"A MONETARY THEORY OF PRODUCTION"

by John Maynard Keynes

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In my opinion the main reason why the problem of crises is unsolved, or at any rate why this theory is so unsatisfactory, is to be found in the lack of what might be termed a *monetary theory of production*.

The distinction which is normally made between a barter economy and a monetary economy depends upon the employment of money as a convenient means of effecting exchanges — as an instrument of great convenience, but transitory and neutral in its effect. It is regarded as a mere link between cloth and wheat, or between the day's labour spent on building the canoe and the day's labour spent on harvesting the crop. It is not supposed to affect the essential nature of the transaction from being, in the minds of those making it, one between real things, or to modify the motives and decisions of the parties to it. Money, that is to say, is employed, but is treated as being in some sense *neutral*.

That, however, is not the distinction which I have in mind when I say that we lack a monetary theory of production. An economy, which uses money but uses it merely as a neutral link between transactions in real things and real assets and does not allow it to enter into motives and decisions, might be called — for want of a better name — *a real-exchange economy*. The theory which I desiderate would deal, in contradistinction to this, with an economy in which money plays a part of its own and affects motives and decisions and is, in short, one of the operative factors in the situation, so that the course of events cannot be predicted, either in the long period or in the short, without a knowledge of the behaviour of money between the first state and the last. And it is this which we ought to mean when we speak of a *monetary economy*.

Most treatises on the principles of economics are concerned mainly, if not entirely, with a real-exchange economy; and — which is more peculiar — the same thing is also largely true of most treatises on the theory of money. In particular, Marshall's *Principles of Economics* is avowedly concerned with a real-exchange economy; and so, I think, is by far the greater part of the treatises of Professor Pigou — to name those English works on which I have been brought up and with which I am most familiar. But the same thing is also true of the dominant systematic treatises in other languages and countries.

Marshall expressly states (*Principles*, pp. 61, 62) that he is dealing with relative exchange values. The proposition that the prices of a ton of lead and a ton of tin are £15 and £90 means no more to him in this context than that the value of a ton of tin in terms of lead is six tons (along with a number of other similar propositions). "We may throughout this volume", he explains, "neglect possible changes in the general purchasing power of money. Thus the price of anything will be taken as representative of its exchange value relatively to *things* in general" (my italics). He quotes Cournot to the effect that "we get the same sort of convenience from assuming the existence of a standard of uniform purchasing power by which to measure value, that astronomers do by assuming that there is a 'mean sun' which crosses the meridian at uniform intervals, so that the clock can keep pace with it; whereas the actual sun crosses the meridian sometimes before and sometimes after noon as shown by the clock". In short, though money is present and is made use of for convenience, it may be considered to cancel out for the purposes of most of the general conclusions of the *Principles*. Or if we turn to the writings of Professor Pigou, the assumptions of a real exchange economy appear most characteristically in his taking as his normal case that in which the shape of the supply schedule of labour in terms of real wages is virtually independent of the changes in the value of money.

The divergence between the real-exchange economics and my desired monetary economics is, however, most marked and perhaps most important when we come to the discussion of the rate of interest and to the relation between the volume of output and the amount of expenditure.

Everyone would, of course, agree that it is in a monetary economy in my sense of the term that we actually live. Professor Pigou knows as well as anyone that wages are in fact sticky in terms of money. Marshall was perfectly aware that the existence of debts gives a high degree of practical importance to changes in the value of money. Nevertheless it is my belief that the far-reaching and in some respects fundamental differences between the conclusions of a monetary economy and those of the more simplified real-exchange economy have been greatly underestimated by the exponents of the traditional economics; with the result that the machinery of thought with which real-exchange economics has equipped the minds of practitioners in the world of affairs, and also of economists themselves, has led in practice to many erroneous conclusions and policies. The idea that it is comparatively easy to adapt the hypothetical conclusions of a real wage economics to the real world of monetary economics is a mistake. It is extraordinarily difficult to make the adaptation, and perhaps impossible without the aid of a developed theory of monetary economics.

