AURORA PHILOSOPHY JOURNAL

2:1(2023)

ISSN 2816-394X (Print)
ISSN 2816-3958 (Online)

AURORA PHILOSOPHY JOURNAL

Volume 2, Number 1
October 2023

Special Issue: *The Relationship between Philosophy and Economics*

Edited by Professor John Smithin

ISSN 2816-394X (Print)
ISSN 2816-3958 (Online)

PUBLISHER

Aurora Philosophy Institute
37 Brookland Avenue
Aurora, ON L4G 2H6
Canada

ISSN 2816-394X (Print)
ISSN 2816-3958 (Online)

Table of Contents

Alla Marchenko & John Smithin
Is philosophy part of economics or is economics part of philosophy? ... 01

Torrey Byles
The ontology of money: where neoclassical economics went wrong … 21

Guillaume Vallet
L'Economie politique du « corps-institution »: une réactualisation de la théorie de la regulation … 39

John Smithin & Andrej Tytchino
The political economy of capital flows, real exchange rate dynamics, and the foreign debt position in sovereign monetary systems … 53

John Smithin
The Hicksian super-multiplier, 'capital' theory, and social ontology: fundamental problems in both mainstream and heterodox macroeconomic theory. … 69

John Smithin
The ethics of income distribution … 95

Noemi Levy Orlik
Mexican monetary policy: to stabilize inflation or the financial system? … 110

ISSN 2816-394X (Print)
ISSN 2816-3958 (Online)

ISSN 2816-394X (Print)
ISSN 2816-3958 (Online)

Aurora Philosophy Journal, Vol. 2, No. 1, pp. 1-20

Is Philosophy Part of Economics or is Economics Part of Philosophy?

Alla Marchenko
Aurora Philosophy Institute
&
John Smithin
Aurora Philosophy Institute & York University

1. Introduction

This is the second issue of the *Aurora Philosophy Journal* (APJ) and is a *Special Issue* on the topic 'the relationship between economics and philosophy'. It follows on directly from the inaugural issue of the *APJ* in 2022 (Marchenko & Smithin 2022) which contained a number of important papers on such topics as social ontology (particularly the ontologies of money and of 'capital'), and the influence of the philosophy of the Scottish Enlightenment on the academic discipline of economics. There is a critical mass of expertise among the Associates and friends of the *Aurora Philosophy Institute* (API) in such areas as social ontology, economic sociology, and political economy, so this focus has been a natural development.

In answer to the question 'is philosophy part of economics or is economics part of philosophy?' we are firmly of the view that the latter rather than the former statement is correct. Indeed, we would argue that thinking about philosophy is essential for any sort of endeavour, and for life in general, not just for economics. It is uncontroversial that many of the original contributors to the subject of political economy, which morphed into 'economics' by the end of the 19th century[1] came to it from philosophy. These include Hume and Smith in the 18th century, Mill and Marx in the 19th, and Keynes and Ramsey in the 20th. The late Robert Heilbroner (1999) wrote a best-selling book about this which went into seven editions, *The Worldy Philosophers*.

In what follows sections 2 and 3 elaborate on this argument, and section 4 goes into more detail about the correspondences between the two disciplines. Section 5 stresses the importance of a realist social ontology, and sections 6 and 7 discuss the implications for national and international political economy, respectively. Section 8 offers some conclusions, and will briefly describe the arguments put forward in the individual papers of the special issue which follow.

2. The Philosophical Order

[1] *Cf.*, in particular Alfred Marshall's *Principles of Economics* (1890).

This notion of the 'philosophical order' comes from a 1935 work by the Catholic philosopher Etienne Gilson, sometime Director of the Pontifical Institute for Medieval Studies (PIMS) at St. Michael's College, University of Toronto. He was a self-proclaimed 'realist' philosopher and on the other hand a critic (no pun intended) of so-called '*critical* realism'. His book was entitled *Methodical Realism: A Handbook for Beginning Realists* (Gilson 1990). As discussed by John Smithin (2022), in the *APJ* inaugural issue, Gilson's notion of the philosophical order was to the effect that philosophy 'the love of wisdom' should be considered an autonomous discipline in its own right, separate from, and logically prior to, each of the 'special sciences' (one of which would be economics or political economy).

Gilson specifically warned against the temptation to base philosophy on the principles of one or another of the special sciences themselves, and in his book gave two notable examples from the history of philosophy. Namely, Aristotle in the 4th century BC and Descartes in the 17th century AD. Aristotle was originally trained in biology and medicine by his own father, who was the personal physician to King Phillip of Macedonia (the father of Alexander the Great). Therefore, at least to some extent, Aristotle based his philosophy on a biological template. The result was ultimately that mediaeval scholastic philosophy - heavily influenced by Aristotle - was ultimately unable to cope with the scientific revolution of the time of Francis Bacon (16th-17th century). Descartes, meanwhile, was a mathematician and seemed to feel that philosophy should operate on a similar sort of basis to mathematics – to establish *a priori* truths, that kind of thing – thereby tipping the balance too far in the direction of 'rationalism' rather than 'empiricism'. Gilson (1990, 73), on the contrary, thinks the special sciences are a 'discourse of methods' (plural, as opposed to *method* singular) - each has their own method. The mathematical method corresponds to notions of abstract quantity, the physical method to the behaviour of inorganic matter, the biological method to the behaviour of organic matter, *etc.* On the other hand in Gilson's view:

… Wisdom, or first philosophy … establishes the principles which regulate all the other sciences and, humanly speaking, depends on none of them … the others study the various modes of being … [*Wisdom*] *… studies being in itself. It is the science of being as being.*

We tend to agree. It would be disastrous, for example, if philosophy had to conform to the methods of the purely abstract and reductive 'science' represented by the mathematical theory of choice that is taught as mainstream economics the in universities. Better would be to work the other round. To start with philosophy or wisdom to see if we can devise a more broadly based political economy more in touch with reality. Moreover, we also think that this idea of the philosophical order can be extended to the different branches of philosophy within philosophy itself. For the purposes of inquiry into political economy these are usually taken to be **Metaphysics**, **Epistemology**, **Ethics** and **Politics**[2] in that order. John Smithin (2013) has referred to

[2] Another, fifth, branch of philosophy which is usually added to this list when dealing with other issues than political economy is **Aesthetics**. This is the study of our ideas

this as a 'rigid hierarchy'. Gilson (1935, 78), eight decades earlier, seems to have pre-emptively concurred:

The first and most necessary … [*good*] *… is the existence of a philosophy which is truly an autonomous discipline of the mind and a* ***metaphysics*** *to crown it.* (emphasis added)

To continue in this vein, the following definitions of the four different branches are taken from a work by Leonard Peikoff (1982, 14-16). Peikoff is a person best known as a follower of the controversial novelist/philosopher Ayn Rand (whose work will be further discussed in section 3 below),[3] but also had a thorough training in academic philosophy, holds a PhD from New York University, and has taught in several universities in the USA. The definitions are as follows:

Metaphysics: *'… (t)he branch of philosophy that studies existence … [it] … identifies the nature of the universe as a whole. It tells … [us] … what kind of world we live in.'*
Epistemology: *'… (t)he branch of philosophy that studies knowledge … [it] … identifies the proper means of acquiring knowledge … which mental processes to employ as methods of cognition … which to reject as invalid.'*
Ethics: *'… (t)he branch of philosophy that studies values … [it] defines a code of values … [and] … tells … [us] … the purpose of life … (i)t … provides the standard by which to judge good and evil, right and wrong … .*'
Politics *' … (t)he branch of philosophy that applies ethics to social questions … [it] … studies … social systems and the proper functions of government*.'

The idea, then, is that the metaphysics must come first, then epistemology, then ethics, then 'politics' (political philosophy). Moreover, that ethics and politics both '[rest] … on' the earlier branches, and it is not possible to address such questions without 'some view of existence … and … [the] … proper means of knowledge' (Peikoff 1982, 15). Gilson in fact, in the earlier book, was also keen to point out that the problem with *both*

---

about art and beauty. This area of philosophy, we think, has much the same sort of standing as **Politics** in the list above. Just as with politics, one might say questions of aesthetics can only be meaningfully considered once one's metaphysical, epistemological, and ethical commitments have been made explicit. Often, also, in sources like popular histories of philosophy and textbooks one sees the topic of **Logic** listed as a sixth branch. For example, Johnston (2006, 1-2) lists the main divisions of philosophy as Epistemology, Logic, Metaphysics, Ethics, Political Philosophy, and Aesthetics. But this ordering seems to us to be confused, firstly in starting with epistemology rather than metaphysics, and secondly in including logic as being a 'branch' of philosophy on it own, rather than merely an epistemological method.

[3] The very fact that Rand's views were so 'controversial' in the mid-twentieth century is precisely why it will be interesting/necessary for us to pay some attention to them. Why was this so? And, other the other hand, why were her views so popular with many?

the philosophy and the science of his day was the final abandonment of this notion of the philosophical order.

Such ideas point to a general problem with modern and postmodern philosophy, which essentially means all of mainstream Western philosophy dating back to Descartes in 1639[4]. There has been a progressive turning away from any desire to deal with metaphysical questions, and a focus mainly on epistemology. Metaphysics has been displaced from its pre-eminent position in the philosophical order, but this is a tendency which ultimately would make philosophy itself redundant. Graham Hubbs (2021), for example, has argued that in the case of two prominent analytical philosophers of the twentieth century, Ludwig Wittgenstein and his Associate Elizabeth Anscombe, one of their reactions to the 'British Hegelianism' of the late nineteenth was profound distrust of metaphysics as such. Fair enough perhaps in the case of Hegel, but surely this should not mean, does not *have* to mean, that all metaphysics or 'foundationalism' should be discarded. As we have already seen, the realist counter-argument would be simply that the obvious alternative is to start with the 'right' metaphysics, whatever that may be. In any event, if this (the abandonment of metaphysics) was the route taken by linguistic analysis, it was evidently even more so for the various rivals of analytical philosophy in the twentieth century, such as pragmatism, existentialism (something of a misnomer?) and all varieties of post-modernism.

The upshot, then, was that throughout the 20th century much academic philosophy was focused exclusively on epistemological questions. In particular, with the implications of the various epistemological *connundra* for the discussion of ethics and politics. The result has tended to be a descent into pure relativism, an attitude of 'anything goes'. Searle (2010) has gone further back than the twentieth century, and also spoken (like Gilson) of the deep-seated historical roots of the tendency. *Cf.* the following passage, as previously quoted in the *APJ* by Smithin (2022, 65):

This … [*Searle's*] *… investigation is historically situated. It is not the sort of thing that could have been undertaken a hundred years ago or even fifty years ago. In earlier eras, from the seventeenth century until the late twentieth century most philosophers in the western tradition were preoccupied with epistemic questions. Even questions of language and society were construed as largely epistemic: How do we know what other people mean when they talk? How do we know that the statements we make about social reality are true? … These are interesting questions but I regard them as largely peripheral … In the present era … we have in large part overcome our three-hundred-year obsession with epistemology and skepticism.*

As Searle implies, only in the early 21st century have there been some signs of what might be called a 'realist turn', as in a later book by Rasmussen & Den Uyl (2020) which had exactly that title, *The Realist Turn*. As with Gilson and Searle, these authors

[4] See also the very important book (in our view) by Mortimer J. Adler (1985), *Ten Philosophical Mistakes: Basic Errors in Modern Thought – How They Came About, Their Consequences, and How to Avoid Them*. Gilson, by the way, was originally a historian of philosophy, focusing initially on the work of Descartes himself.

are also advocates of metaphysical realism, as is D'Ansi Mendoza (2012), a former PhD student of John Smithin, who wrote of 'realism *per totam viam*' (realism all the way). Smithin (2022, 65) has commented that as far as mainstream academic philosophy is concerned Searle's statement that the obsession with epistemology has been overcome might be over optimistic. Nonetheless, at the management level of the *Aurora Philosophy Institute* we agree that realism *per totam viam* must be the way forward.[5] A final quote will suffice to complete this section of the paper. According to Rasmussen & Den Uyl (2020, xi):

Metaphysical realism involves both an ontological and an epistemological thesis – namely, there are beings which exist and are what they are apart from our cognition of them and that we can know the existence and nature of these beings.

The difficulty is that much academic philosophy, until very recently, has tended to deny both of these theses in the name of idealism and the Kantian 'critique of knowledge'.

3. Do We Have a Leg to Stand On?

The title of this section is a tongue-in-cheek reference to an scene in the 1999 biopic *The Passion of Ayn Rand*. As mentioned, Ayn Rand was a controversial novelist/philosopher of Russian-Jewish origin, and an influential figure in the popular culture of the USA in the mid-twentieth century. Like Gilson she was very much what we are here calling a metaphysical realist. Unlike him, however, she was also an atheist. In this section, we need to spend time discussing Rand's views and those of her critics, for a number of reasons. Firstly, because the movie scene speaks directly to the issue of the philosophical order. Secondly because, like ourselves, Rand also held that there was a close link between philosophy and political economy, with philosophy coming first. The third reason is that although there is definitely common ground between Rand and ourselves on metaphysics and epistemology, there is less so as far as ethics and, particularly, political economy is concerned. These are circumstances which require more explanation and detail.

In the film, Rand was challenged by a 'wise guy' at a talk at the Nathaniel Branden Institute (NBI)[6] in New York to provide a quick summary of her philosophy 'standing

[5] This may not, of course, be the view of all of the Associates and friends of the API, or of all of the contributors to this *Journal*. Our policy is the free expression of any and all points of view.

[6] This was an institute originally founded to promote Ayn Rand's philosophical system of 'Objectivism'. Nathaniel Branden was a member of Ayn Rand's inner circle, and was also at one point involved in a romantic relationship with her even though they were both married. This was actually the subject of the movie.

on one foot'. Egged on by the audience, she actually did this. The answers were as follows:

Metaphysics: OBJECTIVE REALITY

Epistemology: REASON

Ethics: SELF-INTEREST

Politics: LAISSER FAIRE CAPITALISM

The first two entries correspond to the theses of Rasmussen & Den Uyl above. Like them, Rand does not defer to either idealism or the critique of knowledge. But, beyond that, and given that Rand was always a controversial figure, even these days one does not have to go far on the internet to find all sorts of attacks on her views, often of an *ad-hominen* nature, She is disliked by Marxists, socialists, and generally those left of centre, for obvious reasons. However, strange as it may seem at first sight, almost equally so by some thought to be on the same 'side' politically.

To clarify we quote from two prominent in-print examples, thirty years apart. The first is from a review of Rand's *Atlas Shrugged* (1957) by a person called Whittaker Chambers, in W. Buckley's (supposedly) conservative journal[7] *The National Review*. Chambers (1958, 1) did not think much of Rand's literary prowess even though most of her books were bestsellers.

The news about this book seems to me that any ordinarily sensible head could not possibly take it seriously, and that, apparently, a good many do. Somebody has called it: 'Excruciatingly awful'. I find it a remarkably silly book.

We are prepared to confess that the writing style is not to either of our tastes, but we are not interested in literary criticism *per se*. What is important from the philosophical point of view are the ideas themselves. We fail to see how these can be called 'silly' (or the opposite) without any apparent discussion of what the arguments actually are.

Chambers's critique of Rand goes way over the top in several other places. He does not resist the temptation to 'go there' (Chambers 1958, 5) with the standard political smear of the second half of the twentieth century, namely:

From almost any page of Atlas Shrugged a voice can be heard … commanding: 'To a gas chamber-go!'

This is an absurd charge against a Jewish woman who was a refugee from the USSR, insisted on the basic similarity of all twentieth century collectivist totalitarian systems,

---

[7] This is not perhaps the place to dwell on the rather byzantine scene that seems always to have existed in US politics on the 'right'. Suffice it to say that the question of just how 'conservative' each of the various factions really is has been a perennial matter of dispute.

communism, national socialism, and fascism, and declared allegiance to the principles of the US 'founding fathers'.

However, perhaps the real problem that Chambers had with Rand's views was her explicit atheism? The following passage from Chambers (1958, 3) suggests this:

Like any consistent materialism, this one begins, by rejecting God, religion, original sin, etc., etc. ... (*t*)*his book's aggressive atheism and rather unbuttoned 'higher morality' ... result inevitably from its underlying premises ... Randian Man, like Marxian Man is made the center of a godless world.*

In our view, this statement involves definite philosophical error (and would do so even if Ayn Rand herself accepted the charge). The point is that realism is not co-extensive with materialism (Smithin 2022, 64-5). Typically in philosophy the main dividing line is held to be that between materialism and idealism.[8] Chambers seems to subscribe to this view, with the fundamentally important mental element taken to be supernatural, but it is false. Idealism and materialism both fail. The genuine struggle is between realism and idealism. Materialism fails because there are being in existence that are factual, real, and have causal effects, without being material. Social facts, such as money, are an obvious example. The same example, however, shows that the non-material does not automatically have to be supernatural, spiritual, or transcendental.

Chambers's own personal background is relevant to his critique of Rand. He was a former active member of the communist party and literally a Soviet spy. He then underwent a 'conversion', denounced his former comrades, and became a political writer. For what it is worth his *Wikipedia* entry reads as follows:

... Chambers substituted his passion for communism with a passion for God and saw the world in black-and-white terms both before and after his defection ...

Thus, he was more than a little uncomfortable, perhaps, with someone who was both a consistent anti-communist and a consistent atheist. Whatever were Chambers's personal views and psychological disposition, this still leaves us with something of an 'elephant in the room' (Smithin 2022, 66) which cannot be avoided entirely. This is the fact that among realist philosophers such as Aquinas, Gilson, Adler,[9] and (*e.g.*) the influential Lublin school in post-WW2 Poland (Lekka-Kowalik 2022),[10] many have had strong religious commitments. In fact, all of the above were/are devout Catholics.

---

[8] Idealism is '… (a)ny doctrine holding that reality is fundamentally mental' and materialism is '… the view that the world is entirely composed of matter' (Blackburn 1994, 184, 233).

[9] A prominent critic of modern philosophy, Mortimer J. Adler (mentioned in *fn*.1 above) actually converted to Catholicism later in life.

[10] This was, for example, the milieu from whence emerged Karol Wojtyła, later Pope John Paul II.

On the other hand, other realists such as Searle and *a fortiori* Rand, are able to make a case for metaphysical realism with no such commitment. This is an issue which at some point needs to be faced by every philosopher, but we will not attempt to do so here. On the face of it, religious ideas and concepts of whatever persuasion, not just Christian, are inevitably going to introduce elements of the supernatural, mysticism, divine revelation, and so forth. Indeed, Aquinas's project way back in the thirteen century was precisely to bring about a satisfactory reconciliation between faith and reason, and much the same could be said of Gilson in the twentieth. Absent any pre-existing religious commitment, however, the question is bound to be asked *why* any such reconciliation is necessary? It does not bear on the two theses of Rasmussen & Den Uyl to any significant extent, but clearly has the potential to lead to bitter disagreement.

To return to the other standard criticisms of Rand, we next quote from a best-selling book of the 1980s, thirty years after *Atlas Shrugged* and Chambers' critique. This was *The Closing of the American Mind: How Higher Education has Failed Democracy and Impoverished the Souls of Today's Students*, by Allan Bloom, billed as '… (a)n unparalleled reflection on today's intellectual and moral climate'. It was about the 'dismantling of the structure of rational inquiry' in American universities - the flight from reason - since the 1960s (Bloom 1987, 313). But Bloom (1987, 62) did not much like Ayn Rand either. He always used to ask his students what books had been important to them personally, and says:

There is always a girl who mentions Ayn Rand's ***The Fountainhead****, a book, although hardly literature, which, with its sub-Neitzschean assertiveness, excites somewhat eccentric youngsters to a new way of life.*

Alla Marchenko objects to the sexism and elitism apparent in this passage. The female university student is referred to as a 'girl', and her views are not taken seriously. Bloom seemingly had little real intention of engaging with these students, discussing their views, or finding out what their needs actually are. It does not occur to Bloom that Rand was speaking to the youth in a way the university system could not, and that it might be worthwhile to investigate why.

In the end, the most striking thing about the criticisms of Rand, religious or secular, is that they rarely if ever address the actual philosophical arguments made about metaphysics or epistemology. The complaints have always to with ethics or politics. They are dismissive, without any real explanation, whenever Rand's views on these issues conflict with their authors' prejudices.

The advocacy of self-interest, or just plain 'selfishness', seems to completely cut across the contemporary *zeitgeist* and decades of social conditioning, to which intellectuals and university professors are far from immune. Such expressions tend to have connotations of greed, lack of interest in others, hedonism, *etc*. But is this really what Rand and her followers were advocating? Alla Marchenko (2023) has suggested that something like 'self-realization' would be a better term. This is closer to the Aristotelian notion that the ultimate purpose of philosophy (the actual point of gaining wisdom and knowledge) is the promotion of *eudaimonia* or 'human flourishing'. We

tend to agree with Rand's critics[11] that in her own moral universe the ties of family, children, community - on most accounts vitally important in human life - tend to be given short shrift. But surely these deficiencies would be easily reparable in the general context of human flourishing?[12] It is no great stretch to argue that things like family, community, social relationships and friendship, are themselves among the goods necessary for human flourishing, albeit with different weights for each individual (Rasmussen & Den Uyl 2016, 2020).

As for being in favour of something called '*laisser faire* capitalism' in politics, this seems to be equally beyond the pale in both academic and popular culture. Something along the lines of socialism, Marxism (cultural or otherwise), radical environmentalism, 'wokeism', or what have you, seems always to be much more fashionable. However, disenchantment/dismay with the contemporary socio-political scene and its trajectory, does not automatically imply sympathy with economic programs of literal *laisser faire* and fiscal/monetary austerity. John Smithin, for example, has been advocating a different system of political economy for over forty years, in a program of work from Smithin (1982) to Smithin (2022). It does seem clear that Ayn Rand, a novelist and philosopher rather than an economist, did not have an accurate understanding of the way in which 'capitalism' operates in reality.[13] She seems to have thought of it as working along the lines of the model of barter exchange from neoclassical economics - a model which is, in fact, unviable. More on this below.

But the essential point we are making here is that most of Rand's critics, as in the examples cited above and many more, never seem to address (or sometimes even to be aware of) the vital questions of metaphysics and epistemology which arise before it is *possible* to have a coherent discussion of ethics or politics. (Again the notion of the philosophical order.) It is true that when we do get to ethics/politics our understanding must build on the prior resolution of the metaphysical and epistemological issues. However, the actual debate along the ethical and political dimensions remains to be carried out. Concretely, there is no reason why agreement on realism and the centrailty of reason should necessarily lead to agreement on ethical or political questions. That remains a case to be argued.

4. Correspondences

---

[11] Including, to be fair, Chambers (1958, 2).

[12] At least, they would be so to a person not committed to the defence of each and every last word that Ayn Rand uttered (as, unfortunately, very many of her followers eventually came to be).This was a very strange twist in the collective thinking of a group supposedly devoted to individualism and self-sufficiency. See, for example, Nathaniel Branden's autobiography *Judgement Day: My Years with Ayn Rand* (Branden 1989).

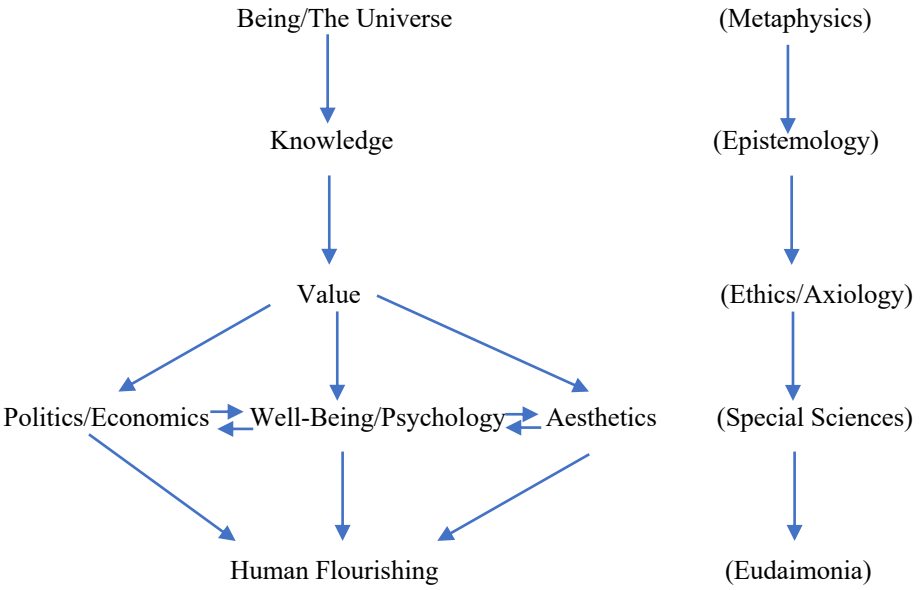
[13] This is an error shared, it must be said, with the vast majority of professional economists of whatever shade of political opinion.

