. Diatkine emphasizes that this principle of limitation is stated by Ricardo in combination with the need to grant the economic system a flexible currency, which means not depriving the system of the advantages of paper money over metallic circulation. The flexibility would be ensured by the notes issued by other banks, which 'are part of credit instruments [and] can be used in payments according to usual practice' (p. 136). In this non-discretionary context governed by the connection between the market price of bullion and its mint price, there would also be the possibility, according to Diatkine, of diversifying the instruments of monetary policy, buying or selling public securities on the open market. If the amount of notes in circulation is less than that required, the mint price of gold is higher than the market price and gold flows into the coffers of the central bank increasing the issue of notes. In this circumstance the bank could also buy public securities, thereby increasing the amount of its issues, thus speeding up the process of convergence of the market price to the mint price (and *vice versa*): 'the Bank disposed of two kinds of instruments: selling or buying gold on the gold market, and selling and buying public securities on the open market. Both had the effect of reducing or increasing the quantity of money by regulating the price of gold and not according to macroeconomic data' (p. 140).

Ricardo's theory of central banking, and in particular his plan for the establishment of a National Bank that would replace the Bank of England, is discussed also by Toshiaki Otomo (Chapter 7: Ricardo's theory of central banking: the monetary system and the government). This paper appropriately follows that by Sylvie Diatkine, focusing more explicitly on the significance of a proposal based on government interference in the monetary system. Toshiaki Otomo proceeds by comparing the 'Ingot plan' of 1811, the 'Secure Currency' of 1816 and the (posthumously published) 'Plan for a National Bank' of 1824, highlighting the elements of continuity and development in

Ricardo's thought. According to the author, in *Economical and Secure Currency* Ricardo—while still far from arguing *à la* Thornton that in a panic the Bank should expand its advances—points out that the real bills doctrine inevitably leads the Bank to reduce circulation. This is not related to the fact that the Bank adhered to the doctrine, but to the fact that it is a private institution that has profit as its goal: 'the Bank's refusal to supply paper money for circulation during a panic situation is because if the Bank were to discount riskier bills, then it would have difficulties withdrawing them. Here he noticed the opposition between the private profit-earning aspect of the issuer of paper money and the social and public aspect of controlling the money supply' (p. 157). But for Ricardo 'public aspect' can hardly be translated into 'public body'. Hence the idea that neither the Bank nor the State must exercise this function, but a 'third party', with commissioners appointed for the purpose. There is then a second and more important argument that Ricardo uses in his attack against the Bank of England, *viz.* the profits of the Bank: in the first place there is seigniorage; in addition, there are profits arising from the fact that taxes levied by the government must be deposited at the Central Bank; moreover, there is an 'exorbitant allowance' for the management of public debt. This leads Ricardo to argue that the government should establish a 'common treasure' into which the proceeds of taxation would be paid (this solution was actually implemented in the USA with the experience of the Independent Treasury). Furthermore, 'since the issuing of paper money produces "seigniorage", it belongs to the State. This is the ground for the government issue of paper money' (p. 161). This leads to the contents of the 'Plan', which, Toshiaki Otomo observes, focuses largely on the substantive reasons that would make the government obliged, like the bank, to the constraint of convertibility. The 'Plan' is an analysis of the relations that, according to Ricardo, should be established between a public but independent central bank and the government. The government should in no case be allowed to borrow from the Bank; if the government needs money, it must obtain it through taxes or by placing debt securities. The advantage of the Plan does not derive from the fact that the government can issue money, but by saving interest on all the assets of the central bank, which belong to the public and not to a private institution. Toshiaki Otomo then discusses the question of how the National Bank may issue paper money, even without being a real bank. His essay here touches the issue of open market operations in Ricardo—a matter that had already been examined by Sylvie Diatkine, but from a completely different perspective. Toshiaki Otomo seems to suggest that, according to Ricardo, the open market operations constitute the natural channel of the involvement in the credit market of a non-lending institution such as the National Bank.

The volume under review concludes with two essays that discuss the aftermath of Ricardo's monetary thought. The essay by Matthew Smith (Chapter 8: Ricardo versus Tooke: on the enduring value of their respective monetary theories to classical economics) compares the contributions of Ricardo with those of Tooke. Tooke is the author who can be placed with more difficulty within the general paradigm of a 'classical monetary economy', as it is possible to argue that, in his work, there is a substantial—though problematic—break from the QTM. This does not derive from the coexistence of a QTM and a theory of the real cost of money, but from questioning the link between changes in the money supply and the price level. Starting from this point of view, Matthew Smith emphasizes the strength of the bond between the QTM and Ricardo, arguing that Ricardo's 'departures' from the QTM are of limited importance. Florencia Sember's essay (Chapter 9: Interwar reflections on the balance of payments: Taussig and the influence of the Ricardian bullionist tradition) discusses the influence of the Bullionist controversy in the debate on England's return to gold at prewar parity, focussing on Taussig's explanation of the adjustment of the balance of payments after unilateral transfers of capital. Also the opening essay in the volume, by David Glasner (Monetary disequilibrium and the demand for money in Ricardo and Thornton) ideally belongs to this group of essays. Glasner focuses on the demand for money in classical monetary theory, and the controversy between Ricardo and Thornton on depreciation and over-issue. His essay concludes by establishing a suggestive connection between the dispute between Ricardo and Thornton, on the one hand, and the dispute—starting in the 1960s—between advocates of the New View of bank and financial intermediaries and advocates of the Old View. At the centre of this controversy there is the role of financial intermediaries in the transmission mechanism of monetary policy, an issue that has sparked renewed interest in recent years.

The aim of this book is stated by its editors to be a reappraisal of Ricardo's monetary and financial thought, also in order 'to offer some historical clues to understanding the current world-wide financial crisis'. There is no doubt that the reader will find in it interesting insights on both counts.

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