One of the chief causes of confusion lies in the fact that the assumptions of the real-exchange economy have been tacit, and you will search treatises on real-exchange economics in vain for any express statement of the simplifications introduced or for the relationship of its hypothetical conclusions to the facts of the real world. We are not told what conditions have to be fulfilled if money is to be neutral. Nor is it easy to supply the gap. Now the conditions required for the 'neutrality' of money, in the sense in which this is assumed in — again to take this book as a leading example — Marshall's *Principles of Economics*, are, I suspect, precisely the same as those which will insure that crises *do not occur*. If this is true, the real-exchange economics, on which most of us have been brought up and with the conclusions of which our minds are deeply impregnated, though a valuable abstraction in itself and perfectly valid as an intellectual conception, is a singularly blunt weapon for dealing with the problems of booms and depressions. For it has assumed away the very matter under investigation.

Even if the above is in some respects an overstatement, it contains, I believe, the clue to our difficulties. This is not the same thing as to say that the problem of booms and depressions is a purely monetary problem. For this statement is generally meant to imply that a complete solution is to be found in banking policy. I am saying that booms and depressions are phenomena peculiar to an economy in which — in some significant sense which I am not attempting to define precisely in this place — money is not neutral.

Accordingly I believe that the next task is to work out in some detail a monetary theory of production, to supplement the real-exchange theories which we already possess. At any rate that is the task on which I am now occupying myself, in some confidence that I am not wasting my time.

Any elementary presentation of monetary theory makes clear that money, besides being a numeÂ´ raire used for measuring prices, performs two main functions: (a) money is an interme-diary of exchange, since, in present-day economies, payment is nearly always made in money, barter having practically dis-appeared; (b) money is a form of wealth, since anybody can hold the whole or part.Â At the end of the current production cycle, traders buy the nished product and replenish their stock. In this case, an amount of money equal to the initial liquidity requirements of producers is always in existence. Introduction 13. Dillard, D. 1980, â€˜A monetary theory of production. Keynes and the institutionalistsâ€™, Journal of Economic Issues, 24: 255â€“73. Eboli, M. 1991, â€˜The finance of fixed and working capital.Â Graziani, A. 1989, The Theory of the Monetary Circuit, London, Thames Papers in Political Economy (also inEconomies et SociÃ©tÃ©s, SÃ©rie Monnaie et Production (1990), 7:7â€“36. Graziani, A. 1991, â€˜La thÃ©orie keynÃ©sienne de la monnaie et le financement de l'Ã©conomieâ€™, Economie appliquÃ©e, 44, 1: 25â€“41. Graziani, A. 1994, â€˜Real wages and the loansâ€“deposits controversyâ€™, Economie appliquÃ©e, 1: 31â€“46. Modern Monetary Theory was pioneered by American economist and theorist Warren Mosler in 1992, along with Bill Mitchell, a university professor based in Australia and a key developer of the theory. MMT argues that nations with the ability to produce their fiat currency can issue as much money as they need, and as a result, they have no pressures when it comes to financing. In other words, the government cannot run out of money and it essentially has no financial constraints. While the government should have a budget, under this theory, the government doesn't necessarily have to worry about the "A Monetary Theory of Production" (1933, Festschrift fÃ¼r Spiethoff). _a monetary theory of production". by John Maynard Keynes. (1933).Â In my opinion the main reason why the problem of crises is unsolved, or at any rate why this theory is so unsatisfactory, is to be found in the lack of what might be termed a monetary theory of production. The distinction which is normally made between a barter economy and a monetary economy depends upon the employment of money as a convenient means of effecting exchanges â€” as an instrument of great convenience, but transitory and neutral in its effect. Monetary circuit theory is a heterodox theory of monetary economics, particularly money creation, often associated with the post-Keynesian school. It holds that money is created endogenously by the banking sector, rather than exogenously by central bank lending; it is a theory of endogenous money. It is also called circuitism and the circulation approach. The key distinction from mainstream economic theories of money creation is that circuitism holds that money is created endogenously by the banking