Alla Marchenko (2023) has suggested a schematic diagram to summarize the argument so far and give something of an overview, before pressing on specifically with the issue of the relationship between economics and philosophy. Alla calls this the 'Universal Philosophical System' (UPS) which is illustrated in **Figure 1**.

Figure 1 uses some more everyday terms for the various philosophical concepts, such as being, knowledge, value, *etc*. Some view of these things must be formed before there can be any consideration of the special sciences. The special science we are particularly concerned with in this paper is political economy and, as mentioned, another field of study often listed as a main branch of philosophy is aesthetics. We also include a third area of interest, namely well-being or psychology which we feel is equally important, and to which philosophy can make a big contribution.

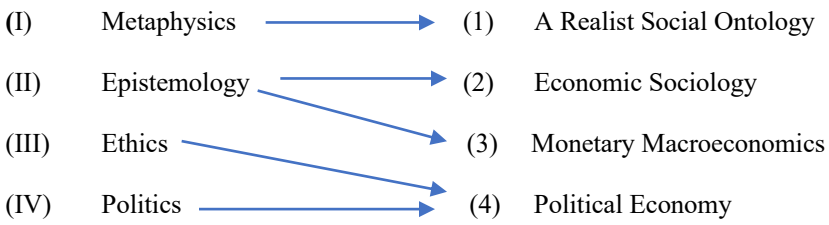
Obviously, we could have included any number of the other special sciences on this line of the diagram, but have limited the choice to just three for space considerations. It is important, also, to note the multiple feedback loops between each of them. The ultimate goal of both philosophy and the special sciences is *eudaimonia* or human flourishing.

Figure 1. *Universal Philosophical System*



At a more granular level, and initially in a *Festschrift* more than a decade ago for the Cambridge University political economist and sociologist (and API Associate) Geoffrey Ingham, John Smithin (2013) commented further on the question of the relation between philosophy and the social science pertaining to the economy, banking, and finance. **Figure 2** below, which summarizes that discussion, is reproduced from a later work by Smithin (2018, 195).

Figure 2: *Correspondences*



The point we are making here is that according to the standard understanding of the relationship between philosophy and the special sciences that existed around one hundred years ago, there was thought to be fairly sharp boundary between philosophy and science. This attitude played an important role in limiting the space for philosophical speculation about the important issues of the day, and ultimately the space for philosophy itself, as we have already seen. It is an attitude which in many ways is still prevalent today. As already mentioned, it is only in the present century that there have been the beginnings of a turning away from the ubiquitous epistemological or 'philosophy of science' approach. In any event, this is what Georg Simmel (1907, 53), author of the influential *Philosophy of Money*, had to say on the matter more than a hundred years ago:

Every area of research has two boundaries at which the process of reflection ceases to be exact and takes on a philosophical character … If the start of the philosophical domain marks … the lower boundary of the exact domain, then its upper boundary is where the ever fragmentary contents of positive knowledge seek to be augmented by definitive concepts into a world picture and be related to the totality of life.

The lower boundary is presumably the place where ontological and metaphysical reflection stops and scientific research begins. Then, when the results of the 'scientific' investigations are in, it will be possible to ruminate on the broader significance of it all. Simmel himself would actually have preferred to avoid the supposedly exact domain entirely. He even went so far as to claim (Simmel 1907, 54):

… (n)ot a single line of these investigations is … a statement about economics …

According to the schemes set out in **Figures 1** and **2**, however, this detached attitude is not going to work. It is certainly true, as shown in **Figure 1**, that the metaphysics must come first, and we must always keep in mind ultimate goals and purposes. But, there is never really any place in which philosophy can just 'switch off' and we can feel safe to leave everything to the technicians. **Figure 2** shows that are no such sharply defined boundaries. There is a philosophical character throughout.

In the double scheme there is a straightforward correspondence between categories (1) and (I). Issues of metaphysics/ontology are paramount, and we should be always be

clear that the ontology of the social world differs from that of the material world. Next, categories (2) and (3), from the list of disciplines, relate to category (II) from the philosophical list. The argument is that economic sociology and monetary macroeconomics together *comprise* the relevant epistemology, as opposed, for example, to the mathematical neoclassical microeconomics taught in universities. The latter wrongly tries to emulate the methods of natural science, such as physics. Finally, the subject of political economy, category (4) from the disciplines list, corresponds to ethics and politics in categories (III) and (IV) in the philosophical list. This is the point at which the ethical and political dimensions become relevant.

5. A Realist Social Ontology

As mentioned, the need for a realist social ontology arises from the fact that social structures and institutions – 'social facts' – do exist and are real, even though they are not material. Moreover they can and do have causal effects in the material world. They are the pre-conditions for human action in the social sphere but, at the same time, they themselves depend on human action (Smithin 2009, 44). In two papers published in the *APJ* Torrey Byles, (Byles 2022) and in this issue, has elaborated on this theme, and also pointed to the failings of the neoclassical approach to economics including its metaphysical shortcomings. However, the important question that needs to be asked here is whether or not these circumstances undermine the general case for metaphysical realism. We are sure that they do not, and that the special case of social facts can easily be accommodated into an overall realist framework.

In various works, Searle (1995, 1998, 2010), has elaborated on the distinction, originally due to Anscombe (1958), between the 'brute facts' of the material world and the social facts that apply in the social sphere. The brute facts are what they, but the social facts depend in large part on the beliefs and attitudes of the participants. They are *subjective* in that specific sense. They are conditioned by such things as collective intentionally and the performance of 'speech acts'. Both the brute facts of the physical/material world and the immaterial social facts are real, but it is somewhat easier to grasp this notion in the case of the natural world, as the brute facts are both ontologically and epistemologically *objective*. What we mean by saying this is that the brute facts are 'ontologically objective' in that they continue to and are 'true' regardless of what anyone thinks about them, or even if there *is* anyone around to think about them. And they are also epistemologically objective, which means that if anyone is around to do so they can indeed be studied objectively. Evidently, the concepts of subject and object, and hence subjectivity and objectivity, are vitally important in philosophy (*Cf.* Ayn Rand's 'objectivism'). But what causes confusion is that the social facts, by definition, must depend in some crucial way on the beliefs and opinions of the collective. They can only have their existence or being in the minds of each of the participants or subjects.

Does this make a difference? We think not. The importance of being able to have 'a grasp of reality' is equally as applicable to the social world (and to social science) as it is in natural science. The immaterial social facts may well be *ontologically* subjective, but just like the brute facts, they are *epistemologically* objective, They are just as real

in their impact on human beings and their environment. It is possible to study them and explain how they work. We merely need to keep clear the difference between the ontological and epistemological spheres. There can indeed be a genuine social science which studies both the nature of the immaterial social facts, and their causal effects on the material world. The *methods* used will have to be different, but we have already argued that it is a crucial feature of the philosophical order that each of the special sciences should have its own method.

It will be useful here to briefly give a practical example of a social fact, and how social facts actually work. John Smithin (2009, 51) has previously used the case of the proverbial 'line in the sand'. Suppose that we do draw a line between two warring factions in a desert-type environment (or maybe just between two quarrelsome individuals on a beach), by marking a line in the sand with a stick. If both groups or individuals respect the boundary and no-one crosses it, it fulfills its function and the peace is maintained. As in the general case of social facts, the boundary does *not* fulfill its function by virtue of it physical properties. There is nothing to actually prevent anyone from stepping across. It is nonetheless effective and has a causal impact on the world – in this case on geographical location – as long as its conditions of existence are in place.

In addition to showing how effective a physically insubstantial social institution can be, our example also explains the opposite. A social convention may easily evaporate. It may seem at one moment to be a solid and time-honoured institution, an unbreakable taboo. At the next, if someone 'steps over the line' and no-one retaliates, it simply crumbles. It is easy to draw obvious parallels with all of the important economic institutions, such as money, private property, firms, banks, government itself, 'markets', debt, mortgages, pension plans, *etc., etc.* They all rely on the same type of conditions of existence, and in normal circumstances can seem just as real and binding on the individuals participating in them. But they can always collapse at any time if the necessary social consent is withdrawn.

6. Laisser-Faire Capitalism?

Once the importance of the study of social ontology is understood, together with the point that the subject matter of social science is quite different from that of the natural sciences, it can immediately be seen how it is that the specific concept of '*laisser faire* capitalism', discussed above, inevitably turns out to be misleading and incomplete. The idea does not constitute a plausible ontology of social relations. Such a statement by no means automatically implies either an anti-capitalist or pro-socialist stance. What it does suggest, however, is that there should be deeper reflection on the nature of these social structures.

To elaborate, *laisser* is a French verb meaning to leave and *faire* means to do. The expression *laisser faire* therefore means something like to 'leave well alone'. As for the term (suffix) 'capitalism' itself, people who use the expression '*laisser faire*

capitalism' seem to think of it as a synonym for something like 'the market'. Its use does not reflect any attempt to investigate whether there does, or does not, really exist a complete social system answering to that description, involving a distinct entity called 'capital'. '*Laisser faire* capitalism' therefore tends to mean merely that the government should leave the market alone to work by itself (a so-called 'free market'), and not interfere with it in any way. There is certainly a legitimate debate to be had about the extent of government regulation, and whether or not any particular regulatory framework, tax, or government agency is desirable. But, as a system of political economy the notion simply cannot work. The underlying idea is that, somehow, a thing called a 'market' just grows up on its own, almost like a biological entity, without any conscious input from those who participate in it, or the society at large, and should be just left to itself. Indeed, this attitude frequently devolves into a stance there is nothing at all that can be *ever* done about economic issues. That there cannot be (should not be?) any sort of policy whatsoever, even just to the extent of setting the 'rules of the game'. No doubt the 'law of unintended consequences' is important, but this kind of thing is simply nonsense as social science because markets themselves *are* social institutions. They are built on all of the other existing social institutions, including whatever systems of government/governance are in place, money itself, a legal system, ideas about private property, and so forth. As we have seen, each of these rests on collective intentionality, and there cannot be a realist social ontology that does not take account of these things. Here we are not attempting to pre-determine the outcome of any debate about either macroeconomic or microeconomic policy. We do want to stress, however, that the 'ontological spadework' has to be done first, before any policy discussion can take place, and on the importance of sticking to the philosophical order.

The sort of confusion that can arise as a result of mistaken ideas about social ontology may conveniently be illustrated by referring back to an episode in *Atlas Shrugged*, the novel by free-marketeer Ayn Rand already cited above. At one point, the heroine encounters a community of dissenters/drop-outs from the existing society (the USA) who have set themselves up in a remote location in the West. She crash lands her light aircraft into their enclave. The group has been concerned about the apparent slide towards a socialist/communist type of society that seems to be underway (*plus ca change*?), and have been attempting to set up their own economic system. This is to be based solely on market exchange and will not allow for any form of altruism, welfare, or anything of the kind. For example, when they give medical treatment to the heroine after the accident, and repair her plane, she has to pay in gold, that is 'gold pieces' (*i.e.*, gold coins) which were not legal in the USA at the time of the Bretton Woods[14] era. One may well sympathize with the dissidents in their attempt to escape from the clutches of totalitarianism. However, if we ask exactly how the heroine is supposed to pay her bills, the answer reveals the lack of coherence (the lack of attention to social ontology) of the blueprint. She is not allowed, at first, to go back to the original society as the locals do not want their whereabouts revealed. But presumably once recovered she could take some kind of job within the colony, if one is available, to get some cash.

[14] See the paper by Smithin & Tytchino (2023), in this *Journal,* for more discussion of the Bretton Woods agreement and the international financial system.

A key question, however, is where does the metal itself come from? If the settlers had brought the gold with them as bullion from the East then they must have already been wealthy people in the existing society. But, if so, then the new society is not independent of the outside world at all. And, also, how did the gold get minted into coins? For that to have happened there must already have been a commercial mint in operation, implying that there must already have been a monetary system of some sort in existence. Which comes first - the chicken or the egg? If, alternatively, the settlers had had no gold to start with, then there must have been some natural gold deposits in the place they chose to settle. What if there was no such thing? Finally, and perhaps most importantly from the point of view of social ontology, if there is a fixed amount of gold and they are not going to trade with the outside world any longer, how is the economy ever going to expand? Profit is the excess of sales revenue over production costs. If the supply of gold coins is fixed for all time, there can never be any profit for the society as a whole, and the economy cannot grow. One persons gain, if any, would be equal to another person's loss.

The point, then, is that essentially no thought has been given to the ontology of money. The fictional construct does nothing more than reflect the emphasis that has always been placed in standard economics on the role of money as *medium of exchange*. This was originally derived from conjectures about how money did arise historically. But those conjectures about history, to the effect that money evolves from a pre-existing system of markets conducted by barter, have never been anything more than just that (conjectures), and the entire approach is misguided (Smithin 2018, 2022).[15] What is truly important about money, as that social institution functions in real economies, is that it is a *means of payment*, specifically a means of payment of debt. This is not the same thing as a medium of exchange, although in a genuinely monetary economy it is true that many of the debts will indeed have been incurred in the process of making trades and fulfilling the associated contracts. Above all, money is a social relationship involving debt and credit.

In the more realistic credit or 'claim' theory of money, money is not thought of primarily as a physical object, nor as somehow representative of pre-existing value, but simply as entries in a ledger, a system of accounts, or a balance sheet (Parguez & Seccareccia, 2000). The purpose of the entries is to record the various social relations of indebtedness. Debts are incurred and paid off by balance sheet and accounting operations. In fact, this is familiar to us all from everyday experience. It then becomes a key issue for the analyst to decide exactly what it is, in a given system, that 'counts as'[16] making payments (that is, discharging debt) in the particular circumstances. In short, and again without pursuing the argument in any more detail here, we find that in reality (in the literal sense of this term) things are much more complicated than the standard approaches to economics make out. These complications require the detailed investigation of the nature of money and other social relations.

---

[15] We literally need to move *Beyond Barter,* as in the title of one of Smithin's books (Smithin 2022).

[16] Another useful philosophical term.

Once this is done it may very well lead to different approaches in political economy (*i.e*., different results in one of the special sciences) even among those social scientists who share the same metaphysical and epistemological commitments. (That, presumably, is actually the point of studying the special sciences). In the case of Randians, and others such as 'Austrian' economists, libertarians, and mainstream economists who share similar views, the lack of consideration of social ontology has led to the major mistake of treating the economist John Maynard Keynes, for example, as if he were as much of a deadly enemy as Marx, Lenin, or Stalin.

7. International Political Economy & Geopolitics

At this stage it might be useful to round off the discussion by summarizing the options available for international political economy *via* the device of a four-quadrant diagram such as Smithin (2013, 2018, 2022) has deployed in earlier work. The diagram distinguishes, on the one hand, between socialism and 'enterprise' (which might be a better term for the commercial society than the amorphous 'capitalism') as alternative economic systems and, on the other, globalism *versus* nationalism in politics. This will yield the different options listed in **Figure 3.**

Figure 3: *Different Orientations in Political Economy*

	globalist	nationalist
socialism	international socialism	national socialism
enterprise	globalization	?

The terms in the NW, NE, and SW quadrants of the diagram are self-explanatory. Each of them, for different reasons, carries a lot of intellectual and historical baggage. There is a question mark for the label of the SE quadrant. This is unfortunate, it because it seems to us to the only option left for the promotion of an 'open society' in the domestic economy, to use Popper's (1945) term.[17] It embraces enterprise, it is not socialist or

[17] In using this phrase we by no means intend to endorse Popper's own particular vision of what an open society might be. Popper's book was called *The Open Society and its Enemies*. Alan Ryan (2013, xxi), in the introduction to a 2013 edition, remarks that

communist, but rejects globalism of either the left-wing or right-wing variety. It emphasises local (in this case national) decision-making and cultures.

But what to call this type of policy stance? It will surely have to be something along the lines of 'monetary mercantilism', 'economic nationalism', or similar Smithin (2013, 2018, 2022). In *Rethinking the Theory of Money Credit and Capitalism*, John Smithin (2018, 186-7) even suggested at one point that it should be called a policy of 'capitalism in one country' - a pun on Stalin's (1924) notorious 'socialism in one country'. 'Capitalism in one country', which would presumably have been anathema to Stalin, is meant to refer to the prospects for a non-socialist domestic economy having the ability to control its own economic destiny by putting in place the appropriately expansionary policies. The expression '*monetary* mercantilism' (emphasis added) means much the same kind of thing. That term does not refer to protectionism as such but, in the open economy context, to a policy of stimulating effective demand by various financial and monetary techniques, and thereby bringing about full employment, economic growth, and general prosperity. Such policies might also have a similar impact on the balance of payments and the foreign debt position to those of conventional 'protectionism', but that that is not their primary purpose. The primary purpose is expansion as such. The terminology is far from ideal, because of the negative connotations of the term 'mercantilist' to almost all professional economists (and apparently now, from recent political debates, to all shades of political opinion). Some such convenient expression, nonetheless, is needed to denote the space between international socialism, on the one hand, and 'free trade', 'globalism', 'the power of market forces' - all that kind of thing - on the other.

8. **Conclusion: The Special Issue**

The conclusion, then, is that economics (and most everything else) is 'part of philosophy' not the other way round. We take the view that both the natural sciences and social science should be based on metaphysical realism, and that it is possible to aspire to knowledge *via* reason and some version of the scientific method in each. But social ontology and the ontology of the natural world are different.The subject matter is different, so the methods are different. Social facts are ontologically subjective, but are nonetheless real and epistemologically objective. It is therefore possible to conduct meaningful investigations in the sphere of social science. However, questions of ethics and political economy can only be reasonably addressed once the ontological and epistemological 'spadework', to repeat this expression, has been undertaken.

The various papers in the current issue of the *Journal* each deal, in one way or another, with this fundamental issue of the relationship between philosophy and

---

some of Popper's students would joke that it should be re-named '*The Open Society by **One of** its Enemies*'.

economics. In the first paper, Torrey Byles (2023) deals directly with the themes of social ontology and the ontology of money, and points up the failings of the neoclassical approach to economics, including its metaphysical shortcomings. In the second, Professor Guillaume Vallet of *L'Universite Grenoble Alpes* contributes a French language paper (Vallet 2023) on what has also become an important issue in social ontology, namely the commodification of the human body in the fitness industry, which he labels 'le corps-institution' (the body institution). The third paper by John Smithin & Andrey Tytchino (2023) also deals with the ontology of money, and the implications of the profound changes currently underway in the international financial system.

This is followed by two papers featuring Smithin (2023a, 2023b) as a solo author, the first on the ontology of capital, and the second on the ethics of income distribution. Unavoidably, all three papers involving Smithin, which handle difficult issues in monetary macroeconomics, make some use of the mathematical method. (For which an apology may be due to some readers). But we believe that this is not a serious deterrent to also reading about the key philosophical issues in those papers. The important thing about the use of mathematics is the issue of *at what stage* it is brought into the investigation. Smithin (2018, 9) has earlier complained about:

... the virtual identification of the term 'economic theory' with the use of differential and stochastic calculus to solve the optimization problems of the representative agent or agents.

This was attributed to the mainstream of the economics profession in the universities, over a period of many decades from the end of WW2 to the present. The complaint is actually that the practitioners of this approach were making exactly the same mistake as Descartes in the 17th century. They try to deduce the nature of the world (in this case the social world) on the model of mathematics (*e.g.,* differential calculus). But mathematics, after all, is merely one of the special sciences. It is not philosophy itself, it is a tool. The correct philosophical order is that work on metaphysics/ontology should come first, and *then* it will be possible (if mathematics is needed) to choose the appropriate type of math to fit the subject matter. Not the other way round.

The final paper is by Professor Noemi Levy Orlik (2023) of the *Universidad Nacional Autonoma de Mexico* (UNAM) and looks at the practical consequences of taking a philosophical outlook on economic issues, focusing on the case of recent monetary policy in Mexico. Contrary to the view of mainstream economics that money is 'neutral', in practice this is not so. The conduct of monetary policy has very important implications for the welfare (well-being) of the citizens. The papers by Byles, Vallet, and Levy Orlik each include a short abstract.

Acknowledgements

We are grateful to the Town of Aurora for proving funding for this latest issue of the *Journal,* and, of course, to our fellow contributors for all their hard work and scholarship.

References

Adler, M.J. 1985. *Ten Philosophical Mistakes: Basic Errors in Modern Thought – How They Came About, Their Consequences and How to Avoid Them*. New York: Macmillan Publishing Company.

Anscombe, G.E.M. 1958. On brute facts. *Analysis* 18: 69–72.

Blackburn, S. 1994. *The Oxford Dictionary of Philosophy.* Oxford: Oxford University Press.

Bloom, A. 1987. *The Closing of the American Mind*: *How Higher Education has Failed Democracy and Impoverished the Souls of Today's Students*. New York: Simon & Schuster.

Branden, N. 1989. *Judgement Day: My Years with Ayn Rand*. Boston: Houghton Mifflin.

Byles, T. 2022. The speech foundations of money and property: a look at Searle and Ostrom. *Aurora Philosophy Journal* 1: 5-20.

Byles, T. 2023. The ontology of money: where neoclassical economics went wrong, this *Journal*.

Chambers, W. 1958. Big sister is watching you. *National Review* (reprint): 1-5.

Gilson, E. 1990. *Methodical Realism: A Handbook for Beginning Realists*. San Francisco. Ignatius Press. (English translation of *Le realisme methodique,* 1935).

Heilbroner, R. 1999. *The Worldly Philosophers* (seventh edition). New York: Touchstone.

Hubbs, G. 2020. Philosophical explanations of the nature of money. Paper presented to the *Aurora Philosophy Institute*, Aurora ON, November.

Hubbs, G. 2021. Elizabeth Anscombe: *Intention*. Paper presented to the *Aurora Philosophy Institute*, Aurora ON, May.

Hubbs, G. 2022. Settling on how to settle: collective intentionality and money. *Aurora Philosophy Journal* 1: 35-51.

Johnston, D. 2006. *A Brief History of Philosophy From Socrates to Derrida*. London: Continuum.

Lekka-Kowalik, A. 2022. The relevance of the Lublin philosophical school to the contemporary intellectual milieu. *Studia Gilsoniana* 11: 595–616.

Levy Orlik, N. 2023. Mexican monetary policy: to stabilize inflation or the financial system?, this *Journal.*

Marchenko, A. 2023. Personal correspondence with J. Smithin.

Marchenko, A. & J. Smithin. 2022. The inaugural issue of the *Aurora Philosophy Journal*. *Aurora Philosophy Journal* 1: 1-3.

Marshall, A. 1890. *Principles of Economics*. London: Macmillan.

Mendoza Espana, A.D. 2012. *Three Essay on Money, Credit, and Philosophy: A Realist Approach per totam viam to Monetary Science.* Ph.D thesis in Economics, York University, Toronto.

Parguez, A. & M. Seccareccia. 2000. A credit theory of money. In *What is Money?*, ed. J. Smithin, 101-23, London and New York: Routledge.

Peikoff, L. 1982. *The Ominous Parallels: The End of Freedom in America*. New York:

Stein & Day Publishers.
Popper, K. 1945. *The Open Society and its Enemies*, (as reprinted by Princeton University Press, Princeton, NJ: 2013).
Rand, A. 1957. *Atlas Shrugged*. New York: Random House.
Rasmussnen D.B. & D.J. Den Uly. 2016. *Norms Of Liberty: A Perfectionist Basis for Non-Perfectionist Politics*. University Park, PA: Pennsylvannia State University Press.
Rasmussnen D.B. & D.J. Den Uly. 2020. *The Realist Turn: Repositioning Liberalism*. Cham, Switerland: Palgrave MacMillan.
Ryan, A. 2013. Introduction. In K. Popper *The Open Society and its Enemies,* ed. A. Ryan, ix-xxi, Princeton, NJ: Princeton University Press.
Searle, J.R. 1995. *The Construction of Social Reality*. New York: The Free Press.
Searle, J.R. 1998. *Mind Language and Society: Philosophy in the Real World*. London: Weidenfield and Nicholson.
Searle. J.R. 2010. *Making the Social World: The Structure of Human Civilization.* New York: Oxford University Press.
Simmel, G. 1907. *The Philosophy of Money*. As reprinted by Routledge: London, 2004.
Smithin J. 1982. *The Incidence and Economic Effects of the Financing of Unemployment Insurance.* PhD thesis in Economics, McMaster University.
Smithin J. 2009. *Money, Enterprise and Income Distribution: Towards a Macroeconomic Theory of Capitalism.* London: Routledge.
Smithin, J. 2013a. Requirements of a philosophy of money and finance. In *Financial Crises and the Nature of Capitalist Money: Mutual Developments from the Work of Geoffrey Ingham*, eds. G.C. Harcourt and J. Pixley, 19-29, London: Palgrave Macmillan.
Smithin, J. 2013b. *Essays in the Fundamental Theory of Monetary Economics and Macroeconomics,* Singapore: World Scientific Publishing.
Smithin, J. 2018. *Rethinking the Theory of Money, Credit and Macroeconomics: A New Statement for the Twenty-First Century*. Lanham MD: Lexington Books.
Smithin, J. 2022. *Beyond Barter: Lectures in Monetary Economics after 'Rethinking'*. Singapore: World Scientific Publishing.
Smithin, J. & Tytchino, A. 2023. The political economy of capital flows, real exchange rate dynamics, and the foreign debt position in sovereign monetary systems, this *Journal*.
Smithin, J. 2023a. The Hicksian super-multiplier, 'capital' theory, and social ontology: fundamental problems in both mainstream and heterodox macroeconomic theory, this *Journal*.
Smithin, J. 2023b. Monetary policy and the ethics of income distribution, this *Journal*.
Stalin, J. 1924. *Foundations of Leninism: Lectures Delivered at the Sverdlov University*, 1924. (As reprinted by Foreign Languages Press, Peking: 1975).
Vallet G. 2023. L'economie politique du « corps-institution »: une réactualisation de la théorie de la regulation, this *Journal.*

Aurora Philosophy Journal, Vol. 2, No. 1, pp. 21-38

The Ontology of Money: Where Neoclassical Economics Went Wrong

Torrey Byles
Aurora Philosophy Institute & Granada Research

Abstract

The prevailing metaphysics of the 18th century, a Cartesian/Kantian dualism of two unbridgeable ontological realms, mind and matter, was inadequate and ill-suited for making a viable theory of money and the market process. Money has the odd ontology of being only a belief, but at the same time, being real, objective, and certainly not 'subjective'. Despite the failed attempts to understand money by the classical and neoclassical economists that continue to this day, philosophy since the Enlightenment has matured and progressed. Now, a metaphysics of embodied realism can resolve the antinomies and paradoxes of money, and a realistic theory of the economic process is attainable.

1. Introduction

Adam Smith's publication of the *Wealth of Nations* occurred at the apex of the Enlightenment era whose conception and theory of knowledge and science was captured by the German philosopher Immanuel Kant in his three volumes, the *Critique of Pure Reason*, the *Critique of Practical Reason* and the *Critique of Judgment*. Each philosopher's work set the parameters, indeed, became the paradigm of two central discourses for the next 250 years, economics and philosophy. Grading the progress of the two disciplines since then, philosophy has come a long way. Economics has travelled less far.

Despite sharing common metaphysical origins in the scientific revolution of the 17th century, formulated by such philosophers as Descartes, Locke, Hume and, ultimately, Kant, philosophy today has seen through its mistaken metaphysical position of that earlier period whereas economics has not. The consequence is that economics remains today a fractured and stunted discipline, consisting of various schools and ideological camps, and providing an amalgam of *ad hoc* and inconsistent policy recommendations and rules of thumb. Even after 250 years of thought on the subject, there is still no coherent theory of price formation, production, inflation, supply and demand, or even the appropriate definition of capital.[18] Furthermore, as a discipline, economics offers

[18] Many other unresolved issues include misunderstanding the finance sector as just another sector, netting out balance sheets for a false sense of stability, not recognizing that flows of funds alter stocks of funds, that there is no equilibrium but rather processes of continual change, a shallow psychology of utilitarian behaviorism, and much else.

no cogent solutions, not even a framework for understanding the two most pressing problems facing the world economy today - inequality and environmental degradation.

It is my claim in this paper that developments in philosophy, particularly its metaphysical paradigm shift away from Cartesian duality, nominalism, and mechanism - towards a metaphysics of human embodied participation in the world (especially through communication with others) - is the critical step necessary for economics to escape its stagnation of thought.

The Metaphysical Realism of philosophy today, taken in its most general form, including some (but not all) of 'constructionist/deconstructionist' and even 'post-modernist' philosophies, gives a realistic and objective, but not necessarily a materialist-idealist conception of socially-created objects such as money, property, economic actors (buyers, sellers, employers, employees, lenders, borrowers, corporations, proprietors, owners), and other modern economic institutions.

Metaphysical realism is a broader tent than Cartesian dualism and is able to include the subject-object disengaged observer of Cartesianism as a special case and method for acquiring knowledge and finding truth. Specific developments in philosophy leading to this new metaphysics are the philosophy of language, the philosophy of mind, semiotics and interpretism.[19]

What I propose is that economics needs to incorporate these modern developments in philosophy to re-envision itself as a science of collective semiosis and self-interpretation**.** Our economy is how we jointly create meaningfulness and coordinated action in material living arrangements, and come to know ourselves through our relations of engagement in community and the world. Money is a linguistic sign used to organize and coordinate commitments to action.

At the time of the emergence of classical science, enlightenment philosophy gave the early (also so-called 'Classical') economists an empirical, nominalist, and dualistic method of investigation into economic phenomena[20]. But that mode, with its strict separation of subject and object, while effective for the natural and physical sciences, was not appropriate for economic and social science. Especially for the economic institution of money, the dualistic and nominal approach was fatal for developing good theory.

Yet, despite the economist's flawed understanding of money (and other social institutions), the tremendous material growth and the rise in standard of living since the Enlightenment, seemed to validate the classic scientific method as understood in the Cartesian/Kantian framework. In spite of the absence of valid economic theory, the vast industrialization was taken as further evidence that our technological culture rested on valid scientific premises. Despite not understanding economic development from a

---

[19] Semiotics is often considered only as a theory of signs, but, according to C.S. Peirce scholar, James Hoopes (Hoopes, 1991) it is equally a theory of interpretation and, with Peirce's comprehensive theory of signs and communication, is congruent with interpretive and hermeneutic frameworks in philosophy.

[20] The Scottish 'common sense school', of which Adam Smith was a leading representative, was in important aspects at odds with Cartesian rationalism and can be considered a proto-pragmatic and metaphysical realism. See Peirce (1871) as reprinted in Hoopes (1991, 139).

theoretical standpoint, we were nonetheless achieving, in the words of the old TV commercial, 'better living through science'.

Paradoxically, while apparently mutually reinforcing the adoption of the one by the other, the natural sciences of the Enlightenment gave economics a methodology that didn't work. The dualistic, nominalistic, positivistic, empirical approach that economists were trying to apply just couldn't adequately cope with a theory of money. The separation of knower and known, subject and object, could not produce a coherent theory of money, nor of society. Such an absolute subject-object dichotomy suggested two grim social-theory alternatives, either the individual war of 'all against all', or absolute totalitarian group think (Taylor 1991, 481).

The single most important thing at the heart of economics – money – defied the empirical, nominalist approach. That approach could not resolve the antinomies and paradoxes of money and could not produce a coherent theory of money. Thus, what seemed to be a fruitful method of science in the natural sciences was not applicable to the social science of economics. Without an adequate understanding of money, there is no possibility for an adequate theory of economy. In the words of Schumpeter (1954, 292):

... any satisfactory theory of money implies a theory of the economic process in its entirety…

In this paper, I will briefly overview a realist ontology of money that has finally come to be understood as a result of applying post-Kantian/post Cartesian metaphysics, and will briefly overview the troubled history that economists, since Adam Smith, have had in trying to conceptualize money in the theory of a modern economy. In the conclusion, I will restate some of the main themes and point to the need for a hermeneutic, semiotic, approach to the economy.

2. The Ontology of Money in Brief

Money is a type of sign used in inter-human communications to organize commitments for action. While money is a measure used to give a quantitative value of a good or service, and thereby does have a representational function, its *primary* function is to allow for an important step to be taken in a process of inter-related activities between actors. The related activities typically are buying property, selling property, hiring people, being hired by people, lending money, borrowing money, giving or receiving money, and so forth.

From a philosophical, particularly a metaphysical, standpoint money's representational aspect is the less important aspect of money. Its principal aspect is to allow action to take place between the payor and payee. The numeric value that money, as a measure, allows parties to agree on (*i.e.*, to establish a particular price or a particular wage) is only a provisional step for an action to go forward. The representational aspect of a price or wage resolves the issue of final payment and settling a debt (Ingham 2004,

70). Money makes final the agreement and eliminates any further obligation on the part of the payer for the receipt of the good or service. Money, like all social objects and institutions, is a marker of a process of action that people may take. The actions are prior and antecedent to the 'thing' that money is. The ontology of money, like all social objects, is constituted by social actions. Money is a possibility of activity (Searle 1995, 33).

The representational function of money to make a price or wage determinate, while pivotal, is only one in a composite series of actions. There is a whole series of economic activities in which money payment (a money transaction) is the core action. But, as a core action, it enables a wide range of other actions that taken together in a public sphere of conversations, called a 'market-place', constitute a financial strategy for the economic life of actors in a highly diversified labour-technological order.

The physical ontology of money – how it physically exists in token form, such as dollar bills, metal coins, plastic cards, electro-magnetic molecular states in digital storage devices, *etc*. – is *not* primary. Money's primary ontology is conceptual, abstract and mental (semiotic). It is a component of the completion of human action/agency in relation to other humans. Each currency unit is a unit of credit, recognized by members of a community, to settle debts owed to one another. It 'exists' but only in the human mind, not in physical reality. It is information. It is neither energy nor matter. It is simply a sign that gets interpreted by an observer as having a range of potential behaviors connected to it.

From the standpoint of 'mainstream science' the ontology of money – the conditions for how it exists in the world, its nature, its quality, its constituent components – is very suspect and hard to grasp. Usually, ontology is about the physical 'thingness' or 'objectness' of something. The ontology of trees and rocks are self-evident. You just point to them, and anyone else can immediately start to understand their ontology. But in the case of money there is no intrinsic physical thing. Money does not exist independently of the human observer, like rocks and trees do. Money is observer dependent. The ontology of money – its existence, its properties, its qualities – are all in an observer's belief that it is money. Children don't see money, as they do rocks and trees. You have to learn to see money. Only adults see money. They have learned to see it.

Part of the definition of money is that people believe it is money. Like all social objects, the attitude taken toward the phenomenon is partly constitutive of the phenomenon. This seems as if it will create a vicious infinite regress or a vicious circle. According to Searle (1995, 33):

If the content of the belief that something is money contains in part the belief that it is money, then the belief that something is money is in part the belief that it is believed to be money; and there is, in turn, no way to explain the content of that belief without repeating the same feature over and over again.

But this problem goes away when you consider that money exists in a sequence of conversational steps or actions. The word 'money' is a node in this network of conversational practices, the practices of owning, buying, selling, earning, paying for services, paying off debts, *etc.* These activities allow us to define the concept of money without using the word money. Searle describes this odd phenomenon, that something

exists only because people believe it to exist, by saying that, *money is epistemologically objective, but ontologically subjective* (Searle, 2006, 55). It is real, but exists only in our minds.

Searle's use of this phrase introduces four distinctions in metaphysics; object, subject, ontology, and epistemology. From an epistemic standpoint, objective and subjective refer to predicates of judgments. Here, judgments are either factual (referring to a reality independent of the subject) or attitudes and opinions of the individual subject. From an ontological standpoint, objective and subjective refer to predicates of entities and ascribe their mode of existence. Here, entities are either physical things or inferred physical things (such as gravity) or they are abstract concepts such as mind, risk, income, or taxes, and the predicates describe how they can exist in the human world. On the other hand, such things as itches, bodily pains, or a stomach ache, are subjective entities because their mode of existence depends upon being felt by a subject.

As a result of these four distinctions – epistemic and ontological objectivity and subjectivity – there are three general categories of intelligibility[21] of the world:

1. An uninterpreted, subjective, personal, pure awareness of the individual subject (of the individual intelligent organic being).

2. Full objectively factual reality that humans (and all intelligent beings) cognize.

3. A reality that exists in the cultural meanings and abstractions invented by the community of speakers.

Money and all economic institutions such as corporations, governments, private property, *etc.,* are similar to itches and stomach aches in that they are 'ontologically subjective' where they only exist in peoples' minds. Yet because everyone shares these beliefs, they are epistemically objective and real. They are independent of any single individual observer.

---

[21] I use the word intelligibility as a synonym to the philosophical technical term intensionality. It does not refer to truth or truth conditions. Also, there are only three general ranges of intelligibility (not four as one might conclude from the four terms being discussed that is episteme, ontology, objective, subjective). The reason there is no 'ontologically objective' category is because intelligibility of reality infers a point of view toward reality that can be communicated and represented in language and signs. Points of view, communication and representation are all epistemic issues. Ontologically objective reality does not have a point of view; it just is (Searle 1995, 175-176, 194-197). This is an important point and distinguishes the modern/post-modern metaphysical realism from the Cartesian-Kantian metaphysical dualism where the latter metaphysical position always risks skepticism that there could be an independent reality from the human observer. The three kinds of intelligibility shown here correspond to Peirce's three metaphysical categories.

Epistemic objectivity does not require ontological objectivity. And this fact, says Searle, is the basis for all of the social sciences. If the modern social sciences began with Kant and Smith, by the beginning of the 20th century, many philosophers and social theorists (Peirce, Durkheim, Trigant, Burrow, Mead) began to recognize that an individual's cognition is socially conditioned. Husserl gave it the name of *intersubjectivity*, meaning a common belief shared by many individual subjects. There are many other names for this, including: social ontology, collective intentionality**,** consensus reality, background understanding, average mutual intelligibility, discursive formations, anonymous meanings (Byles 2021). Twentieth-century economists have come close to the concept, calling it bounded rationality, rational expectations, or the *macro* foundations of individual behavior. The institutional economists, such as Veblen, Hamilton, Patten, Commons and Bourdieu, also refer to intersubjectivity when they say that we both make, and are made by, institutions (Hodgson 2000).

3. Constitutive Speech and Performativity

The factual, objective reality of money and other social objects and institutions (such as corporations, government agencies, and property) are created in conversation and, in particular, through a class of speech acts that Searle calls declarations, directives and commissives. Examples of declarations are when a bank grants a mortgage to a homebuyer or when a credit-card issuer tells you and the retailer at the point-of-sale, that your credit is good, the buyer's money is real. Declarations create the reality by saying that it is created and is now existent. Directives are such things as ordering, offering, requesting. Commissives are promises, *etc.*

Declarations, promises, and directives are all of class of speech-acts that Searle (1979) calls *performatives*. With performatives, speakers of language attempt to alter social reality – including the social situation in the moment – by making reality fit the words they utter. Once declared into existence, money becomes a marker in a conversation and referencable by the transactors to make further speech acts. The seller may *promise* to give title to the buyer for the property paid for. Or, once the wage-salary is agreed to, the employer *directs* the newly hired employee on tasks to be accomplished at the work site.

The monetary transactional process begins when money is spoken into existence by banks. Then, through conversation, prices and wages are made quantitatively determinate by transactors. Once these declarative speech actions take place, people have a new reality to reference and can make further speech actions now that the money and the price are epistemologically objective, *i.e*., they are real. Performative speech actions constitute the social objects of the situation: first *money* by bank declaration, then *seller* and *buyer*, self-identified by their mutual promise and commitment to settle an exchange of property or work using the intersubjectively certified credit unit. With such an objectification of the situation, the socially identified actors proceed with the *exchange* or *transaction*, which itself becomes another factual social object, as for instance, in the two accounting ledgers of the transactors.

The factual existence of all of these imagined, invisible, but nonetheless real, institutions and representations *create reasons for us to act*. For example, I seat myself

in a restaurant. After reviewing the menu options and their prices, I order food, it is brought, and I finish my dinner. Once eaten, the person brings a slip of paper with numbers on it. I respond in a distinctive way – either with slips of paper or a plastic card – and the person, expressing satisfaction with my response, declares that I am free of any further obligatory action. Another example. The house on the corner of my street has a nice grassy lawn in front. When I walk down to the corner, and want to turn ninety degrees onto the intersecting street, I am tempted to walk diagonally across my neighbor's front lawn. I don't do this because I have learned to recognize the lawn as private property, and I walk around it. Only the meaningfulness of money and property, as sets of rights and obligations, cause my behaviour. The semantics of money and property (what they mean to me) become reasons for me to do the right thing (deontic power). Money and all institutions give reasons for acting. This is linguistic, or more broadly, semiotic performativity.

The power of the signs and language of money and commerce are twofold; firstly semantic power allows humans to construct reasons for acting, then the ethical-moral or 'deontic' power we possess fulfills the stipulations of the meanings. People are obligated to fulfill the agreed upon action that money sets up between two parties, asking for the food, delivering it, paying for it, *etc.* Money's power, therefore, should be construed not as a natural material force, nor an unconscious psychological force such as physiological/neurological instincts, hedonistic compulsions, drive, psychic forces, the power of volition, the will (as 19th century philosophy would have had it), or even general traits such as honesty, conscience, *etc.* (Taylor 1985a, 43, Taylor 1985b, 117-38). The power of money is its action-indicating semantics (*aka* meaningfulness).

The power of language goes beyond language and impacts the real world, the physical and social world alike, by the action it generates in humans and the material effects these actions have. Money is a human-made sign used in a conversational process of human self-organization through interactive semiosis, where the money sign is used to organize commitments to action. Modern money began in fourteenth century Italy with the emergence of credit banking along with a market among banks and other dealers for trading financial assets and liabilities (Hicks 1989). Here began the great separation between money as an apparent one-to-one correspondence with something physical such as a precious metal, and money as a pure symbol of social credit such as a demand deposit against which a depositor can write a check. This separation between physical and symbolic money, because it opened a time interval between transactions and final payment (change in balance sheets of the two counterparties reflecting money 'movement'), gave great flexibility and elasticity to the supply of money in a single-currency community. Now unconstrained by the physical, the use of money to catalyze action became more and more prevalent in societies. Activities of all sorts, including serfs paying manorial lords for feudal obligations in cash instead of in kind, now could be done using money, a practice known as commutation (Hunt and Lautzenheiser 2011, 15).

The organization of commercial activities depends on money contracts which act to catalyze specific interpersonal relations to allow actions to proceed. Activities and processes of interaction *are* the reality and the community's wealth. Money's

purchasing power toward other members of the community is directed to this organized activity. When everyone in the community is doing their work, this organized activity can be considered a flow of service or a 'capital stock in motion'. The motion or activity of people at work, structured by money contracts, using various technical devices that leverage their efforts, delivers services to the holders of money.

4. Money Problems in Economics

The ontology of money, as defined so far, was way off the radar of people at the time of Adam Smith and the classical economists in the 18th century. But, money had been around for thousands of years in Eastern and Western cultures, and in Northern and Southern cultures as well (Africa and Pacific Islands, South and Central America).

Aristotle (*c*. 350 BC) recognized that money was a human creation and instituted in law. He also claimed that money was outside of genuine economy. Economy was about household self- sufficiency in the production of food and materials for living (autarky). Contrary to the self-contained notion of household management (economy), money came into existence for obtaining goods and supplies from distant places that the household could not produce on its own. But, if you resorted to trade with distant parties, you had to first accumulate money with which you could pay your foreign counterparties. Thus you had to produce more than your needs in your household in order to get money. Aristotle held that true economy was about production for one's own use whereas using money to obtain goods and services from outside the household, in the public space involved production for gain, *i.e.* profit. This became, in the words of Karl Polanyi (1944, 53):

… (*t*)*he most prophetic pointer ever made in the realm of the social sciences…*

In addition, Aristotle held that money and markets (the public space outside of the household) were one and the same phenomena. They had one and the same ontology, they were ontologically inseparable. I will call this the 'money-market mechanism'. For thousands of years, the money-market mechanism played a very small role in the societies that had money. Genuine economy, in the Aristotelian definition, was the norm: household production for its own use. It wasn't until the 13th to15th centuries in Northern Italy, with the invention of banking and paper money (and public finance), that money and markets started proliferating and becoming a central feature of social organization. The specialization of productive activities and the vast reach that money allowed, linked different regions and societies of the world in trading networks that gave considerable rise in material wealth.

By the time of Adam Smith and the Physiocrats the money-market mechanism was very conspicuously changing the world. But they did not really understand why that was happening. Instead, they took the interdependence for granted and according to Schumpeter (1954, 272) instead studied only the mechanics of:

The interdependency of economic phenomena and whether analysis of that interdependence will yield relations sufficient to determine – if possible, uniquely – all

the prices and quantities of products and productive services that constitute the economic system.

David Hume, the skeptic of matter and mind, made an idiosyncratic use of the word 'nominal' to characterize money inflation and this became the 'classical dichotomy' where the economy was divided into two parallel worlds, the nominal and the real (Nitzan and Bichler 2009, 30). David Ricardo recognized that money's value was not constant. And sought in vain to find an invariable measure of value in the mode of physical units of measure (*e.g.,* kilograms, inches, or feet). He coined the idea that money created a 'veil' behind which one could find the real economic mechanisms, and that to make money's value constant, its circulating quantity had to be controlled. This was the beginning of the (apparently) sensible 'quantity theory of money' which explained inflation as too much currency in relation to the number of goods and services. Opposing Ricardo and the quantity theorists was the Thornton-Mill school which was informed by actual banking practices (Mehrling 2017, 4). In their attempt to explain the system of interdependence, economists identified social groups as possessing certain attributes called 'factors of production'. These factors were the money of the entrepreneurs, the land of the landowners, and the labor of employable workers. But generalizing these factors of production as a natural-physical force was a mistake. Factors of production are not natural, physical forces, but rather activities whereby humans generate money incomes from the expenditures of other humans. Jean Baptiste Say conflated money with natural forces of supply and demand in his theory whereby 'supply creates its own demand'.

Then ninety years after Smith's *Wealth of Nations*, Leon Walras's mathematical conception of general economic equilibrium, provided the first comprehensive 'solution' of the interdependence problem. Schumpeter called it the '*Magna Carta*' of economics. But this was not to be. Walras' achievement, while elegant, was faulty. As an amalgam of physicalist and utilitarian theories, its pre-analytic framework was utopian: a reality that existed nowhere and could never exist anywhere. It was pure fantasy. It held that money had to be a physical thing and a fixed invariable neutral standard of value, that all transactions were settled at spot prices, that balance sheets of all economic actors had no debt, and that inventories of goods and services never existed. Empirically, ontologically, money is not neutral, is not physical. It is not invariable. And, in fact, it was known for centuries that the value of money was not fixed nor neutral. Hundreds of years before Adam Smith, merchants, statesmen and other observers invented a name for inflation (*caristia*), and were able to distinguish it as a phenomenon separate from an increased price due to a supply shortage (Fischer 1986, 83).

Despite these conceptual failures, throughout the 19th and into the 20th century, economists kept attempting to apply the unworkable classical science approach to understand money as a neutral measure of value and a physical thing. They invented all kinds of workarounds to fill the gaps in their logical positivist theory of economy. They invented methods to index the changing value of money. Fixing a basket of goods that are purchasable with a variable measure of value, allowed some semblance of

seeing equivalency of money's power over time. They developed indices for special social groups based on typical baskets of goods each group purchased; producer price indexes, consumer price indexes, construction industry indexes, and now medical indexes specialized for people stricken with various chronic diseases.

By the late 19th century economists were resorting to esoteric-sounding rubrics for money, such as that of American economist, Francis Walker, who came up with a pragmatic placeholder name for money when he said 'money is what money does'. (To be fair, we will see that in some respects this was a good insight.) Such a performative notion of money appeared again in the writings of German sociologist, George Simmel, in 1907, when he described money as a social norm that obeys its own expectations. Alfred Marshall, also at the turn of the century, attributed the uselessness and unrealism of supply-and-demand analysis and Walras' self-contained model of self-balancing economy, to 'market externalities'. These were supposed to be factors outside our focus as economists that explained why Walras's 'Magna Carta' didn't work. By the mid-20th century, with the theory getting ever more mathematical and abstract, the die-hard advocates, instead of conceding defeat and going back to the theoretical drawing board, simply 'waived their hands in the air' and attributed the massive loss of realistic descriptive and explanatory power of the theory as being due to the 'veil of money' and that humans by their nature are irrational, ignorant. and susceptible to delusion. The mainstream economists believed that '… it's not *our* theory that is deficient, it's *their* behaviour … '.

Keynes, in the 1930s, did put together a new paradigm of money that somewhat fit into the framework of interdependency. He built on the insights of Knapp in Germany, and Innes, a British colonial administrator, and was in intensive conversation with colleagues at Cambridge, UK. This was a circle that included two of the most influential philosophers of the 20th century, Bertrand Russell (who was Keynes' graduate advisor) and Ludwig Wittgenstein. It could be argued that Keynes was the breakthrough scientist because he was first and foremost a philosopher who completed his dissertation under Russell, and only anecdotally and informally learned economics through a friend of his father, Alfred Marshall.

5. The Monetary Production Economy

Keynes discovered and made a theory about the performativity of money under the rubric of 'the monetary production economy'. By this felicitous phrase, Keynes implied as least three things. There is an anthropological sense, a community makes a money token so that everyone in the community can specialize their work and buy what they need from others. Also, a socio-technological sense, the community's productivity is supercharged by money. The community as a whole produces many more things than if they did not have the money device. Finally, there is an intentional-psychological sense, each actor in the community, in order to survive, has to 'make money', *i.e*., earn or otherwise generate a money income.

This idea added a whole new dimension to the meaning of an 'economy'. As a device for production, not merely for trade and commerce, the scope and possibilities for understanding interdependent human activities coordinated by *money* were now

greatly expanded. Instead of thinking that 'interdependence' was strictly about moving existing things around among agents, *i.e.,* merely a device for trade, Keynes' conception of money allowed for a more Promethean and dynamic notion of economic activity, making new things that never existed before, transforming raw materials into things that previously never existed. More than a vehicle for trade and commerce, money allowed for *production*.

Keynes' insight and theory was a great leap forward for economics. But he didn't have all the details spelled out. In part, this was due to his lacking important philosophical distinctions regarding how the performativity of anything, including money, could be possible. He called it, 'the marginal efficiency of capital … in funnels of activity' which is pretty close to accurate. But, his phraseology was so esoteric that it was easy to ignore, which is what happened. For one thing, he should have said marginal efficiency of *money*, instead of capital.

The attainment of a realistic, objective, and plausible theory of the economy - in which money was given a realistic treatment - was not possible using the classic materialist approach to science. Mainstream theory was especially misguided in its belief that money was a physical, objective, neutral thing, and that it was used to represent and measure an independent reality of things and human satisfaction. It did not understand money as a sign that enables conversational process and series of institutionalized activities. Modern economics could not get the ontology of money right because it was still married to the classical version of science, as practiced in the physical and natural sciences. The classical version of science adhered to an absolute duality and the separation of subject and object in the creation of knowledge. In this way, it couldn't handle real things that exist only subjectively and intersubjectively, such observer-dependent but objective, factual, realities as money and property. Economics blindly took up this strict metaphysical duality, and as a result has been in a state of chaos and confusion ever since. According to Robertson (2012, 77):

The outcomes of demand and supply in any particular situation are not objective outcomes or processes governed by Nature or God. They are outcomes of how people have made the money system work.

There is no invisible hand, there is no self-regulating market equilibrium.

Today, at the beginning of the 21st century, we face two immense challenges which the current state of economic theory, with its naturalistic 'invisible hand' dogma is unable to deal with. These are inequality as a result of financialization and the vast unstoppable destruction of the planetary biosphere as a result of industrialization and the burning of fossil fuels (coal, oil, and gas). Here money-contracted 'equilibria' destabilize the natural ecological homeostasis. Not only do we have an extreme economic crisis of inequality and ecological destruction, but we also have a crisis in economic science, *i.e.,* a poor theoretical understanding of our predicament. According to the doctrines of mainstream economic theory, there are no solutions to these problems. There is not even a hint of a solution.

6. Metaphysical Conundra

Performative constitutive speaking creates objects in the moment which allow the conversants to carry out actions. Also, in the conversational process, participants take on roles and identities that come to be mutually understood by all in the conversation.

To make a rational account, as economists and other social theorists try to do, of humans acting according to interpretations, including self-interpretations, and coordinating their actions only in linguistically created conventions, must be done by understanding how these human practices are the expression of a way of life. You won't understand money or any of the observable money behaviors (paying, earning, investing, saving, borrowing, *etc*.) without 'the locus of shared understanding organized by social practice' (Dreyfus & Taylor 2017, 44). This can still be done, but not from the traditional empirical-science standpoint. There has to be more than a strictly behavioural description. A description that makes a significant difference in understanding economics must account for the inner beliefs and attitudes of the actors. This does not lend itself to the Cartesian method.

Human practices (*i.e.*, actions) are the kind of thing that makes sense to the actor. Certain ideas are internal to them. One cannot distinguish the practice – the action – from the idea that the action expresses. Thus, because you cannot distinguish the practice from the idea, you can't assign or distinguish one as causing the other (Taylor, 2004, 31-2). It is a 'false dichotomy to believe that either ideas or material factors are rival causal agencies. Human practices are both at once'. And human self-understandings are the essential condition of the practice to make sense to the participants of the practice. There is a further complication that eludes objective description in the Cartesian sense. These actions and the things involved, such as dollar bills and changing ownership (of the groceries from the retailer to the consumer), are themselves only relational and mutual. They are not reducible to stand alone definitions. They are meaningful holistically, and in a process of inter-related actions. Each one makes sense only in a web of mutually defined things and actions.

To understand and make a rational account of someone buying groceries, you have to understand these activities. (According to Taylor 2016, 21):

Our words only have the meaning they have within the 'language games' we play with them and these in turn find their context in a whole form of life.

Taylor (1985c, 291) also states that:

You will not understand how words relate to things until you have identified the nature of the activities in which they get related to things … The Wittgensteinian slogan turns out to be completely true, 'To understand a language you have to understand a form of life'

For an economist or other social theorist to understand the agents and their motivations for action, the economist must understand the life form and associated

activities that mutually make up the significance that motivates the agents. Again, according to Taylor (1985c, 280)

… (t)*o understand the terms … you have to understand what it would be like to be a participant …*

This violates the classical science maxim of 'objectivity', the desire to be free of all cognitive bias in observation. The kind of understanding required in economic theorizing does not lend itself to the disengaged observer of an independent reality, which is the traditional Cartesian approach. Specifically, where the Cartesian approach breaks down is in its belief that language merely describes a given reality. But once we understand the performative and constitutive aspects of language – that through declarations, commands, and promises, humans make new realities – we see that language is not confined only to *post facto* description, as the classical scientists (particularly Bacon and Hobbes) believed it to be. 'Language's designative function is only one province in a larger country' (Taylor 2016, 83).

Thus, understanding economic phenomena cannot be reached on the representative model of language only. To quote Taylor (1985c, 277) again:

To understand what these terms represent, to grasp them in their representative function, we have to understand them [*first*] *in their articulating-constitutive function … (t)here is no understanding* [*of the terms which are new to the observer who has not previously participated in the culture*] *without seeing how* [*they*] *function* [*in life*]*. This is not the same as seeing how …* [*the terms*] *… describe an independent reality, because there is no independent reality. Rather it is a matter of seeing how within a certain context of other concerns, and the practices in which they are pursued, the term in question could serve to articulate our concerns in just this shape and definition.*

The articulating-constitutive and performative powers of language were recognized during the scientific revolution of the 17th century and the Enlightenment of the 18th by such figures as Vico, Herder, Hamann and Humboldt. Yet, a theory of performativity didn't get formally established until the 20th century with the overthrow of the Cartesian/Kantian dualist metaphysics, first by such thinkers as Peirce, Heidegger, Wittgenstein and Merleau-Ponty. Later in mid-century the so-called 'ordinary language philosophers' Austen, Strawson, Grice, Anscombe and Searle, and anthropologists and sociologists such as Whorf, Sapir, Garfinkel, Goffman and Sacks (Rawls 1989) delved deeper into the philosophy of language and specific linguistic mechanisms therein. Developments in the philosophy of language found certain parallels with findings of the earlier thinkers of communication and information theory Shannon, Wiener, Deutsch and Bateson (Garfinkel 2008, 101-109). Performativity is a kind of projective meaningfulness and acts as kind of causal, efficient force in the social world, itself part of the real natural world. Thought, mediated through signs with other intelligent beings, is action and a real historical force (Hoopes 1991, 10-12). There is pragmatism and implied practical use of semantic meaning.

Primarily money allows action to take place. Only secondarily does it represent things. It is an engine, not a camera (McKenzie 2006, 2009). Crudely speaking, the more money that is created and distributed to the community, the more action that becomes possible. It is the *carrot* that brings people to do things. Insolvency and the loss of social power is the *stick*. And, of course, money is only used by humans to get each other to do things. We don't pay nature for the resources we extract from it even though we value those resources by money's measure. Whatever sum of money we place on nature, it is merely a promise of payment to other humans to fetch and transform nature for us. Money is only a social relation (Ingham 1996).

6. Conclusion

In this paper I have tried to point out that the concept of knowledge that the early European scientists and philosophers latched onto and formalized in the era of the Enlightenment, was too narrow and did not work for understanding the nature of money, and the other socially invented institutions of economy such as marketplaces, property, corporate entities of various distinctive functions (v*iz* banks, government agencies, private agencies, *etc*.). The problem was that these investigators were using a metaphysical conception that was at bottom unrealistic.

The stumbling block that prevented attaining a realistic metaphysics was the naturally occurring experience in human consciousness, the sense of an inner world versus the sense of a world external to one's body. With the scientific revolutions in the 17th and 18th centuries, these dimensions of experience got hardened and were given names, subject and object. This created an unbridgeable ontological chasm that persists today even in science (Lakoff & Johnson 1999, 93). By this ontological split, knowledge of reality became a problem of reconciling what is perceived inside the 'mind' and whether it correlates to what exists externally in objects. The assumption that we could have reliable knowledge about the external world suddenly became problematic. It seemed highly dubious according to Hoopes quoting William James (Hoopes 1998, 62):

… that what is evidently one reality should be in two places at once, both in outer space and in a person's mind …

And, as explained by Lakoff & Johnson (1999, 93):

The problem with this ontological split is that it gives two equally erroneous conceptions of objectivity [*aka reliable knowledge*]. *Objectivity is either given by the 'things in themselves'* (*the objects*) *or by the intersubjective structures of consciousness shared by all people* (*the subjects*).

The first is erroneous because the subject-object split is a mistake and there are no 'objects-with-descriptions-and-categorizations' existing in themselves. The second is erroneous because mere intersubjectivity, if it is nothing more than social or communal agreement, leaves out our contact with the world and suggests that we can make reality

to be whatever we want as long as we are unanimous in our beliefs about it. So, today, much of mainstream science and philosophy hold that our knowledge – including theories, concepts, and forms of reason – are not characterized by our bodies or brains, but by the external world itself. Logic, truth, and meaning are 'external' and 'out there' or otherwise transcendental to the mind. This doctrine even calls itself 'metaphysical realism'.

The core of a genuine realistic metaphysics must recognize that our physical engagement with the environment in an ongoing series of interactions will produce mental conceptions that meaningfully and effectively guide human functioning. This recognition is the accomplishment of philosophy beginning in the late 19th century with such thinkers as Peirce, the pragmatists and then the phenomenologists and historical philosophers, Dilthey, York, Husserl, Heidegger - then later Wittgenstein and Merleau Ponty. It is our bodily action and interaction in the world, the ongoing practices of living, that grounds our understanding, meaning and truth: *i.e.* our knowledge.

Some of the implications of such an interactionist, participatory, or embodied metaphysics for the study of economic phenomena such as money and markets, are the following:

1. The method of natural science, with its strict, absolute duality between subject and object, is inappropriate for economics. It cannot deal with observer-dependent, intersubjective, ontologies of social objects which are rife in economics.

2. Economic institutions – money, property, corporations, government agencies, even 'private-citizen subjects' – are shorthand symbols (signs) that people mutually understand and use to coordinate action and establish recurrent orders of activity.

3. These signs, like all language, are learned by the individual from the speaking community/culture. They inform the individual's intentionality, subjectivity and action. This individual subjectivity is part of a community-spoken intersubjectivity – a rationality of commonly held beliefs.

4. There is no objective behavior of an individual subject. The behavior is an expression of the community's rationality as best interpreted by the individual. Each individual is a self-interpreting being, using common meanings of the speaking community, including institutional symbols and signs.

5. To develop knowledge of the economic semiotic order, both as a participant as well as an investigating scientist (*aka* 'professional economist'), one must already understand and act according to the meanings that the participants use in their economic action. There is no strict separation or duality between observer and observed, subject and object as explained above.

6. Economics, like other semiotic disciplines, is the study of imposed order based on meaning rather than natural or physical order.[22] The object of study is the same sort of activity or being that carries out the inquiry. Interpretation (hermeneutics) is inherent to the study of economy.

7. The superiority of the hermeneutic/interpretive/semiotic approach to the naturalistic Cartesian approach is that it allows for the study of economics to be an objective science but not a strictly physical or material science (Hoopes 1991, 13).

8. The meanings that participants understand, as well as the objective conditions of living, change over time. Therefore, economic science is an evolutionary science, as is the economic order created in speech.

9. *Ex-post* examination of statistical aggregates of behaviours (a common methodology in mainstream economics) misses the performative and constitutive functions of conversations (Rawls 2009) and thereby misses the performative-constitutive dimension of money. By contrast, an ex-ante, 'forward-looking' view toward money conversations, not only highlights the performative nature of money, but also the proactive structuring of public space into markets (White 1981), the sociology of inflation (Maier 1978, Hirschman 1981, Gourevitch 1977), and the distinction between finance and economics (Mehrling 2012)

In this paper I have covered the ontology of money, and the conceptual problems that economists and social theorists have had with money since the time of Adam Smith. In an earlier paper (Byles 2022) I reviewed the work of Searle and Ostrom, respectively, in their theories of speech action theory and the grammar of institutions, particularly concerning money and property. In a forthcoming paper, I will look at the shift in philosophy itself from the 18th to the 20th centuries, particularly the philosophies of language and of mind, and the rise of semiotics. This sets the stage for an alternative theory of economics as a *semiotic* science - economy as conversation and semiosis.

Acknowledgements

I'd like to acknowledge my appreciation for good discussions and feedback about these topics with James Hoopes of Babson College, Boston, John Smithin of York University Toronto, and the attendees of the Aurora Philosophy Institute in Toronto who participated in a series of talks I gave there.

[22] *Cf.* Roy D'Andrade as quoted in Richardson *et al.* (1999, 179).

References

Byles, T. 2022. The speech foundations of money and property: a look at Searle and Ostrom. *Aurora Philosophy Journal* 1: 5-20.

Dreyfus, H. & C Taylor. 2017. *Retrieving Realism*. Cambridge, USA: Harvard University Press.

Gourevitch, P.A. 1977. International trade, domestic coalitions, and liberty: comparative responses to the crisis of 1873-1896. *Journal of Interdisciplinary History* 8: 281-313.

Hicks, J. 1989. *A Market Theory of Money*. Oxford. Clarendon Press.

Hirschman, A. 1981. The social and political matrix of inflation: elaborations on the Latin American experience. In Hirschman, A. *Essays in Trespassing: Economics to Politics and Beyond*. Cambridge, UK: Cambridge University Press.

Hodgson, G. 2000. What is the essence of institutional economics. *Journal of Economic Issues* XXXIV: 317-29.

Hoopes, J. 1991. *Peirce on Signs*. Chapel Hill: University of North Carolina Press.

Hoopes, J.1998. *Community Denied: The Wrong Turn of Pragmatic Liberalism*. Ithaca: Cornell University Press.

Hunt, E.K. and M. Lautzenheiser. 2011. *History of Economic Thought, A Critical Perspective* (third edition). Armonk, NY: M.E. Sharpe

Ingham, G. 1996. Money is a social relation. *Review of Social Economy* LIV: 507-29.

Ingham, G. 2004. *The Nature of Money*. Cambridge: Polity Press.

Lakoff, G. and M. Johnson. 1999. *Philosophy in the Flesh: The Embodied Mind and its Challenge to Western Thought*. New York: Basic Books.

MacKenzie, D. 2006. *An Engine Not a Camera: How Financial Models Shape Markets*. Cambridge, USA: MIT Press.

MacKenzie, D. 2009. *Material Markets: How Economic Agents are Constructed*. Oxford: Oxford Press.

Maier, C. 1978. The politics of inflation in the twentieth century. In *The Political Economy of Inflation*, ed. F. Hirsch, & J. Goldthorpe. Cambridge, USA: Harvard University Press.

Mehrling, P. 2012. *Lecture Notes to Money and Banking*, downloaded, Jan. 2023.

Mehrling, P. 2017. The monetary education of John Hicks. In *Money, Finance and Crises in Economic History*. ed. Rosselli, A., N, Naldi & E. Sanfilippo. London: Routledge.

Nitzan, J. & S. Bichler. 2009. *Capital as Power, A Study of Order and Creorder*. London: Routledge.

Peirce, C.S. 1871. Fraser's *The Works of George Berkeley*. *North American Review* 113. (As reprinted in Hoopes, 1991, 116-4).

Polanyi, K. 1944. *The Great Transformation: The Political and Economic Origins of Our Time*. (As reprinted in Beacon Press, Boston 1957).

Rawls, A.W. 1989. Language, self, and social order: a reformulation of Goffman and Sacks. *Human Studies* 12: 147-72.

Rawls, A.W. 2009. An essay on two conceptions of social order: constitutive orders of

action, objects and identities *vs.* aggregated orders of individual action. *Journal of Classical Sociology* 9: 500-20.
Richardson, F., B. Fowers & C. Guignon. 1999. *Re-Envisioning Psychology: Moral Dimensions of Theory and Practice*. San Francisco: Jossey-Bass Publishers.
Schumpeter, J. 1954. *History of Economic Analysis*. New York: Oxford University Press.
Searle, J. 1995. *The Construction of Social Reality*. New York: The Free Press.
Taylor, C. 1985a. What is human agency? In *Philosophical Papers, Volume 1*. New York: Cambridge University Press.
Taylor, Charles. 1985b. Peaceful coexistence in psychology. In *Philosophical Papers, Volume 1*. New York: Cambridge University Press.
Taylor, C. 1985c. Theories of meaning. In *Philosophical Papers, Volume 1*. New York: Cambridge University Press.
Taylor, Charles. 1991. Overcoming epistemology. In B. Baynes and McCarthy, eds. *After Philosophy: End or Transformation?* (Fifth printing). Cambridge, USA: MIT Press.
Taylor, Charles. 2004. *Modern Social Imaginaries*. Durham: Duke University Press.
Taylor, Charles. 2016. *The Language Animal: The Full Shape of the Human Linguistic Capacity*. Cambridge, MA: Belknap Press of Harvard University Press.
White, H. 1981. Where do markets come from? *American Journal of Sociology* 87: 517-47.

Aurora Philosophy Journal, Vol. 2, No. 1, pp. 39-52

L'Economie politique du « corps-institution »: une réactualisation de la théorie de la régulation

Guillaume Vallet

Résumé

Cet article a pour objectif de comprendre en quoi le corps possède le statut d'institution au regard de la théorie de la régulation (*TR*). *Le concept de « corps-institution » permet de comprendre en quoi le corps est intégré au fonctionnement d'un régime d'accumulation et d'un mode de régulation propre au capitalisme. Au sein de la phase actuelle du capitalisme que nous qualifions de « capitalisme des vulnérabilités », le concept de « corps-institution » offre de nouvelles perspectives de recherche pour comprendre les rapports au corps des individus aujourd'hui. De ce fait, en appliquant au corps une démarche en économie politique, cet article vise également à participer au renouvellement du programme de recherche de la TR.*

Abstract

This article aims to explain why the body has gained the status of an institution in today's capitalism, the so-called 'capitalism of vulnerabilities'. Resting on the economics of regulation theory (*RT*)*, we develop the concept of 'body-institution' to shed light on the way the body is integral to a regime of accumulation and a mode of regulation. In the age of the 'capitalism of vulnerabilities', the concept of the 'body-institution' allows us to explore new perspectives in research to analyze the relationship of individuals to their body. Also, by applying a political economy approach to the body, this article also aims to participate in the renewal of the RT research program.*

1. Introduction

Au sein de nos sociétés dites « hypermodernes », l'individu est placé au cœur des interactions sociales. En effet, la vie économique et sociale s'organise à partir de ses actions, censées être constitutives de sens individualisé, dans un monde où les repères traditionnels s'effacent. C'est dans ce cadre que les individus se tournent vers leur corps, perçu comme lieu de centration ultime de la vie et source de définition identitaire. En effet, en « redécouvrant » leur corps par différentes formes de sollicitude (sport, relaxation, méditation, *etc.*), les individus se redécouvriraient, tout en donnant accès symboliquement à la totalité de leur Être. Il serait donc envisageable de se transformer en transformant son corps, dans une société où tout semble possible, à condition de le vouloir. De ce fait, un imaginaire particulier du corps existerait, renvoyant à l'idée d'un corps malléable et extensible à souhait, permettant à la fois une

libération et une sagesse retrouvées, mais aussi la possibilité d'une amélioration de soi source de reconnaissances et de valorisations diverses.

Sur le plan économique, le corps entre également dans une logique particulière. Il est perçu par les individus comme une ressource directement accessible, et valorisable sur différents types de marché. Dans le capitalisme, c'est cette institution du marché qui permet de transformer le statut du corps, en le faisant passer de ressource en capital, résultat d'un projet de production. Or pour réaliser ce projet, l'individu peut et doit même devenir l'entrepreneur de son propre corps. Concrètement, cela signifie mettre en œuvre un véritable travail de celui-ci, entendu ici au sens d'activité productive consistant par une action humaine à transformer de façon conscientisée la nature – ici la ressource biologique corps. Cette définition implique que le travail dépasse le cadre de l'emploi, dans la mesure où le corps est un espace d'application potentiel du travail en dehors de la sphère professionnelle. L'objectif de ce travail est l'amélioration du corps, mais plus largement dans une quête de transformation de soi. D'où le rôle d'une connaissance approfondie de l'anatomie du corps, des activités et des techniques associées au mouvement du corps – sportives la plupart du temps – mais aussi de la nutrition.

Appliquant à son corps les principes de la rationalité instrumentale faisant concorder de la façon la plus efficiente les fins et les moyens, l'individu cherche à produire un corps performant, à travers même parfois une organisation codifiée et systémique de son existence. Ainsi, bien que de grandes variabilités existent dans la vision et la façon de mettre en œuvre ce projet, il apparaît malgré tout que le travail du corps, et le corps lui-même, peuvent revêtir une importance forte voire centrale dans la vie quotidienne des individus.

C'est dans ce cadre que nous conférons au corps le statut d'institution, en nous rattachant à la grille de lecture du courant des sciences économiques de la théorie de la régulation (TR). Le concept de « corps-institution » permet à la fois de comprendre les rapports au corps subjectivés des individus, tout comme les liens entre ces corps individualisés et la dynamique du capitalisme, dans une logique d'économie politique.

Dans cette perspective, l'article est organisé de la façon suivante. Dans une première partie, nous revenons brièvement sur les principaux éléments constitutifs de la TR. En second lieu, nous utilisons cette grille de lecture pour définir le concept de « corps-institution ». Dans la troisième partie qui se veut conclusive, nous relions le « corps-institution » à la dynamique du capitalisme, et plus spécifiquement au « capitalisme des vulnérabilités » (Vallet 2021) caractérisant notre période actuelle.

2. L'économie politique de la théorie de la régulation (TR): une brève description

Pour commencer, rappelons que la TR repose sur une approche en économie politique, au sens où elle insiste sur deux caractéristiques majeures (Vallet 2020):

- les phénomènes économiques sont considérés comme encastrés dans des rapports sociaux et politiques. Cela implique que les sciences économiques – en charge de l'analyse scientifique de ces phénomènes économiques – sont ouvertes à la

collaboration avec d'autres disciplines, en particulier celles appartenant aux sciences sociales. Autrement dit, les phénomènes économiques étant complexes à analyser, l'expertise économique doit s'appuyer sur des concepts et méthodes forgés par d'autres disciplines, dans le but d'enrichir cette expertise. Une telle posture permet notamment de comprendre en quoi les comportements individuels sont reliés à des structures sociales qui les encadrent, tout comme les structures sont susceptibles d'évoluer en fonction du comportement des acteurs,

- les rapports sociaux et politiques qui sous-tendent les phénomènes économiques sont des rapports de pouvoir. De ces rapports de pouvoir découlent des situations d'inégalités et de conflits potentiels au niveau de l'accès à certaines ressources, tout comme ces rapports de pourvoir peuvent faire émerger des rapports d'autorité. Dans ce dernier cas, l'autorité est perçue comme un pouvoir légitime, accepté, ou du moins consenti.

Ces deux caractéristiques de l'économie politique nous permettent de comprendre les contours et les contenus de la TR, qui est apparue à la fin des années 1970 en France au sein de deux grandes « écoles » historiques, Grenoble et Paris, affiliées à des économistes majeurs (Aglietta, Billaudot, Boyer, De Bernis, Lipietz, Saillard, *etc*.). Sur le plan épistémologique, les économistes de ces deux « écoles » avaient pour intention première de critiquer le courant néoclassique, incarné par le modèle de l'homo oeconomicus, non à même selon eux de rendre compte des relations économiques encastrées dans le social. Dans cette perspective, la TR s'est construite tout d'abord à partir de l'influence des idées de Keynes et de Marx. En ce qui concerne Marx, il convient cependant de préciser que si les économistes de la TR ont repris à leur compte la grille de lecture marxienne, ils se sont distanciés de certaines conclusions politiques de Marx. En particulier, l'idée de la disparition inéluctable du capitalisme a été critiquée par de nombreux économistes de la TR. D'où le fait que nous parlons d'influence marxienne et non marxiste. Cependant, pour conclure ce point, il est fondamental de souligner que les rapports critiques à la théorie de Marx ne sont pas de même nature que ceux relatifs à la théorie néoclassique : dans le premier cas, il y a adhésion avec différenciation – en degré – alors que dans le second cas, il y a une rupture totale – en nature.

Cette rupture est accentuée par le fait que les économistes de la TR ont très tôt, comme évoqué plus haut, pris leur distance avec l'idée d' « impérialisme économique » en matière de production du savoir. Cela signifie qu'ils se sont intéressés aux concepts des autres sciences sociales pour renforcer le cadre analytique macroéconomique de leur théorie. Lorsque l'on considère leur rapport à la sociologie par exemple, on retrouve ici des influences diverses, Simmel pour la monnaie, Durkheim pour l'influence des normes sociales, Weber au niveau des différentes formes de rationalité, ou encore Bourdieu pour une transposition de l'habitus aux comportements de consommation (Berthaud *et al.* 2021).

Au total, c'est à partir des éléments précédents que l'on comprend mieux que la TR avait pour objectif originel de comprendre la globalité des crises du capitalisme, et plus

largement sa dynamique endogène, puisque le capitalisme parvient à évoluer davantage qu'à disparaître (Berthaud *et al*., 2021). Cette régulation possible du capitalisme n'est bien évidemment pas synonyme d'équilibre pour les économistes de la TR, en lien avec leur critique forte de l'approche néoclassique. De la même manière, on comprend également pourquoi la TR insiste sur l'existence de la variété des capitalismes, du fait de la diversité des interactions entre les institutions qui sous-tendent le système (Boyer 2022).

En effet, la TR montre que ce sont les actions des institutions qui font évoluer le capitalisme. Ces institutions sont elles-mêmes encadrées par des formes institutionnelles, « entendues comme codification de rapports sociaux fondamentaux » (Boyer 2003, 80). La TR s'est focalisée en particulier sur cinq « formes institutionnelles » permettant la régulation du capitalisme (Boyer & Saillard 1995, 486):

- l'état (la nature de l'intervention de l'état dans l'économie),

- la monnaie (la politique monétaire, et plus largement le rôle des activités bancaires et financières dans l'économie),

- les relations internationales (les accords commerciaux, monétaires et financiers internationaux),

- la compétition inter-firmes (la formation des prix, la concentration du capital),

- les relations salariales (la détermination des salaires, les lois du travail, la division du travail).

Ensemble, ces cinq « formes institutionnelles » permettent de réguler et de stabiliser un ordre du capitalisme, comme par exemple la période dite du « Fordisme » pendant les « Trente Glorieuses » (1945-1970), une période continue de forte croissance économique comme la France n'avait jamais connu jusqu'à lors. Ces cinq formes facilitent en effet le processus d'accumulation du capital, ainsi que sa valorisation économique et sociale, dans plusieurs sphères, ce qui assure la dynamique et la reproduction du système. Par contre, quand au moins un de ces éléments n'est plus en phase avec les autres, alors une crise du capitalisme peut survenir : le système économique ne produit pas toujours des équilibres – et c'est même rarement le cas.

Cela s'explique en particulier car les rapports sociaux et politiques s'inscrivent dans un contexte d'incertitude, si les institutions exercent une influence sur les individus, les actions de ces derniers les modifient aussi en retour, d'une façon non forcément prédéterminée et totalement prévisible. C'est pourquoi il convient de mieux comprendre, à partir des actions individuelles, le fonctionnement des institutions qui sous-tendent le capitalisme. C'est ce que nous visons en abordant désormais les caractéristiques du concept de « corps-institution ».

2. Le « corps-institution » au regard de la TR

Dans le prolongement des éléments précédents, il est essentiel de considérer que les « formes institutionnelles » du capitalisme sont devenues davantage sophistiquées, et donc plus difficiles à analyser. Un focus sur les mécanismes de coordination associés aux institutions, tout comme une centration sur la diversité des types de comportements économiques reliés à ces « formes institutionnelles », deviennent essentiels pour renouveler le cadre analytique de la TR (Boyer 2022, 30), une ambition revendiquée de longue date par de nombreux économistes de ce courant de pensée (Boyer 2003).

Avec cet objectif à l'esprit, il paraît heuristique de se focaliser sur l'individu, ce qui n'est pas contradictoire avec les travaux macroéconomiques de la TR. En effet, si ce dernier est bien devenu l'acteur central de nos sociétés hypermodernes tel que décrit en introduction, ses actions sont toujours socialement situées. L'individu n'est pas extérieur au monde économique qui l'entoure, il est influencé par ce monde. De ce fait, c'est le corps, en tant que matière sensible, qui constitue l'interface physique, mentale, sensorielle et émotionnelle entre le Moi individuel et le système macroéconomique. En conséquence, les particularités du système économique sont intériorisées et subjectivées par les acteurs à travers leur corps. S'il est certain que « corps et âme » ne font qu'un, le corps est malgré tout conscientisé par l'individu comme ressource distincte de la pensée, possédant une certaine extériorité. En somme, par le corps, l'individu, à travers ses actions, vit le système économique.

Mais symétriquement, l'individu participe à la reproduction du système économique, par ses actions il concrétise à son échelle les grands principes et valeurs de ce système. Il en est donc un vecteur. De même, lorsque des actions individuelles convergent dans une même direction, créant une dynamique collective, le système est susceptible de se transformer. C'est pourquoi, en phase avec l'approche en économie politique de la TR, nous pouvons affirmer que le corps individuel forme avec le système économique une configuration, où les deux s'influencent mutuellement.

Cela amène à réfléchir alors à l'économie politique du corps, pour comprendre dans quelle mesure le corps individuel est à la fois reflet comme véhicule du système économique. Ainsi, dans le capitalisme actuel, l'individu agit dans un monde économique qui valorise la recherche de l'accumulation du capital, le profit (le but), et l'organisation optimale de ses actions pour y parvenir, autrement dit l'entreprise (le moyen).

Concrètement, la référence incontournable à l'entreprise implique en premier lieu de valoriser, voire de sacraliser, la rationalité instrumentale, celle qui permet de mettre en concordance de façon optimale les fins et les moyens. C'est pourquoi, comme nous y reviendrons dans la dernière partie, l'entreprise du corps est en ce sens à considérer au niveau physique. Il existe dans nos sociétés des lieux spécifiquement dédiés à la production du corps réalisée à partir de la rationalité instrumentale, c'est-à-dire de véritables « usines » ou « fabriques » du corps (Vallet 2022). Deuxièmement, c'est le modèle de l'entrepreneur qui est célébré (Vallet 2021), dans la tradition schumpétérienne, l'entrepreneur est ce personnage qui innove et prend des risques, dans le but de réaliser une production économique valorisée sur le marché, lui permettant d'en tirer un bénéfice individuel légitime.

Ainsi, le modèle de l'entrepreneur, et de l'entreprise qui l'accompagne, peut être appliqué à l'économie politique du corps. A travers « l'entreprise » de son corps, l'individu se gouverne pour exister dans le monde économique, marqué par des rapports sociaux et politiques qui affectent la distribution des ressources et des positions sociales. C'est dans cette perspective que l'on comprend le concept de « biopouvoir » de Foucault (1994). Dans un monde où le corps est placé au centre, parvenir à exercer un pouvoir sur son corps revient indirectement à posséder un pouvoir sur les autres. D'où la centralité de l' « entreprise » du corps dans nos sociétés, qui devient un projet incontournable pour espérer se positionner favorablement dans la distributions des ressources sociétales. Logiquement, cette « entreprise » du corps induit alors de fixer des « règles du jeu », à la fois contraignantes et légitimes, qui fait basculer le corps du côté d'une institution (North1990, 3-4) au sens de:

… the rules of the game of society or, more formally, the humanly devised constraints that shape human interactions. Institutions reduce uncertainty by providing a structure to everyday life. They are a guide to human interaction …

Qualifier le corps d'institution implique tout d'abord de considérer que le corps est régulé par d'autres structures et d'autres institutions sociales d'importances similaires (Etat, famille, école, entreprise) qui lui donnent une existence plus ou moins valorisée économiquement ou socialement, dans différents espaces de production et de consommation. Au sens de la TR, le « corps-institution » est dans ce cadre articulé à des « formes institutionnelles » qui lui confèrent un statut social.

Or cette régulation du corps s'est construite historiquement dans des rapports sociaux. Chaque société définit des règles sociales relatives au « bon » et au « mauvais » corps, ce qui donne au corps une dimension morale, à la fois dans les espaces de production et de consommation. Par exemple, le statut – dévalorisé – économique et social d'un corps qualifié médicalement obèse aujourd'hui avait une signification très différente au début du 20ème siècle : il était le symbole de l'opulence et de la rente. A l'inverse, dans des sociétés valorisant la performance, la santé et l'apparence de la santé telles que les nôtres, le corps « fit » est associé à un signal positif en termes de productivité potentielle, de contrôle de soi et de maîtrise ; autant d'atouts pour se valoriser positivement sur le marché du travail (Vallet 2022).

Mais ces règles qui encadrent les activités du corps possèdent aussi une dimension interne. Autrement dit, leur légitimité ne peut fonctionner uniquement par soumission individuelle à une contrainte externe et coercitive. Cette légitimé se construit par intériorisation et même « encorporation » des règles. L'intériorisation et l' « encorporation » entraînent une autocontrainte et une autodiscipline qui donnent du sens à l'action, et permettent à leur tour une inscription de l' « entreprise du corps » dans la durée. C'est ainsi que les règles appliquées au corps sont individualisées et donc susceptibles d'être transformées, car ce qui compte, c'est qu'elles constituent un ordre cohérent dans la vie de l'individu, leur conférant alors le statut d'institution (North 1991, 97).

Ce statut est visible lorsque le corps possède une position centrale dans les espaces de production et de consommation. Interconnectés dans la réalité, nous les détaillons de façon séparée ci-après dans le souci pédagogique:

(1) En tant qu'espace de production, le corps représente une ressource individuelle que tout un chacun possède, et qui lui est directement accessible. Ainsi, chaque individu peut tout d'abord l'utiliser dans le processus de production comme outil, en vue de produire un autre objet. Dans ce cadre, le corps est fortement engagé, comme Karl Marx notamment l'a largement mis en avant dans ses écrits. Ses muscles comme son esprit sont intégrés aux caractéristiques de la production dans la recherche de la performance. Notons cependant que le capitalisme a tendu à laisser croire que le corps pouvait être détaché de l'Etre du fait de la séparation individu ou force de travail. L'extension de la subordination de la masse des individus à un employeur à travers le salariat a permis de créer un marché du travail sur lequel s'échange cette force de travail. On retrouve une des caractéristiques essentielles de la TR à savoir que l'accumulation du capital émerge dans le rapport salarial (Boyer 2022). Or, dans les sociétés hypermodernes plus individualisées dans leur vécu, la centralité du marché du travail renforce l'idée de la nécessité de se préoccuper du corps pour accroître la productivité de sa force de travail.

Toutefois, le corps est également une ressource que l'on peut chercher à produire « pour elle-même », dans la perspective de la transformer en capital valorisable sur différents marchés : le marché du travail certes, mais aussi le marché symbolique des interactions sociales, le marché du choix du conjoint/de la conjointe entre autres. « Avoir » un corps envoie un signal, assimilable à un prix, sur ces différents marchés. On peut valoriser un certain type de corps dans certains métiers pour viser une embauche ou un meilleur salaire, comme on peut valoriser un certain type de corps pour attirer un partenaire sexuel ou une conjointe potentielle. La digitalisation des interactions sociales qui caractérise nos sociétés actuelles renforce considérablement ce processus. En effet, dans un monde classifiant rapidement et sacralisant l'immédiateté, l'important est l'image envoyée socialement. Au final, il y a bien clairement une offre et une demande de la production du corps, ce dernier justifiant son statut de capital.

Cette quête du corps capital s'inscrit dans le fonctionnement du mode de régulation capitaliste caractérisé par la centralité de l'investissement en capital humain, qui inclut la santé et l'apparence de la santé. Effectivement, prendre soin de soi et le montrer est un indicateur de productivité potentielle, pour l'individu comme pour le système. Cette importance du capital humain fait que le corps de chacun est encadré dès la naissance par les règles économiques et sociales d'institutions diverses (famille, état, marché, école, monde du sport) pour assurer la concrétisation individuelle de l'investissement en capital humain. Le corps est ainsi institutionnalisé, car à travers la socialisation individuelle à l'investissement en capital humain, chaque individu devient porteur du système économique et social par ses actions (Parsons 1937). On peut ajouter aussi, en reprenant la terminologie de Bourdieu dont s'est inspirée la TR, le corps affiché participe à la constitution du capital social. Ce dernier, entendu au sens de relations mobilisables par un individu pour améliorer son accès aux ressources économiques et sociales, est au cœur de la « force des liens faibles » (Granovetter 1973) permettant de se situer positivement dans un champ social.

C'est pourquoi on comprend à nouveau ici que cette normalisation du corps n'est pas seulement externe. Elle se couple d'une normalisation interne, nécessaire au consentement à la contrainte exercée par les institutions : dans le système capitaliste,

chaque acteur est amené à entreprendre son corps pour le rendre performant, mais aussi de mettre en avant la démonstration de cette performance. Autrement dit, ce n'est pas seulement la santé que la démonstration de la santé qui est centrale pour la catégorie sociale dans les interactions de même que la valorisation économique des individus. Le développement des pandémies comme celle de la « COVID-19 » tout comme la persistance de nouveaux risques (conflits, attentats, agressions, *etc.*) renvoient l'individu à son corps comme voie de salut pour se protéger.

Dans cette perspective, entreprendre son corps pour viser une performance nécessite de valoriser le travail comme activité productive tout comme imaginaire, et de construire un corps « rationnel » en lui appliquant les principes de la rationalité instrumentale (Vallet, 2017). Produire un corps « rationnel » requiert d'organiser en permanence l'investissement du corps, que ce soit au niveau de la nutrition, du type d'activités réalisées (le sport en particulier) comme de la nature des interactions sociales dans lesquelles un individu est engagé (repensons à nouveau à la digitalisation des interactions sociales).

Dans le prolongement de ce qui précède, notons l'existence des rapports complexes entre travail professionnel et travail du corps, comme l'illustre tout d'abord le cas de la production du corps dans le bodybuilding (Vallet 2014). Dans ce sport, des pratiquants construisent leur corps en valorisant le travail du corps lui-même, en opposition avec la nature de celui effectué dans le cadre professionnel. Selon Vallet (2014), il s'agit du modèle de la substitution, c'est parce que le second ne fait pas sens que le pratiquant s'investit pleinement dans le second, car il offre des perspectives de valorisation plus grandes et est davantage porteur de sens. A l'inverse, dans le modèle dit de la complémentarité, la nature du travail relié à la production du corps est similaire à celle réalisée dans le cadre du travail professionnel, les deux formes de performance visées dans le travail se renforcent mutuellement. La nature du travail est la même car la performance du corps participe à l'augmentation de la performance dans le travail professionnel.

De même, les arguments ci-dessus montrent alors que ce sont les frontières entre travail et loisir qui deviennent de plus en plus brouillées. Le temps de loisir n'est pas celui de l'inactivité et de l'oisiveté, il est celui de l'extension de la logique du travail. C'est la nature du travail qui est par contre différente aliénante d'un côté, libératrice de l'autre par la maîtrise du processus de production du corps. La pandémie de la « COVID-19 » en est à nouveau l'illustration, avec à la fois le développement du télétravail et la croissance de la pratique sportive à domicile.

(2) En ce qui concerne le corps comme espace de consommation, le corps a acquis un statut central dans notre existence. Il constitue le bien à chérir par exemple, il est même « le plus bel objet de consommation » (Baudrillard 1970). Réfléchir au corps comme espace de consommation nécessite de se centrer sur la construction sociale des désirs individuels. La dimension sociale des désirs indique la différence avec les besoins : contrairement à ces derniers qui peuvent être ou qui sont limités, les désirs appartiennent au domaine de l'infini, particulièrement au sein du système capitaliste qui tend à créer de la rareté, donc de la frustration, permanentes. Les désirs sont infinis car ils émergent dans un cadre interactionniste marqué par le mimétisme, au sens où « je désire ce que les autres désirent ». A nouveau, la digitalisation de nos sociétés exacerbe ce processus puisqu'elle connecte en permanence les individus, les abondant

au quotidien d'images sur la vie et le corps des autres. C'est en se montrant sur les réseaux sociaux qu'on espère acquérir une reconnaissance sociale, d'où le statut central du corps dans les sociétés hypermodernes. Or ce statut central du corps dans la consommation est plus largement le produit d'une longue évolution historique où la centration des individus sur leur corps renvoie à une subjectivation de l'existence liée trois facteurs majeurs, **(i)** la perte d'influence des grandes idéologies normatives, **(ii)** la sportivisation des activités et **(iii)** la médicalisation de l'existence.

(i) Au sein de l'hypermodernité apparue après la seconde guerre mondiale, rappelons que ce sont les individus qui construisent leur identité en effectuant des choix souverains. Les grandes idéologies normatives telles que les idées politiques ou religieuses exercent moins une influence imposée sur eux non pas qu'elles disparaissent totalement, mais c'est aux individus d'effectuer leurs propres choix de vie. C'est dans ce cadre, où chaque individu est sommé de se constituer un « projet » de vie, que la consommation du corps prend tout son sens elle est perçue comme permettant à l'individu de développer une singularité, de « se retrouver », et *in fine* d'exister. Sur ce plan, le corps est institution car il est censé concrétiser la liberté de l'individu, et plus largement, libérer. Socialement, la consommation est aussi devenue centrale pour définir le statut des individus. Cela est lié à la croissance d'une nouvelle forme de capitalisme, qui s'appuie sur le loisir comme sphère de consommation et de satisfaction des besoins. De ce fait, il s'opère une forme de régulation des désirs individuels autour de cette norme de consommation, censée valoriser l'hédonisme et l'eudémonisme (Kinnunen & Vallet 2018).

(ii) Cette norme de consommation est visible à travers l'importance croissante des activités physiques et sportives dans notre vie quotidienne, signe de la sportivisation de notre existence (Quivu 2018). Un chiffre l'illustre, en 2020 en France, soixante-cinq pourcent des Français de quinze ans et plus ont pratiqué au moins une activité physique et sportive au cours des douze derniers mois (INJEP, 2021). La consommation de sport est vécue comme essentielle pour avoir la sensation d'exister et d'être en vie, ce qui est fortement visible dans les sports dits « à risques » ou « risqués » qui sont en pleine progression.

De même, la consommation s'appuyant sur des normes de consommation, il est fondamental de rappeler le rôle que les sportifs jouent dans la constitution de ces normes. En effet, nous vivons une époque où les sportifs et leurs performances constituent le benchmark auquel les individus doivent se mesurer. En conséquence, ils nous influencent dans notre consommation du corps, créant de nouveaux besoins mais surtout désirs, comme évoqué supra.

(iii) La médicalisation de l'existence est le troisième pilier de ces transformations contemporaines autour de la consommation du corps. La médicalisation de l'existence signifie que la médecine, en tant que discipline scientifique, exerce une autorité centrale dans la régulation de la vie des individus, et donc dans leur consommation du corps. Spécifiquement, cela se concrétise par un recours au savoir médical dans la recherche

des facteurs de santé et de mise en scène sociale de la santé (la santé apparente surtout, montrée et visible à travers les réseaux sociaux notamment). Ces transformations celle une transformation de la médecine, puisqu'elle n'a plus seulement une fonction de traitement et de prévention, mais aussi de confort. Mais cela se concrétise aussi par une adhésion davantage « interne » au savoir médical de la part des individus, qui deviennent des véritables acteurs de médecine : à leur échelle, ils développent des formes – très variées – d'automédication, pour leur bénéfice, mais aussi pour celui du système économique dans son ensemble. Effectivement, par leurs actions privilégiant la recherche de la santé, ils deviennent « porteurs de tout le système » (Parsons 1937), participant alors à sa reproduction.

Au final, la centralité du « corps-institution » dans nos sociétés fait que lorsque les espaces de production et de consommation se rencontrent, on aboutit à la constitution de nouveaux marchés et donc de nouvelles sphères d'accumulation du capital. Par exemple, notons que le marché des compléments alimentaires est en pleine progression dans le monde, en France, le chiffre d'affaires sur ce marché, estimé à deux milliards d'euros, a connu en 2020 un essor de dix pourcent. Il avait déjà doublé entre 2011 et 2018. De même, on estime que dans le monde, ce chiffre d'affaires atteindra 250 milliards de dollars en 2024 (Cocquebert 2021).

Plus largement, le concept de « corps-institution » est fondamental pour comprendre les dynamiques du capitalisme, en particulier sa forme actuelle, celle des vulnérabilités.

4. Le « corps-institution » pour comprendre les dynamiques du capitalisme: le cas du « capitalisme des vulnérabilités »

La valorisation du corps sur des marchés et dans des sphères d'accumulation dépend des contextes macroéconomiques. Comme nous l'avons précisé, selon la TR, il n'existe pas dans la réalité historique et géographique un seul type de capitalisme, mais des capitalismes. En fonction des périodes ou des situations, le capitalisme est susceptible de revêtir des formes très diverses (un capitalisme de marché, un capitalisme financier, un capitalisme d'état, *etc.*), avec des conséquences très différentes sur l'économie politique du corps. A titre d'illustration, dans un capitalisme industriel intensif en main d'œuvre, le corps est au cœur de la production en tant qu'outil principal.

De façon complémentaire, nous avons insisté dans la première partie sur le fait que la TR est une théorie des crises (Boyer 2023), qui produisent aux niveaux collectif et individuel des vulnérabilités. Or, depuis les années 1980, ces vulnérabilités constituent le trait significatif des capitalismes occidentaux. Les vulnérabilités désignent ici des situations de vie dans lesquelles l'individu manque de ressources (économiques, sociales, de santé, *etc.*) pour affronter ces situations de vie et mener une existence inclusive à la société (Abel *et al.* 2018). Si les vulnérabilités sont souvent associées à l'emploi, des vulnérabilités relatives au sentiment d'insécurité physique, à l'identité de genre, à la santé et à l'environnement prennent une place de plus en plus déterminante. Ces vulnérabilités s'accompagnent de peurs diverses, la peur d'être agressé ou agressée la peur de ne pas être « assez » homme ou femme, la peur d'être malade, la peur de mourir, et désormais la peur collective de voir l'espère humaine disparaître. En somme,

protéiformes (multidimensionnelles, multiniveaux, multidirectionnelles), les vulnérabilités désignent des situations de vie dans lesquelles les individus manquent de ressources (économiques, sociales, de santé, *etc.*) pour affronter ces situations, et mener une existence inclusive à la société.

C'est pourquoi les individus sont prêts à entreprendre des actions économiques et sociales visant à répondre à ces vulnérabilités, ce qui inclut la production et la consommation du corps. Il est alors clé de noter que ces actions sont menées dans un contexte de progression de l'idéologie néolibérale sacralisant les libertés individuelles, notamment à travers la valorisation de l'entrepreneuriat cité précédemment. Ce mouvement a accentué les inégalités de diverses natures (Piketty 2013), affectant aussi le corps. En effet, dans le capitalisme contemporain, le statut d'institution conféré au corps crée un idéal du « bon » corps, opposé au « mauvais » corps. Le « bon » corps se veut musclé, débarrassé du gras visible, flexible en mouvement. Le « bon » corps concrétise à la fois la « lean production » visée dans les organisations du travail, tout comme l'entrepreneuriat et le management par projets du capitalisme de plateforme. Ce capitalisme de plateforme est aussi incarné par l'omniprésence des réseaux sociaux dont nous avons parlés, où l'on s'expose en permanence et où l'instantanéité prime pour catégoriser et valoriser les individus. Ce sont ces réseaux sociaux qui rendent visible l'omniprésence de la digitalisation.

Dans ce cadre, les acteurs économiques sont en permanence exposés aux réseaux sociaux, de manière « passive » (récepteurs) ou « active » (producteurs de contenu). Un processus de valorisation économique et sociale des données est alors à l'œuvre, sur différents types de marchés (symbolique (par les interactions sociales) ou réel (comme celui du travail par exemple)). Sur ces réseaux sociaux, le corps des individus est l'interface physique qui relie les acteurs au système, susceptible d'être contraint comme source d'évolution des normes économiques et sociales relatives au corps : l'économie du corps passe par le « E-corps ». En somme, quelque que soit son support de valorisation, le « bon » corps est ainsi à la fois le reflet comme le véhicule du « nouvel esprit du capitalisme » (Boltanski & Chiapello 1999), autonomie, adaptabilité, polyvalence, mobilité, capacité à fonctionner en réseau, dépassement, efficacité, rentabilité.

Les espaces en apparence ludiques, comme le sport, sont déterminants pour comprendre cette évolution des relations entre corps et capitalisme; ils sont révélateurs de nos modes de vie « hyperactifs », et permettent d'acquérir les dispositions corporelles attendues par le système économique (Quidu 2018, Vallet 2017). Il est d'ailleurs essentiel de comprendre que ces espaces fonctionnent comme des « fabriques du muscle » (Vallet 2022), dans la mesure où ils sont organisés rationnellement pour produire le corps désiré. Nous faisons référence ici aux salles de sport dont la diversité de l'offre associée (du low-cost au premium, du bodybuilding aux sports de combat) démontre l'engouement croissant autour des pratiques de développement du corps. En 2019 six millions de personnes environ étaient affiliées à une des 4370 salles de fitness présentes en France. En tendance, on considère que la progression de l'adhésion à ce type de salles est d'environ quatre à cinq pourcent par an (Deloitte 2019). Cette fabrique

représente le lieu d'exercice de la rationalité instrumentale et de l'accumulation du capital corporel, mais aussi physique.

En effet, en référence à la TR, on remarque qu'à partir de l'univers de la salle, tout un ensemble de secteurs économiques reliés ont prospéré (coachings, spécialistes du corps divers, produits nutritionnels et pharmaceutiques, *etc.*), qui permettent de créer de nouveaux espaces d'accumulation du capital, et donc de participer à la régulation du capitalisme. Au sein du « capitalisme des vulnérabilités » où l'économie de plate-forme est reine, la place des réseaux sociaux modifie le rapport des acteurs économiques à l'accumulation du capital et à la relation salariale : considérant que le coût d'entrée comme le coût d'opportunité pour « faire carrière » via les réseaux sociaux en vendant une image du corps sont faibles, ils surinvestissent de devenir entrepreneurs grâce à leur corps.

De même, le « bon » corps mentionné plus haut est recherché pour gérer l'incertitude qui rend le corps vulnérable dans le « capitalisme des vulnérabilités » (Vallet 2021). A ce titre, la pandémie de la « COVID-19 » a renforcé le besoin de production et de consommation du corps, et plus largement le statut d'institution du corps car le sentiment de vulnérabilité donne la priorité au corps comme recherche de protection ultime.

Toutefois, le « capitalisme des vulnérabilités » renforce les inégalités relatives au corps. D'une part, parce que la valorisation du « bon » corps contraste avec le « mauvais » corps, comme par exemple le corps « gras » qui se laisse aller et qui doit être combattu – au-delà même des enjeux médicaux. Sur le plan économique notamment, le corps « gras » est symbole de manque de d'organisation et de faible productivité (Vallet 2020).

D'autre part, le « capitalisme des vulnérabilités » met en relief qu'il n'est pas aisé d'atteindre le « bon » corps recherché. En effet, tous les individus ne sont pas égaux face à l'information – médicale en particulier – suffisante et nécessaire pour savoir comment produire et consommer le corps. En retournant à nouveau à la TR, l'atteinte du « bon » corps suppose un certain habitus, qui induit une connaissance du corps et des institutions médicales permettant de se situer positivement dans le système économique.

Enfin, notons que cette quête parfois obsessionnelle du « bon » corps dans le « capitalisme des vulnérabilités » est source de contradictions pouvant conduire à des pathologies majeures. Nous pensons ici au fameux « mal de l'infini » caractérisé par Emile Durkheim (2013), pathologie sociale dans laquelle l'individu n'arrive plus à borner ses désirs. Dans le cas du « corps-institution » ce « mal de l'infini » peut survenir à partir du décalage entre le processus de production et celui de consommation du corps, qui ne répondent pas à la même temporalité. En lien avec ce que nous avons énoncé dans la seconde partie, la production du corps s'inscrit dans le temps long, faite de sacrifices, d'ascétisme, de constance et donc d'application de la rationalité instrumentale.

A l'inverse, la consommation du corps repose sur l'immédiateté, l'éphémère, le toujours plus, en lien avec les valeurs hédonistes et eudémonistes que l'on cherche à appliquer au corps. Ce décalage entre production et consommation est d'autant plus marqué dans notre ère des réseaux sociaux, qui exacerbent la tendance. Dans ce cadre, il existe le risque que les désirs relatifs au corps prennent le pas sur les besoins,

engendrant une situation où l'individu « se perd » dans son corps et finit par s'isoler totalement du reste du monde.

Cette dérive potentielle nous révèle alors toutes les facettes du « corps-institution ». Quand le corps fait sens, il est alors source de pouvoir. Mais quand l'institution est défaillante, elle ne régule plus l'individu, mettant en danger à la fois l'individu et cette institution, mais aussi le lien social par extension. A l'extrême, cela fait courir le risque d'une autodestruction du corps. Paradoxalement pourrait-on dire, la négation des faiblesses du corps par une volonté de repousser sans cesse ses limites et de cacher ses dysfonctionnements pose des questions sérieuses sur la déshumanisation du corps : produire le corps pour mieux le faire disparaître?

5. Conclusion

Cet article a permis de relier deux ambitions. La première était de démontrer en quoi le corps a acquis au fil des années le statut d'institution dans nos sociétés dites hypermodernes. La seconde consistait à participer au renouvellement du programme de recherche de la Théorie de la Régulation. En nous focalisant sur l'idée d'une économie politique du corps, nous avons mis en évidence la nécessité d'explorer de nouvelles voies de recherches sur le corps en sciences économiques. Longtemps considéré comme un simple outil voire totalement ignoré par certaines théories économiques (l'économie néoclassique surtout, à travers le modèle de l'homo oeconomicus), le corps peut en fait être considéré comme un réel espace de production et de consommation encastré dans des rapports sociaux. C'est à ce titre que la grille de lecture de la TR est heuristique pour comprendre en quoi le corps participe à la dynamique, la reproduction et l'évolution du capitalisme. Nous espérons que cet article ouvre de nouvelles voies dans ce sens, à l'heure où le « capitalisme des vulnérabilités » impacte de plus en plus nos vies quotidiennes.

Acknowledgments

I would like to thank Alla Marchenko and John Smithin for their support for this research. I am really grateful to them.

Bibliographie

Abel, T., Burton-Jeangros, C. & Cullati, S. 2018. Vulnerability in health trajectories: life course perspectives. *Swiss Journal of Sociology* 44: 203-16.

Baudrillard, J. 1970. *La société de consommation.* Paris: Gallimard.

Berthaud P., Figuière C., Rocca M. & Vallet G. 2021. The political economy of regulation theory: toward a creative integration of social sciences. *History of Economic Ideas* 29: 113-42.

Boltanski, L. & Chiapello, E. 1999. *Le nouvel esprit du capitalisme*. Paris: Gallimard.

Boyer, R. 2003. L'anthropologie economique de Pierre Bourdieu. *Actes de la Recherche en Sciences Sociales* 50: 65-78.

Boyer, R. 2023. *Political Economy of Capitalisms.* Palgrave Macmillan.

Boyer, R. & Saillard, Y., eds. 1995. *Théorie de la régulation. L'état des savoirs*. Paris: La Découverte.

Cocquebert V. 2021. Cures de vitamines et fleurs de Bach: comment je suis devenu mon propre docteur avec les compléments alimentaires. *Le Monde,* 18 Novembre.

Deloitte, 2019. Le fitness en France: 5,96 millions d'adhérents et 2,5 milliards d'euros de chiffre d'affaires. 11 avril.

Durkheim, E. 1893. *De la division du travail social*. (As reprinted by Presses Universitaires de France, Paris, 2013).

Foucault M. 1994. *Histoire de la sexualité* (3 volumes). Paris: Gallimard.

Granovetter, M. 1973. The strength of weak ties. *American Journal of Sociology* 78: 1360-80.

INJEP. 2021. Baromètre national des pratiques sportives 2020. *INJEP Notes & rapports/Rapport d'étude*.

Kinnunen, T. & Vallet, G. 2018. Vertu et vice de la combinaison du contrôle et du désir. Le bodybuilding et le capitalisme post-industriel. *Revue STAPS* 119: 81-94.

Quidu, M. 2018. Le CrossFit, le Mixed Martial Arts et le néolibéralisme. *Esprit* 4, 131-39.

North, D. C. 1990. *Institutions, Institutional Change and Economic Performance*,

Cambridge: Cambridge University Press.
North, D. C. 1991. Institutions. *Journal of Economic Perspectives* 5: 97-112.
Parsons, T. 1937. *The Structure of Social Action*. New York: McGraw-Hill.
Piketty, T. 2013. *Le capital au XXI^e^ siècle*. Paris: Seuil.
Vallet, G. 2014. *Le sens sexué d'une pratique sportive extrême: le cas des pratiquants de bodybuilding*. Thèse de doctorat en sociologie, Université de Genève et Ecole des Hautes Etudes en Sciences Sociales.
Vallet, G. 2017. The gendered economics of bodybuilding. *International Review of Sociology* 27: 525-45.
Vallet, G. 2020. *Economie politique du genre*. Louvain-La-Neuve: De Boeck.
Vallet, G. 2021. Sport: quand le corps devient une ressource à valoriser. *The Conversation. Politique + Société*. 9 décembre.
Vallet, G. 2022. *La fabrique du muscle*. Paris: L'Echappée.

Aurora Philosophy Journal, Vol. 2, No. 1, pp. 53-70

The Political Economy of Capital Flows, Real Exchange Rate Dynamics, and the Foreign Debt Position in Sovereign Monetary Systems

John Smithin
Aurora Philosophy Institute & York University
&
Andrey Tytchino
Aurora Philosophy Institute & Quansimex, Inc.

1. Introduction

This paper has two main objectives. The first is to present some important analytical results for two of the key indicators of the state of international economic relations for an economy with a 'sovereign' monetary system. These are the real exchange rate and the foreign debt position as a percentage of GDP. From the point of view of a developing economy, the key question to ask is the extent to which the monetary system of such an economy can be called a sovereign system. This would involve either a floating exchange rate (or at a minimum a 'fixed but-adjustable' exchange rate), an independent fiscal and monetary policy, and the ability to issue foreign debt denominated in the domestic currency. *If* (and this may be a very big 'if') such a system obtains, then it may be possible to reverse the dependence on foreign direct investment (FDI) - in particular that by large multinational corporations - which has typically existed in systems dominated by a hegemonic reserve currency. Instead of uncontrollable capital *inflow*, increasing indebtedness, and a negative current account, it may be possible to turn this around and to become an international creditor with a positive equilibrium current account balance as a percentage of GDP.

The latter, in turn, is one of three desirable economic circumstances that can lead to a sustainable increase in economic prosperity as measured by real GDP growth. The other two are a primary government *deficit* as a percentage of GDP, and a total of private sector autonomous spending as a percentage of GDP (including that resulting from Keynes's 'animal spirits') greater than the average propensity to save.[23] In short, the analysis explains the conditions under which it would be possible to pursue a policy of what has variously been called 'economic nationalism', '*monetary* mercantalism',

[23] See Smithin (2018, 2022). This is not say that it is impossible for growth to occur with any of a higher savings propensity, a budget surplus, or a balance of payments deficit. But it does mean that at least one of the original three conditions must obtain, and also be large enough to outweigh the other two.

or 'capitalism in one country' (Smithin 2022, 129-34),[24] as opposed to submission to the vagaries of globalism, the 'New World Order', the 'Great Reset', *etc.*, *etc.*

The second objective is to focus on the extraordinary geopolitical situation which exists at the time of writing (in mid-2022) and what now seems to be a watershed in the development of the international monetary system. A set of circumstances has arisen that at long last threatens the hegemony of the US dollar as an international reserve currency. It possibly also heralds a bifurcation of the international financial and economic system into two competing blocs. On the one hand, there might be the remnants of the 'Western' system (the G7, the rest of the EU, Japan, and Oceania) but, on the other, much of the rest of world (ROW).[25] If these sorts of changes do eventually occur (with the obvious caveat that firm predictions at this stage are somewhat hazardous), the urgent question will arise as to where the developing economies might be best be advised to throw their lot. The question also remains as to whether the new system will be more conducive to national economic development and prosperity than it was before.

In what follows, section 2 first elaborates on what is meant by the notion of sovereignty in the present monetary context, while section 3 presents some analytical results. Section 4 discusses the practical implications of the results, and section 5 offers some thoughts on the geopolitical consequences. Section 6 provides a brief summary and conclusion.

2. Is Monetary Sovereignty an Option for a Small Open Economy (Particularly a Developing Economy)?

Paraskevopoulos *et al.* (1996) posed this very question in an earlier contribution, published at the beginning of the globalist era more than 25 years ago. The answer is *YES*, but this is conditional on the polity under discussion having a *sovereign* national currency, in the sense in which that term has been used in the literature on modern monetary theory (MMT), as explained in such sources as Kelton (2020), Mitchell *et al.* (2019), and Wray (2012).

According to Smithin (2022), the mainstream approach to monetary theory and policy has failed because it is based on the wrong premises. It does not address the real complexities of the social ontology of the macroeconomy and tries to explain all economic activity with reference to the model of barter, thereby treating money as nothing more than a 'medium of exchange'. According to the conventional approach money may help to facilitate trades that would take place anyhow, but its existence

---

[24] The expression 'capitalism in one country' is a pun on Stalin's (1924) notorious 'socialism in one country'.

[25] It is often asserted, for example, that the new system will be centred on the so-called BRICS (Brazil, Russia, India, China, South Africa), with the addition of more and more new members to the bloc as time goes on.

does not change anything fundamental in economic life. However, this ontology was ultimately based on nothing more that false conjectures about money's historical evolution, and the entire approach turns out to have been misguided in theory and practice. What is truly important about money is that it is a 'means of payment', specifically a means of payment of debt. As explained by Ingham (*e.g.*, 1996, 2004) money is actually a 'social relation' involving debt and credit.[26] While it is true that in a modern monetary economy many of the debts are indeed incurred in the process of making trades and fulfilling the associated contracts, the focus on debt marks a fundamental change of emphasis. The analyst is forced to recognize the importance of bank credit creation and endogenous money for the generation of profits denominated in monetary terms, and thereby for the entirety of the scale and structure of economic activity. Confusion arising from basic misunderstandings about the nature of money was revealed in dramatic fashion by the policy debates over MMT in the USA in recent years. MMT was championed by some radical politicians and just as strongly resisted by those of a different political persuasion. However, as the philosopher Graham Hubbs (2020) has suggested, all along the protagonists have essentially been arguing about the ontology of money without perhaps being fully aware of it. By now, it is clear that there are some 'empirical problems' (Smithin 1990) that have arisen in the practical application of MMT-type policies - such as the onset of stagflation. However, the core argument of MMT rests on the 'logically unassailable proposition' (Smithin 2022, v-vi) that the central government of an economy with its own sovereign currency and a floating exchange rate faces no binding financial constraints (to which we would add a 'fixed-but-adjustable' exchange rate). Under these circumstances fears about unsustainable budget deficits, and so forth, do not make sense. Those empirical problems that have occurred in practice, some of which were predicted by Smithin (2016a, 2016b, 2020, 2021), have had mainly to do with debates about the correct level of interest rates. What seems to be most important is whether we should define and think about interest rates primarily in *real* or *nominal* terms.

Textbook discussions often start with the notion of identifying the 'functions' of money. The so-called functions are often given as a triad, namely (1) a unit of account, (2) a medium of exchange, and (3) a store of value. The idea seems to be that money can be defined simply as the asset which best performs the three functions in any given state of society. Keynes (1930), albeit using a slightly different terminology, had actually argued that the unit of account function was fundamentally important, but this view is not shared by modern textbook writers. They don't seem to think it is important at all. This is a serious mistake. If there were no unit of account it would be impossible to conduct business on a rational basis by quoting prices, keeping accounts, and obtaining the necessary finance. On the other hand, the notion of a medium of exchange *is* regarded as important, because of the supposed analogy to barter. Another mistake. Finally, in standard theories of the demand for money and portfolio choice, the idea of money as a store of value continues to be emphasized. Also an error. Experience over long periods shows that money is certainly not the only store of value, and not necessarily the best, often far from it. Yet it continues to be used long after inflation

[26] See also Bell (2001).

.

rates have reached very high, and even hyper-inflationary, levels.[27] In a posthumously published book entitled *A Market Theory of Money*, the late Sir John Hicks (1989) finally broke entirely with the usual three-fold classification. Translated into the terminology we have been using here, Hicks's argument was that the two main functions of money were (1) a *unit of account*, and (2) a *means of payment*. Ultimately - in practice - 'money' will always turn out to be that asset in which the two functions are combined (Smithin 1994). The store of value aspect is downplayed.

How does the notion of a means of payment differ from that of the medium of exchange? Hicks's answer was that, in reality, the typical transaction is not simply a straightforward 'spot' exchange of goods for money or *vice versa*. Particularly for the more important large value transactions, some sort of agreement (an explicit or implicit contract) is required for trade to take place. The timing of delivery and payment is highly variable. Debt are continually being created and extinguished, but it is not possible to be dogmatic about exactly when. In some cases, the buyer must pay 'cash in advance' before delivery of the item. In others, payment is made later, 'in arrears'. Spot payment is only a special case. In all three cases it is implicit that money, the thing offered in payment, is in a different category altogether from the goods and service being offered for sale. Otherwise, when trading apples for oranges why not consider either one of them 'money'? The concept of a means of payment also extends quite naturally to cover the case of purely financial transactions.

The next question to ask is how all this works out in an actual economy. The MMT school, for example, explains what happens by their mantra that 'taxes drive money'. Consider the two following statements as quoted by Smithin (2022, 8). The first is by Ingham in the previously cited work *The Nature of Money*:

All money is debt in so far as issuers promise to accept their own money for any debt payment by any bearer of the money.[28]

The second is by Hicks himself, in *A Market Theory of Money*:

Money is paid for a discharge of debt when that debt [*itself*] *has been expressed in terms of money.*

So, building on these statements and others like them, the MMT argument is that the state has the power to tax, which means to legally enforce an obligation on everyone in society to become indebted to them. If, therefore, the state is always prepared to accept its own liabilities in payment of those obligations (the taxes) it will establish its liabilities as a sovereign money. If it does not do that (if the state will not accept its own liabilities, insisting rather on payment in things like gold, foreign currency, or

---

[27] To make such a case is not to deny that money might be more useful in capitalism if its real value could be kept more stable. But it is not a primary. It is not part of the ontology of money.

[28] The converse in not true. It is not the case that 'all debt is money' (Smithin 2022).

bitcoin!) it loses any such power. In practice, the liabilities of other institutions such as commercial banks may also 'count as' money, when denominated in the national unit of account. This is due to:

(a) An explicit or implicit commitment to convertibility.

(b) The fact that those liabilities are also acceptable in payment of taxes.

These mechanisms are thought to work not only at the level of the individual national economy but also at the international, or geopolitical, level. Similar sorts of considerations, if not the power to tax *per se*, will be decisive as to which is to be the most acceptable international currency, *i.e.,* a reserve currency. When a national currency becomes an international reserve currency that nation gains hegemonic power (Bell 2001). And, as already mentioned, from the point of view of the developing economy two issues are important:

(i) The extent to which the government of a developing economy is able to establish itself as sovereign. This will be largely a question of the domestic political settlement, and the establishment of the appropriate set of domestic institutions.

(ii) What type of international arrangements need to be in place to allow the developing economy to exercise sovereignty. If all that happens at the international level is the replacement of the hegemony of a gold standard, for example, with that of the nation controlling the reserve currency, or that of a multi-national union currency union, nothing will have been achieved.

3. Balance of Payments and Exchange Rate Dynamics for Sovereign Monetary Systems

In another significant contribution, Hicks, whose views on the ontology of money have just been discussed, also applied similar ideas to the evolution of the international monetary system. Particularly important was a lecture entitled 'Managing without Money' delivered many years ago to the Academia Sinica and the Chu-Huang Institution for Economic Research in Tapei, Taiwan. Hicks (1986, 26) stressed that 'there is … an intimate relation between money and trade'. In the following passage, he then went on to seemingly anticipate some of the points later made by the MMT school, well before these arguments became popular and were widely discussed:

One can lay it down as a general principle that in any country with a single government, a well-established government, and with no trade, anything that that government should like to say was money would be money. There are two ways in which it could ensure that that would be so. One is that the government itself would accept it, in payments, such as taxes that were due to it; the other that contracts, expressed in that money, would be enforced in courts of law.

But an important caveat here is that Hicks did not appear to accept that these principles might also apply to a well-established government *with* trade. This was the point of his notion of 'managing without money'. He was specifically referring to the impossibility (as he saw it) of managing without an *international* money, that is without a reserve currency. He did not think that this could be achieved. The context was an earlier watershed event in the international monetary system of half-a-century ago, namely the collapse of the Bretton Woods system in 1971 when then US President Richard M. Nixon cut the link between the US dollar and gold. Hicks's argument was that the world did try to get along 'without money' (without an international reserve currency) in the immediate aftermath of the financial crisis of 1971, but failed to do so. This is how he proceeded to argue the point (Hicks 1986, 28):

When the dollar was floated ... in 1971, it was intended that it should be abdicating from the special position which it had occupied for so long. That is what, for a while, did actually happen. The world had to manage without an international money, and [*as I ... have shown*] *it managed very badly. Then, at the next round, the international money came back. Governments would not provide an international money; so traders had to find one for themselves. There was no alternative; they had to go back to dollars. The abdication, that is to say, was not accepted.*

We have already suggested, however, that this is not quite the right way to put it. Of course, capitalism cannot exist without 'money' in the most basic sense. This point is not in dispute. The question is always rather 'what do we mean by money?' in any given context. Regardless of how Hicks and others may have interpreted the experience of the early 1970s, the analytical results we next go on to present will show that there is, in fact, a theoretically quite coherent alternative to the existence of some kind of international money. That is, a system of floating exchange rates between the several issuers of separate sovereign monies.

In such a sovereign economy the effects of most policy and other macroeconomic changes will be qualitatively the same as those in the equivalent closed-economy case (Smithin 2013, 2018, 2022). The domestic authorities will have no difficulty in issuing debt denominated in their own currency, and they are therefore able to conduct exactly the same fiscal and monetary policies as they would do in the closed economy case. All that is then needed for a complete analysis of the open economy is simply to add the results for changes in the real exchange rate and the foreign debt position to those already worked out. For an economy with a fixed-but-adjustable exchange rate the results also resemble those of the closed economy. Note that these considerations completely overturn the old idea, derived from the Mundell-Fleming model of the 1960s, that monetary policy can be assigned to a floating exchange rate regime and fiscal policy to fixed exchange rates. To successfully pursue either monetary or fiscal policy requires a sovereign currency, and a floating exchange rate or a fixed-but-adjustable exchange rate.

On the other hand, none of this applies to jurisdictions that have an irrevocably fixed exchange rate, nor to those embedded in a currency union. Nor does it apply to the

individual 'Provinces' or 'States' in a federal system. In spite of the name, a putative 'hard peg' for the nominal exchange rate (such as, *e.g*., a metallic standard, a credible fixed exchange rate regime, or a currency board with no loopholes) is actually an unstable system and will eventually break down.[29] There is no effective sovereignty in this case. The further idea, of a currency union, is to do away with exchange rates altogether. That is a total abandonment of sovereignty. And, remarkably, even though the intent is to eliminate exchange rate problems, experience shows that,when actually applied, the currency union has more-or-less the same instability characteristics as those of a hard peg. For a currency union, unless the domestic polity is willing to give up control over economic policy entirely, there are only two possible long-run outcomes:

(A) A break-up of the system, which would be the equivalent of an exchange rate crisis in this context.

(B) Eventual evolution into a true federal state, with a developed system of fiscal federalism. In the latter case, the different countries literally turn into mere 'Provinces', and no longer have even the semblance of national sovereignty.

Next, we work out the dynamics of the foreign debt position, and those of the real exchange rate itself, in the sovereign system. Here we can focus here solely on the case of a flexible exchange rate system, because the dynamics for the case of a fixed-but-adjustable exchange rate are similar.[30] First, note that in a flexible rate system the capital account (*KA*) of the balance of payments (BOP) will be the inverse of the current account (that is $KA = - CA$). In turn, *CA* itself is made up of two components, namely, net exports ($EX - IM$) and foreign investment income (FII). Therefore, we may write:

$$(1) \qquad KA = - (EX - IM + FII)$$

Next, let the symbol *B* stand for the total real value of domestic bonds outstanding in the hands of foreigners (assumed to be denominated in domestic currency), and *r* for the domestic real rate of interest. This gives:

$$(2) \qquad B - B_{-1} = - (EX - IM) + r_{-1}B_{-1}$$

Then divide through by real GDP (*Y*) to obtain:

$$(3) \qquad B/Y - (B_{-1}/Y_{-1})(Y_{-1}/Y) = - [(EX - IM)/Y] + r_{-1}[(B_{-1}/Y_{-1})(Y_{-1}/Y)]$$

[29] There are numerous historical examples. Incidentally, the use of term 'credible' as applied to such a system invariably turns out to be a misnomer. The analysts concerned will typically have been applying the results of financial modeling learned in business school rather than the lessons of historical experience.

[30] See Smithin (2013, 296-97).

Now define the foreign debt to GDP ratio, b, as $b = B/Y$, and also specify the trade balance as a percentage of GDP [that is, $(EX - IM)/Y = ex - im$] as a negative function of the real exchange rate Q[31]. For example, we may specify that $ex - im = -e_2q$, where $q = lnQ$ and $e_2 > 0$. We therefore arrive at the following difference equation in the foreign debt position:

$$b - b_{-1} = e_2q + (r_{-1} - y)b_{-1}. \qquad e_2 > 0 \tag{4}$$

Here, lower-case y stands for the growth rate of real GDP, that is $y = [(Y - Y_{-1})/Y_{-1}]$.

Also, as in Smithin (2022, 123), the expression for the real interest differential between the domestic real interest rate (r) and the foreign real interest (rf) is given as follows (where the symbol Z represents the currency risk premium):

$$r - rf = [(Q - Q)/Q] + Z \tag{5}$$

The exchange rate dynamics themselves may therefore be inferred by lagging equation (5) by one period and rearranging:

$$[(Q - Q_{-1})/Q_{-1}] = r_{-1} - rf_{-1} + Z_{-1}. \tag{6}$$

Supposing that the risk premium (or discount) Z may be specified as $Z = -z_0 - z_1b$, where $z_1 > 0$, this implies that:

$$q - q_{-1} = r_{-1} - rf_{-1} - z_0 - z_1b_{-1}. \tag{7}$$

For a debtor country Z will be a negative number, and will become the more negative the greater is the foreign debt to GDP ratio. The term z_0, meanwhile, may be thought of as a measure of 'international liquidity preference'. It is an index of the extent to which investors feel safer in holding foreign currencies rather than the domestic currency.

The following is thus a continuous time approximation to the original system set out in equations (4) and (7):

$$db/dt = e_2q + (r - y)b, \qquad e_2 > 0 \tag{8}$$

$$dq/dt = rf - r - z_0 - z_1b. \qquad z_1 > 0 \tag{9}$$

Temporarily setting $drf = dr = dz_0 = 0$, this reduces to:

---

[31] If E, the nominal exchange rate, is defined as the domestic currency price of one unit of foreign exchange, P is the domestic price index and Pf is the foreign price index, the real exchange rate Q is given by $Q = EPf/P$.

$$(10) \qquad \begin{vmatrix} db/dt \\ dq/dt \end{vmatrix} = \begin{vmatrix} e_2 & (r-y) \\ 0 & -z_1 \end{vmatrix} \begin{vmatrix} dq \\ db \end{vmatrix}$$

Global stability for this system (in the mathematical rather than the geopolitical sense!) would require that the trace (*Tr B*) of the right-hand side (RHS) matrix '*B*' is negative and that the determinant (*Det B)* is positive. However:

$$(11) \qquad Tr\ B = -e_2z_1, \qquad (< 0)$$

$$(12) \qquad Det\ B = -e_2z_1. \qquad (< 0)$$

The trace is negative but so also is the determinant. It is *not* positive as a finding of globally stability would require it to be. A negative determinant, in fact, indicates that the equilibrium is a saddle-point. The upshot is that the system is neither globally stable, nor completely unstable.

What are the implications of the above finding? An argument that is sometimes made is that *if* some sort of economic adjustment mechanism does exist to place the economy on the single 'stable arm' of the phase plane, then eventually the system will be able to reach an equilibrium. In most cases, clearly, we would be justified in thinking that such an argument is dubious in practice. In the present instance, however, *given flexible exchange rates*, there may actually be a stabilizing factor, namely expectations of how the exchange rates themselves are going to adjust.[32] If so - if the system does follow the 'stable arm' - the equilibrium solution is as follows:

$$(13) \qquad \begin{vmatrix} -e_2 & -(r-y) \\ 0 & +z_1 \end{vmatrix} \begin{vmatrix} dq \\ db \end{vmatrix} = \begin{vmatrix} 0 & 0 & 0 \\ 1 & -1 & -1 \end{vmatrix} \begin{vmatrix} dr \\ drf \\ dz_0 \end{vmatrix}$$

Next we can work out the determinant (*Det A*) of the left-hand side (LHS) matrix '*A*'. This turns out to be:

$$(14) \qquad Det\ A = -e_2z_1.$$

With this information, we may then solve by 'Cramer's Rule' (Chiang and Wainwright 2005, 199-205) to obtain the following results;

$$(15) \quad dq/dr = -(r-y)/e_1z_1\ (?), \quad dq/rf = (r-y)/e_1z_1\ (?), \quad dq/dz_0 = (r-y)/e_1z_1\ (?),$$

$$db/dr = 1/z_1\ (+), \qquad db/drf = -1/z_1\ (-), \qquad db/dz_0 = -1/z_1\ (-).$$

[32] See, for example, Paschakis & Smithin (1998) and Kam & Smithin (2004).

In the truncated system in (13) the only policy option available to the authorities of the domestic economy is to influence the domestic real rate of interest *via* monetary policy. But in context this remains a valuable policy tool precisely because the domestic authorities need not be influenced or constrained by whatever is happening in the ROW. The results show that a lower domestic real rate of interest rate improves the foreign debt position by reducing capital inflow and improving the current account. In turn, this will improve the economic growth rate, reduce unemployment, and increase real wages. Interestinlgy enough, the effect of a lower domestic real rate of interest on the real exchange rate is ambiguous. It all depends on the starting value of the term $(r - y)$, that is, on the difference between the domestic real rate of interest rate and the rate of real growth. There are thus some circumstances in which a deliberate policy of *lower* real interest rates may actually improve the economy so much as to cause an eventual *appreciation* of the real exchange rate.

4. Implications of the Analytical Results

Overall economic equilibrium for a sovereign economy does not entail either 'external balance' or 'internal balance' as these are conventionally defined. It is therefore possible for such an economy to continuously run a budget deficit, for example, and nonetheless the (national) debt-to-GDP ratio will converge to some sustainable steady-state level. The foreign debt position itself will similarly converge. It is also possible for the state of animal spirits or business confidence in the domestic economy to be such that the ratio of private sector autonomous spending as a percentage of GDP is permanently greater than the marginal propensity to save. In short, Keynes's original idea of 'abolishing the trade cycle' by 'keeping us in a state of semi-boom' rather than 'permanently in a state of semi-slump' (Keynes 1936)[33] would be well within reach. Expansionary policy need not be constrained by the usual balance of payments or budgetary considerations.The real exchange rate, meanwhile, is an endogenous variable. It will simply adjust to whatever the state of the economy happens to be. It is not tied down by any notional barter terms of trade, any more than the domestic rate of interest itself can be tied down by the (entirely mythical) 'natural rate' of interest (Graeber 2011, Smithin 2018, 2022).

Turning now to the specifics of macroeconomic policy in the sovereign open economy, we have already seen that permanently lower real rates of interest on money will tend to permanently increase economic growth - albeit at the cost of a somewhat higher inflation rate. However, an important point to note is that although the inflation rate does increase, it does not continue to 'accelerate' after the new equilibrium is reached. It does not get totally out of control. At the same time the foreign debt position will be reduced or, alternatively, the foreign credit position will be strengthened. This occurs because lower real interest rates, in addition to their direct effects on growth,

[33] As quoted by Smithin (2022, 101).

cause capital outflow and thereby improve the current account of the balance of payments. The effect on the real exchange rate is ambiguous, depending on initial conditions. As already stated, in an open economy with flexible exchange rates the real exchange rate simply adjusts to whatever the new situation is. It may appreciate or depreciate, but in neither case will the changes in the exchange rate constrain economic expansion.

Details about the effects of other macroeconomic changes, including changes in fiscal policy, and in such factors as business confidence and/or liquidity preference, have been provided elsewhere (Smithin 2018, 2022). An expansionary fiscal policy, in the sense of an increase in the ratio of government spending to GDP, will unambiguously increase the growth rate, just as Keynesian advocates of 'fiscal stimulus' have always argued. As a result of such a stimulus there will indeed be a somewhat higher inflation rate, but again this will not be an ever-accelerating increase. Moreover, the increase in inflation will lead to precisely the opposite results for the effects of fiscal policy on interest rates to those based on either the old IS/LM model, or the Mundell-Fleming model. There is actually a negative relation between real interest rates and inflation,[34] and therefore the real lending rate of the commercial banks, *r*, will *fall.* As for international economic relations the foreign credit position and the current account will both improve, whereas the real exchange rate could go either way. (This may seem to be a drastic reversal of orthodox thinking about the international economy).

A reduction in the average tax rate (a lower overall tax burden) also constitutes an expansionary fiscal policy, and also has the effect of increasing the rate of growth of real GDP. In the case of tax cuts, however, this is not just a question of increasing aggregate demand. Tax cuts work *via* a combination of demand-side and incentive (supply-side) effects. It is very important to notice that when an expansionary fiscal policy is effected by reducing the tax burden, rather than increasing spending, the inflation rate does not rise[35] but actually *falls*, due to the impact of the lower taxes on production costs. This is a major difference between the two alternative types of fiscal expansion (Smithin 2013, 259-60). Given a *lower* rather than a higher rate of inflation, there will also be an increase in the real lending rates of interest charged by the commercial banks. We therefore get a worsening of the current account and an increase in foreign indebtedness. Again, the effect on the real exchange rate will be ambiguous.

It is also interesting to consider the effects of an exogenous or spontaneous increase in productivity that might occur in the domestic economy (say as a result of technological innovation). As might be expected this increases the growth rate and reduces the inflation rate, again *via* lower production costs. The domestic real rate of interest is again likely to increase *via* the Mundell-Tobin effect (see *fn.*12). Note, however, that this has nothing to do with conventional ideas about how productivity

---

[34] This is the so-called 'Mundell-Tobin effect' (*aka* in the history of economic thought as the 'forced saving effect') as explained by Smithin (2022, 55-60).

[35] The opposite assumption was invariably made in the era of *faux* Keynesianism in the thirty-five years or so after WW2, with the dangerous corollary that one of the ways cure inflation is to *raise* taxes. In some quarters this idea has lasted even down to the present day.

changes affect the supposed 'rate of return to capital'.[36] It is the real rate of interest on *money* that is affected *via* the effects on domestic and international financial markets. If there are no financial effects, there is no impact on interest rates. In effect, we now have a 'monetary theory of the real rate of interest' rather than a 'real theory of the real rate of interest' (Burstein 1995).[37]

5. The International Monetary System at a Crossroads

Returning to the sphere of geopolitics, we have already made reference to Sir John Hicks's insightful discussion of the events that took place in the international monetary system half-a-century ago, leading to the collapse of the 'Bretton Woods' system. In fact, Hicks was describing the very origins of the international regime that has persisted to this day, and is now itself apparently on the point of collapse. Under the pressure of world events in our own times, we have again arrived at a juncture in geopolitics that seems to herald great changes in the international monetary and economic system. To be specific, it is about the potential displacement of the US dollar as a reserve currency. The question naturally arises as to the type of system that might replace it. We earlier spoke, for example, of a possible bifurcation of the system that may be happening as a consequence of the collapse of the pre-existing unipolar geopolitical system. To repeat, from our point of view the vital question is whether, or not, the new emergent system will allow for the type of economic nationalism discussed above (with floating exchange rates, *etc*.) to the mutual benefit of all?

To re-use Hicks's clever metaphor, the US dollar now seems again to be 'abdicating' from its central position in the international monetary system, exactly as happened fifty years ago. Might it be the case that this time the abdication will be accepted? What has now happened is that under the pressure of the extraordinary series of geopolitical events of recent years, such as the COVID pandemic, concerns around climate change, US military reverses, the Ukraine war and other potential conflicts, and even increasing political instability in the USA itself, the governments of what we now call the 'collective West' have increasingly taken policy decisions to 'weaponize' the economic and the financial system against their perceived enemies, domestic and foreign. The US government and others have taken to a form of economic warfare, for example by simply seizing the property of both foreign nationals and domestic citizens by executive order. In the financial sphere, the authorities have also frozen or confiscated the bank accounts of political enemies, both individuals and foreign national governments, thereby effectively shutting these entities out of the dollar-based international financial system.

Whatever may be the rights and wrongs of the multiple political disputes, the decision-makers concerned have seemingly failed to appreciate the very serious

---

[36] Which, in any event, is itself an incorrigibly incoherent and confusing idea (Smithin 2022, 56-58).

[37] See also Smithin (2018, 2022).

consequences of these actions, up to and including the survival of the international financial system itself. We should immediately recall Ingham's (2004) concise statement, already quoted above, that ' … all money is debt in so far as issuers promise to accept their own money for *any* debt payment by *any* bearer of the money …' (original emphasis). This is a basic requirement for any money, including an international money, *to be* money. It is a fundamental ontological issue. In effect, the USA and others have *not* been honouring their own 'promises-to-pay'. If this continues, it can only mean that in the long run the claims will no longer to be able to count as money, except perhaps within the limited national circle, as Hicks already pointed out. They can hardly continue to serve as international reserves.

As a recent example of this kind of thing, consider the monetary and financial side-effects of the war in the Ukraine in the current year 2022. Economic and financial sanctions against the Russian side have been applied by the NATO[38] allies, the European Union (EU) and others, preventing either the Russian government or individual citizens from accessing their dollar denominated assets, and thereby from either paying off dollar denominated debts, making interest payments, or purchasing goods and services with dollars.[39] Before the war the Russian Federation had been a major supply of energy such as oil and gas, and other commodities, to many of those nations in the NATO alliance and the EU who later became their *de facto* adversaries. Typically, payment for these goods had been made in terms of US dollars, the 'international money' that Hicks had claimed, back in 1971, the world could not do without. In 2022, many of the nations that were unfriendly to the Russians either refused outright to continue to trade (even to their own economic detriment), or if they were willing to continue, expected still to be able to make payments in a currency that was no longer of any use to their trading partners. To the extent to which trade in the ROW had also been conducted in terms of dollars, this would be a problem even with those nations/trading blocs that remained on friendly terms with the Russian Federation. For the Russians, therefore, one obvious solution was to require payment for energy supplies in their own currency, the rouble. Regardless of how those participants are able to acquire roubles, it can be seen that this already foreshadows the kind of exchange rate system analysed in Section 3 above. In general, the geopolitical events seem to have persuaded some of those nations *outside* of the collective West that some other form of trading and payments system will have to be set up, one which does not rely on the dollar or Western-orientated banking mechanisms such as SWIFT.[40]

The latest blow to the US dollar, at the time of writing, happened at the BRICS meeting in August 2022. At this meeting a discussion about excluding the US dollar from the international trade settlements system was brought to the table. Therefore, if the financial policies of the BRICS and other countries continue to move in the intended

---

[38] That is the *North Atlantic Treaty Organization*.

[39] Ironically, of course, the main losers from this, in pure economic terms, were the internationals bondholders or customers/importers themselves!

[40] The acronym stands for the *Society for Worldwide Interbank Financial Telecommunication*, an international financial messaging system.

direction then, instead of the US dollar, currencies such as the Russian rouble, the Chinese yuan, and the Indian rupee, will take centre stage. The Iranian real may also be another possible currency option. (In that case, because Iran having already been under international economic sanctions for 40 years the Iranian currency has not been exposed to externally destabilizing financial regulations.)

Another recent serious action against the US dollar was the directive of the National Bank of Russia to accept payments for oil and gas in roubles only, prohibiting US dollars and other currencies for use in energy transactions. Also, Russia has refused to settle debts on bonds outstanding in any currency other than roubles, and this has forced Western economies to buy massive amounts of roubles on FOREX markets. Still another factor playing against (much of) the collective West is the need to now replace Russian energy sources with more expensive alternatives. This will greatly exacerbate production costs and supply chain issues generally, and increase inflation. This will put pressure on the exchange value of the Euro and ultimately threaten the very integrity of the economic and financial system of the EU.

No doubt it is too early to say how this is all actually going to work out in the future. And, on this point, we can conveniently quote from Hicks (1986, 28) once again. Referring to the later historical developments in the international monetary system from the collapse of Bretton Woods up to his time of writing, he writes:

[*My final remarks*] *... will be confined to what has happened. I have seen too many economists come to grief by making predictions! I shall not follow their example.*

We should also be prudent and try rather to follow Hicks's own example. We will simply say (again) that, in our view, the most important issue to consider is whether or not any new system would devolve back simply into a regime with an alternative reserve currency system involving (say) the rouble itself, or perhaps the Chinese yuan - or a system of floating exchange rates such as that described in Section 3 above. In that case, every jurisdiction trades in terms of its own currency, and has the ability to issue foreign debt denominated in that currency. An alternative reserve currency would be the logic of Hicks's argument, but the system of floating exchange rates, we think, would be preferable for the reasons explained above. For the developing countries, in particular, is certainly the case that the preferred alternative requires considerable political will and enhanced institutional flexibility on their part. Each government, society, and central bank must take active steps to establish their own liabilities as a sovereign money. A difficult task, perhaps, but surely worth the effort?

6. Conclusion

A basic question to be asked about 'money' is a very simple one. What exactly is it that makes any given promise-to-pay count as money? This applies both at the level of the domestic economy and *a fortiori* at that of the international monetary system. The analytical part of this paper has shown that a nation possessing a sovereign currency,

and with a floating exchange, has a great deal of latitude to pursue both monetary and fiscal policies that are in the national interest. Policy-makers are unconstrained by either budgetary or balance of payments considerations. It will at least be possible for that jurisdiction to successfully manage what we have called a 'capitalism in one country' even though, needless to say, this is by no means a guarantee that the authorities concerned will actually pursue the right combination of policies in practice.

This is the opposite position to that taken by Sir John Hicks in his discussion of the great watershed in the international monetary system of half a century ago, when the Bretton Woods system collapsed. Hicks thought that it was impossible to 'manage without' an *international* money, even though at least some exchange rates were then floating. This was his explanation as to why the 'abdication' of 1971, as he put it, was not accepted. As it turned out, those events were the opening acts in the creation of the unipolar financial and geopolitical system that still exists today hanging by a thread, but is now itself under immense pressure. Will this latest abdication, 50 years on, now be accepted? If so, what will be the nature of the new system that will emerge to take its place? It is most certainly the case that for there to be 'capitalism in one country' there must be a sovereign and well-managed monetary system in that country. Nonetheless, contrary to Hicks, the analytical part of this paper has shown that a viable system can indeed exist without there being an international currency *per se.* What is required is for each of the partners concerned to have the ability to issue foreign debt denominated in their domestic currency, and either a floating exchange rate or a 'fixed-but-adjustable' exchange rate.

In any event, we would argue (and imagine that there are few who would disagree) that the experience of the developing economies has been much less than ideal during the revived hegemony of the US dollar as the reserve currency in the *post* Bretton Woods era of the past half-century. It has been extremely difficult to manage capital flows, and there has been an unhealthy dependence on FDI by multinational corporations. It has generally been difficult for developing economies to pursue independent fiscal and monetary policies.

In the changing and emergent system, it seems likely that most such countries will eventually have two difficult strategic policy choices to make. Firstly, the decision as to where best to cast their lot, which side to take, if a new multipolar international system arrives. Secondly, to be willing be consider the necessary domestic political and social changes that need to be in place to ensure national monetary sovereignty, escape from globalism, and gain (or regain) the ability to conduct the appropriate nationally based monetary and fiscal policies.

References

Bell, S. 2001. The role of the state and the hierarchy of money. *Cambridge Journal of Economics*. (As reprinted in *Concepts of Money: Interdisciplinary Perspectives*

from Economics, Sociology and Political Science, ed. G. Ingham, Cheltenham, Edward Elgar, 2005, 496-510).

Burstein, M.L. 1995. *Classical Macroeconomics for the Next Cen*tury, manuscript, York University, Toronto.

Chiang, A.C. and K. Wainwright. 2005. *Fundamental Methods of Mathematical Economics,* Fourth Edition. New York: McGraw-Hill.

Graeber, D. 2011. *Debt: The First 5000 Years*. Brooklyn, NY: Melville House Publishing.

Ingham, G. 1996. Money is a social relation*. Review of Social Economy* 54: 243-75.

Ingham, G. 2004. *The Nature of Money*. Cambridge: Polity Press.

Hicks, J.R. 1986. *Chung-Hua Series of Lectures by Invited Eminent Economists, No. 11.* Tapei: The Institute of Economics, Academia Sinica.

Hicks, J.R. (1989). *A Market Theory of Money*. Oxford: Oxford University Press.

Hubbs, G. (2020). Philosophical explanations of the nature of money. Paper presented to the *Aurora Philosophy Institute*, Aurora ON, November.

Kam, E. and J. Smithin (2004). Monetary policy and demand management for the small open economy in contemporary conditions with (perfectly) mobile capital. *Journal of Post Keynesian Economics* 26: 679-94.

Kelton, S. 2020. *The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy*. New York: Hachette Book Group

Keynes, J.M. 1930. *A Treatise on Money*, vol. 1, *The Pure Theory of Money*. London: Macmillan.

Mitchell, W., L. R. Wray, & M. Watts 2019. *Macroeconomics.* London: Red Globe Press.

Paraskevopoulos, C.C., J. Paschakis & J. Smithin 1996. Is monetary sovereignty an option for the small open economy? *North American Journal of Economics and Finance* 7: 5-18.

Paschakis, J. & J. Smithin 1998. Exchange risk and the supply side effects of real interest rate changes. *Journal of Macroeconomics* 20: 703-20.

Smithin, J. 1990. Empirical and conceptual problems in contemporary macroeconomics. *British Review of Economic Issues* 12: 73-95.

Smithin, J. 1994. *Controversies in Monetary Economics: Ideas, Issues, and Policy*. Aldershot: Edward Elgar.

Smithin J. 2013. *Essays in the Fundamental Theory of Monetary Economics and Macroeconomics.* Singapore: World Scientific Publishing.

Smithin, J. 2016a. Endogenous money, fiscal policy, interest rates and the exchange. rate regime: a comment on Palley, Tymoigne, and Wray. *Review of Political Economy* 28: 64-78.

Smithin, J. 2016b. Endogenous money, fiscal policy, interest rates and the exchange rate regime: correction. *Review of Political Economy* 28: 609-11.

Smithin, J. 2018. *Rethinking the Theory of Money, Credit and Macroeconomics: A New Statement for the Twenty-First Century*. Lanham MD: Lexington Books.

Smithin, J. 2020. Interest rates, income distribution, and the monetary policy transmissions mechanism under endogenous money: what have we learned thirty

years on from *Horizontalists and Verticalists*?. *European Journal of Economics and Economic Policies*: *Intervention* 17: 381-98.
Smithin, J. 2021. The methodology for assessing interest rate rules: a reply, *European Journal of Economics and Economic Policies*: *Intervention* 18: 286-92.
Smithin, J. 2022. *Beyond Barter: Lectures in Monetary Economics after 'Rethinking'*. Singapore: World Scientific Publishing.
Stalin, J. 1924. *Foundations of Leninism: Lectures Delivered at the Sverdlov University*. (As reprinted by Foreign Languages Press: Peking, 1975).
Wray, L.R. 2012. *Modern Money Theory: A Primer on Macroeconomics for Sovereign Monetary Systems*. New York: Palgrave Macmillan.

Aurora Philosophy Journal, Vol. 2, No. 1, pp. 69-94

The Hicksian Super-Multiplier, 'Capital' Theory, and Social Ontology: Fundamental Problems in Both Mainstream and Heterodox Macroeconomic Theory

John Smithin
Aurora Philosophy Institute & York University

1. Introduction

The following is a statement (as quoted by Fletcher 2005, 402-3) by the 20th century English economist, Dennis Robertson, who was at first a collaborator of John Maynard Keynes at Cambridge University in the 1920s and 1930s but later Keynes's opponent:

The increase in saving may itself generate an increase in capital outlay ... high-brow opinion ... is like a hunted hare; if you stand long enough in the same place ... it is apt to come round to you in a circle. Mr. Kalecki, than whose no brow is higher ... offers the following thought. 'A reasonable interpretation of the inter-relation between the level of investment and investment decisions should be based ... on the fact that with the high level of income there is correlated a high level of saving, and that the stream of new savings stimulates investment because it makes it possible to undertake investment without increasing indebtedness'. The wheel has come full circle. If you want to be really up to date you can now say that it is not so much investment which governs savings as savings which govern investment. But you had better be careful to give Mr. Kalecki as your authority, otherwise you may be suspected of vulgar schoolboy error.

This passage clearly states the key issue raised by Keynes's theory as against that of traditional 'classical' or 'neoclassical' economics. Namely, the question of whether 'savings drives investment', as the traditional argument would have it, or 'investment drives savings', the conclusion (or claim) of the new Keynesian approach to monetary economics of the 1930s. Robertson, in spite of his friendship with Keynes, staunchly defended the traditional approach.

Michal Kalecki, however, was famous as one of the first generation of 'Post Keynesian' economists, his work being promoted by such prominent figures in the Keynesian camp (and opponents of Robertson) as Joan Robinson. Kalecki himself went even further, and claimed to have actually anticipated Keynes's theory in his own work (Kalecki 1971, vii):

The first part ... [*of this volume*] *... includes three papers published in 1933, 1934 and 1935 in Polish before Keynes's* ***General Theory*** *appeared, and containing, I believe, its essentials* (*an English translation was first published in ...* [*my*] *...* ***Studies in the Theory of Business Cycles, 1933-39 … ,*** *1967*).

As pointed out by Fletcher in his biography of Robertson this apparent conjunction of the views of Robertson and Kalecki is therefore something that very much needs to be explained. At least one of the 'essentials' *does* seem to be missing from Kalecki's approach, regardless of how similar his model might otherwise seem to be.

In this paper, I will argue that this early apparent convergence of views between a prominent orthodox/mainstream economist and one of his heterodox counterparts prefigures a more general failure of the discipline of macroeconomics since its founding by Keynes in the 1930s. In the decades since, even those economists professing themselves sympathetic to Keynes's approach seem always to have shared much the same sort of confusion on the investment/savings issue. This applies equally to the contributors to the literature on the Harrod-Domar model (Harrod 1939, 1948, Domar 1946) in the decade or so after Keynes, as well as (even) to the work of two famous economists who subsequently won the Nobel Prize - Sir John Hicks in *A Contribution to the Theory of the Trade Cycle* (1950) and Robert Solow (1956) in his influential 'growth' model.[41] It continues to this day in the basic structure of the mainstream macroeconomics of the textbooks.

In the case of Hicks, we will be able to illustrate the point with reference to the notion of the 'super-multiplier' from *A Contribution*. Even though the analysis in that book does contain an explicit investment function, which at first sight seems to enhance the Keynesian multiplier analysis *via* the notion of the super-multiplier, when it is applied *specifically* in the context of growth and capital accumulation the upshot is a reversion to the classical ordering of savings and investment. In recent decades the notion of a super-multiplier has been revived in the literature on what is sometimes called 'Classical Post Keynesianism' - as described by Marc Lavoie (1992, 2014) – which discussion is based originally on a Cambridge University PhD dissertation by Serrano (1995).[42] What this genre of the literature has in common with Hicks, and others, is the reliance on a 'production function' involving the notion of a stock of 'capital' (symbolized by the letter '*K*'), that is supposed in some way to represent an aggregate of the physical plant and equipment used in the production process. This reason for taking this stance, as Lavoie (2014, 347) explains, was a concern on the part of this group to:

... combine the classical concerns for growth and income distribution with the Keynesian principle of effective demand ... the focus move(*s*) *to rates of growth of output, rates of profit and rates of capacity utilization*.[43]

---

[41] As will be further explained below, the latter was not even really a growth theory as such, but rather a theory of the determination of the 'optimal', or steady-state, capital/labour ratio. For a textbook exposition see, for example, Mankiw (1992, 79-84).

[42] Note that reference in Serrano's title was to the 'Sraffrian' … [super] … multiplier - as opposed to the 'Hicksian' version which is the subject of this paper.

[43] In spite of the fact that on the very first page of the *General Theory*, Keynes (1936, 3) Keynes says that ' … the postulates of the classical theory are applicable to a special case only and not to the general case … '.

In the process, however, the change in focus seems to have lead the contributors to this field to cover much the same sort of ground as the writers quoted above. More recently, in 2022, the prominent heterodox economic journal *The Review of Political Economy* announced an upcoming symposium on this very topic of the super-multiplier[44] to be published some time the following year (2023). As I understand it, this collection of papers will deal mainly with questions internal to the Post Keynesian literature. The present paper, on the other hand, addresses what I take to be fundamental problems that are common to both the mainstream and heterodox literature.

In what follows, section 2 identifies what seems to me to be *the* key problem responsible for these confusions. Namely, the neglect of the role of money in the economy and a lack of clarity on what a philosopher would call the ontology of money (the nature of money). Interestingly enough, even though Hicks dismissed money as a 'secondary factor' in the opening pages of *A Contribution* (1950, 3) he nonetheless added two chapters (XI and XII) to make what he thought were appropriate caveats. These clearly did not go far enough. From my own point of view it also seems 'significant' (at least to me) that *A Contribution* was first published in the year before I was born. I get a strong impression of the discipline of macroeconomics 'going off the rails' (in spite of the efforts of Hicks and others) long before I had the chance to do anything about it.

Section 3 goes on to describe the 'devolution', as I call it, of macroeconomic theory from the promising start by Keynes in the 1930s and after his untimely death in 1946. Section 4 then provides an exposition of Hicks's super-multiplier in terms of a fairly standard notation, similar to that used in some of my recent work (Smithin 2018, 2022). Section 5 shows how the idea of the super-multiplier itself serves (as it turns out in a quite precise manner) to illustrate the confusion/contradictions around investment and savings. I draw a sharp contrast between a 'Keynes-type' theory of economic growth and a generic 'Classics-type' approach.[45] The Keynes-type theory validates three very important ideas in macroeconomics, that investment drives saving, that fiscal expansion leads to growth, and that a trade surplus also leads to growth. The Classics-type theory, on the other hand, leads to anomalous results. It does not provide a solid foundation for the classical theories of trade, savings, and public finance. Problems in both the mainstream and heterodox economic literature seem to always arise in the attempt to integrate, or reconcile, these two fundamentally contradictory strands in economic thought.

Section 6 then offers some conclusions. Mention has already been made of the neglect of the ontology of money. It turns out that a similar lack of attention to the ontology of capital itself may be equally important.[46] The basic idea of a homogenous

---

[44] The symposium was announced by the editor of the *Review of Political Economy*, Louis-Phillipe Rochon, in an e-mail circulated on May 25, 2022.

[45] This terminology also originated with Hicks (1985, 108-30) in his *Methods of Economic Dynamics*.

[46] I would like to make reference here to two important works by Leo Zelmanovitz, *The Ontology and Function of Money: The Philosophical Fundamentals of Monetary*

stock of 'capital' which (somehow) plays a decisive role in the production function, seems to be common ground to many mainstream and heterodox economists alike. But what is this *soi-disant* capital actually supposed to consist of? What is it's nature? Confusion between capital as representing a sum of money, and the same term as representing a collection of physical things, lies at the heart of the 'paradox of thrift'.

2. The Neglect of the Ontology of Money and (Therefore) of the Importance of the 'Role of Money' in Capitalism[47]

The mainstream approach to monetary theory and policy has failed because it is based on the wrong premises (Smithin 2022, v-vi). It does not address the real complexities of the social ontology of the macroeconomy, and tries to explain all economic activity on the model of barter exchange. It treats money as nothing more than a 'medium of exchange' which serves merely to facilitate the trading process. According to this conventional approach money may help to 'lubricate'[48] trades that would take place anyhow, but its existence does not change anything fundamental in economic life. This ontology, however, was ultimately based on nothing more than false conjectures about money's historical evolution, and the entire approach turns out to have bee misguided. What is truly important about money is that it is a 'means of payment', specifically a means of payment of debt. As argued, convincingly, by the economic sociologist Geoffrey Ingham (1996, 2000, 2004) money is a 'social relation' involving debt and credit.[49] While it is true that in a modern monetary economy many of the debts are incurred in the process of making trades and fulfilling the associated contracts, the focus on debt marks a fundamental change of emphasis. The analyst is forced to recognize the endogeneity of money and the importance of bank credit creation for the generation of monetary profits, and thereby for the entire scale and structure of economic activity, not just trade.

Institutions (2016) and *The Representational Theory of Capital – Property Rights and The Reification of Capital* (2020). These book are written from the point of view of 'Austrian' economic theory, and therefore may not come to the same sorts of conclusions that can be derived from a more Keynesian approach. Nonetheless they make crystal clear the importance of social ontology, and philosophy generally, when dealing with concepts of either money *or* capital.

[47] 'The role of money in capitalism' was the title of a paper co-written around twenty years ago by myself and Jeffrey Y.K. Lau (Lau & Smithin 2002). I also later used this expression as a chapter heading - for chapter 3 of *Rethinking the Theory of Money, Credit and Capitalism* (Smithin 2018).

[48] This expression (lubrication) was a term often used in expositions of the standard approach, likening the economic system to some sort of mechanical device rather than a set of social relations (Ingham 1996, 208).

[49] See also Bell (2001).

According to the famous sociologist Max Weber (as quoted by Collins 1986, 21-22) the most plausible description of 'modern capitalism'[50] (in Weber's own phrase) is:

The provision of human needs by the method of enterprise, which is to say by private businesses seeking profit.

But, what *is* this 'profit' that provides the economic incentive for private firms to act? Most obviously it is a sum of money, implying that the system could not function in its absence and ruling the possibility of achieving the same results by non-monetary methods. Moreover, recalling Ingham's (2004, 198) demonstration that:
All money is debt[51] *in so far as issuers promise to accept their promises to pay for any debt payment by any bearer of the money …*

… it is difficult to see how there can be either money, or profit, unless there is credit creation by the banking system and the money supply is endogenous.

Keynes seems to have been well aware of the profound implications of this simple (but hardly simplistic) point. Commenting on Marx's notion of the monetary circuit, while preparing his own major work for publication, Keynes (1933a, 81) argues that:

[*This*] *distinction … bears some relation to a pregnant observation by Marx … though the subsequent use to which he put it was highly illogical. He pointed out that the nature of production in the actual world is not, as economists seem often to suppose, a case of C -> M -> C' … of exchanging a commodity (or effort) for another commodity (or effort). That may be the standpoint of the private consumer. But it is not the attitude of business, which is a case of M -> C -> M' … parting with money for a commodity or effort in order to obtain more money.*

If money is a social relation involving debt, credit, and so forth, how is *M*' *ever* going to be greater than *M*, thereby allowing the generation of monetary profit? It cannot be - unless, as I myself have put it (Smithin 2018, 76):

… (*i*)*n general one sector or another of the economy …* [*is*] *… continuously willing to become indebted to generate profits for current producers.*

We will see below that this condition is directly relevant to the investment/savings conundrum.

---

[50] That is, of course, 'modern' as of Weber's day, over a century ago.
[51] But note that '… the converse is not true, it is not the case that 'all debt is money'… ' (Smithin 2022, 08, fn.)

3. The (D)evolution of Macroeconomic Theory in the 1930s, 1940s, & 1950s

In this section the objective is to sketch the evolution (or the reverse) of macroeconomic theory in the crucial twenty or so years after the *General Theory* - to identify what went wrong. I will use a notation previously employed in *Rethinking* (2018) and *Beyond Barter* (2022) involving money magnitudes deflated by a price index. Following Hicks's (1950, 9) explicit statement about this, in *A Contribution*, we are therefore dealing throughout with 'real' economic variables in this specific index number sense, rather than those expressed in Keynes's original notion of 'wage-units'.[52]

There are two important caveats to the above. Firstly, it should be borne in mind that during the time period we are discussing, when macroeconomic theory was in its infancy, so too was the statistical work leading to the current system of national income accounting. We cannot take for granted the close relationship between the two lines of research that seems to be assumed in the modern textbooks. Secondly, there is a strong case to be made that the national income accounting frameworks are themselves unfit for the purpose to which we put them. The published statistics are not 'stock-flow consistent' (Lavoie 2014, 264-69).[53] Intuitively, we can immediately recognize that this issue is very closely related to the saving/investment conundrum itself. For theoretical consistency therefore the various nominal (money) quantities discussed below, whether or not deflated by the appropriate price index, should be taken as referring to actual flows of funds (transactions in which money has actually changed hands during the accounting period), not the imputed values provided by the statisticians. If, and only if, the sums of money recorded in an income statement are actually 'receivables' will it be possible to make the correct entries in the corresponding balance sheet.

3.1 *The Original Keynesian Framework in a Standard Notation*

Let the symbol Y stand for real gross domestic product (real GDP), calculated on a flows of funds basis, C for real consumption spending, I for real 'investment' expenditure,[54] and S for real savings. A representative version of the simplest Keynesian system, as this had emerged by the mid-twentieth century, would therefore be:

---

[52] It needs to be mentioned at this point that the various and different meaning of the terms real (and for that that matter nominal) in both economics and philosophy has been a source of much further confusion. In economics, there is not only the 'index number' sense used here, but also a notion of the 'real economy' which is somehow supposed to be 'non-monetary' - not involving money. But 'real balances' (money holdings deflated by a price index) are also a *'real'* social relation in the philosophical sense. They are not nugatory.

[53] For a detailed exposition of this issue see the influential volume by Godley & Lavoie (2007) *Monetary Economics: An Integrated Approach to Credit, Money, Income, Production and Wealth*.

[54] I have put the term 'investment' in quotes here for the reasons to be explained below.

(1) $Y = C + I$

(2) $C = C_0 + cY, \qquad C_0 > 0, \quad 0 < c < 1,$

(3) $S = Y - C \qquad$ [implying that $S = -C_0 + (1 - c)Y$],

(4) $I = S.$

Equation (1) is a truncated version of the national income identity omitting both the government sector and the foreign sector. (These omissions are just for the sake of simplicity. As we will be see below, it is a simple matter to bring both the government sector and foreign sector back into the picture.)[55] Equation (2) is the consumption function, with C_0 standing for the 'autonomous' component of consumption and lower-case c for the 'marginal propensity to consume' (MPC). Given the consumption function there is also a savings function, equation (3), which is its mirror image. Equation (4) is the equilibrium condition absent the public sector and the foreign sector.

The basic premise of the mid-twentieth century literature was that we can treat both I and C_0 as exogenous variables. This notion of autonomous spending was used frequently in the original 'Keynesian' textbooks, and was originally taken to mean those expenditure decisions that are *not* dependent on the spender's current income (Davidson 2011, 41-3). As we have already seen, at the macroeconomic level the total of these expenditures must therefore presumably be financed by credit creation. The C_0 term, the intercept in the consumption function, is thus one component of total autonomous expenditure. It was also usual to treat the whole of spending by business firms - labelled I (or 'investment spending') - as dependent on things like Keynes's 'animal spirits' (Keynes 1936, 161) or business confidence, and not primarily on objectively calculable factors such as the level of income itself, interest rates, or realized profit.

The lack of dependence of consumption/savings and investment on the rate of interest was the presumably result of treating money as a 'secondary factor', as in the quote from Hicks above. Needless to say, this was incomprehensible to adherents of the 'loanable funds' theory of interest rates such as Robertson (1934) himself. If possible, it was even more so to those who accepted the IS/LM interpretation of Keynes, itself the invention of Hicks (1937). As it has turned out, however, even though Hicks was surely wrong in principle in his dismissal of money in *A Contribution*, the past half-century of work in the heterodox tradition of monetary theory in particular the

---

[55] From the point of view of pure monetary theory, particularly that of the school of 'modern monetary theory' (MMT), it is admittedly difficult to imagine any sort of monetary economy existing without the government sector in particular. On this view 'taxes drive money' (Mosler 1997-98, 2011) and 'money is a creature of the state' (Lerner 1947). But there is no harm in the algebraic simplification itself once the underlying economic sociology is understood.

theory of endogenous money, has served by now to render these assumptions more understandable. In my own case (Smithin 2013, 2018, 2022) I have consistently argued that the real rate of interest on money is determined essentially in the financial/monetary sector *via* a combination of monetary policy, the setting of the real policy rate of interest (the nominal policy rate less the currently observed inflation rate) - and various other factors, such as changes in liquidity preference in financial markets. It cannot, therefore, be treated as a 'real' phenomenon in the simple-minded economist's sense of depending on the putatively 'real economy' and the ubiquitous notions of 'productivity and thrift' (Humphrey 1983, 23).[56] Actually, it works the other way around. The real economy of output, employment, and so on, adjusts to the 'real' (as opposed to nominal) interest rate determined in *financial* markets. So, a more plausible interpretation than was available *circa* 1950 is that the analysis describes the effect of changes in autonomous spending *with the level of real interest rates determined elsewhere*. Under endogenous money neither the loanable funds theory nor IS/LM has any relevance.

Returning to the exposition, and using the equilibrium condition $I = S$, the equilibrium solution for the level of output, or national income, Y, is given by:

$$Y = [1/(1 - c)](C_0 + I) \tag{5}$$

We can therefore work out two so-called 'multipliers' (essentially two comparative static derivatives) both of which will have the same numerical value:

$$\Delta Y/\Delta I = [1/(1 - c)] \tag{6}$$

$$\Delta Y/\Delta C_0 = [1/(1 - c)]. \tag{7}$$

---

[56] Again, notice the awkwardness of the multiple senses of the term 'real' in economics, philosophy, and everyday life, as already pointed out in *fn.* 12 above. I think that a locution coined by my late colleague, Professor Meyer Burstein (1995, 1), can goes a long way toward sorting out this particular confusion. According to Burstein:

... a principal discriminant between 'classical' and Keynesian economics pivots on whether real rates of interest have monetary or real causes ...

The 'real rate of interest' is simply the inflation adjusted rate of interest, whereas a 'real cause' would be one originating in the so-called 'real' economy - which in principle (supposedly) is just a question of barter exchange. As mentioned in the text, however, because money itself is, in fact, a real (in the sense of binding) social relation there should be no difficulty understanding why, on the contrary, the inflation-adjusted real rate of interest can have a 'monetary' cause. Moreover, that it is the 'real' economy that has to adjust to the 'real' rate of interest rather than the other way round. Indeed, it seems to me that this idea was the main point of the difficult chapter 12 of the *General Theory* about the marginal efficiency of capital (MEC) - to be further discussed below.

Equation (6), for example, states that if the level of real investment spending, in a particular time period such as a quarter or a year, increases by a given amount of constant dollars, the GDP in that period will increase by a multiple of [1/(1 - *c*)] constant dollars. So, if the value of the MPC is $c = 0.8$, then, for a $1,000,000 constant dollar increase in investment spending the level of GDP will increase by $5,000,000 constant dollars (Keynes 1936, 115). For the purposes of the present paper, however, it is important also to realize that an increase in the level of autonomous *consumer* spending of $1,000,000 constant dollars will have exactly the same effect. At Hicks's time of writing, and ever since, most of the attention was focused on the 'investment multiplier', which (naturally?) leads on to the various *connundra* about reconciling stocks and flow, how to relate (real) money values/magnitudes to putatively 'physical' items, and so on. The category of investment was thought to be a special case in that respect. If we look into the matter a bit more closely, however, it is clear that it does not really matter on what the money is spent consumption or investment. The multiplier effect is exactly the same. This is an argument that goes all the way back to Mandeville's *Fable of the Bees* in the 18th century (Mandeville 1723), to which Keynes (1936, 359-62) made explicit reference. It was also the point of Keynes's (1936, 128-31) earlier famous passage about burying 'banknotes in bottles' and then digging them up again to stimulate economic activity. But economists seem always to shrug off this aspect of Keynes's argument. It goes against the grain of their way of thinking is some fundamental way.[57]

There has always been some unease in the literature about reducing the heuristic notion of the multiplier to a simple matter of comparative statics. The original article on the multiplier by Keynes's younger colleague Kahn (1931), for example, had seemed to stress a multiplier *process*. This argument was along the lines that one 'round' of spending in a first period would lead to a second 'round' of spending in the next, and so on. It seemed awkward, therefore, to reduce the discussion to a question merely of comparative statics. Nonetheless, on the key issue of whether investment causes savings or savings causes investment, the message seems clear. An increase in investment, I, leads to an increase in income, Y, and then savings increases to match, *via* the savings function $S = - C_0 + (1 - c)Y$. Savings is an endogenous variable that depends on income. It is neither the cause, nor the precondition, of investment.

And, from the beginning another perceived problem with type of analysis, at least as it was presented in textbooks such as that by Samuelson (1948), was this all seems to relate only to the various sums of money (albeit now 'real' money balances, in the

---

[57] It seems that Keynes (1936, 129) himself did not always have the courage of his own convictions. On the topic of his 'banknotes in bottles' proposal he correctly remarks … there need be no more unemployment and … the real income of the community … and its capital wealth … would probably become greater …'. But then he goes on … 'It would indeed be more sensible to build more houses and the like … but … [this] … would be better than nothing.' However, why 'more sensible'? If income and wealth are a 'good deal greater' (Keynes's own words) that is surely going to increase the demand for, and eventual supply of, housing in any event?

index number sense) that are going to be laid down. These sums seem only to represent the 'demand side' as it were. What about the 'supply side'? Where does the actual physical stuff or specific services, corresponding to the sums of money, come from? The short answer is obviously *production* and, to be fair, Keynes (1933, 408) did go out of his way to label his argument a 'monetary theory of production'. However, this important point never really got the amount of attention it deserved. It got lost in the secondary literature, particularly when the ideas were rendered in static sets of equations such as those above. This sort of consideration is what led up to the notion of the 'production function' in macroeconomics, an attempt to add at least some sort of minimal description of the production process. These efforts, however, seem only to have further confused the economist's understanding of the underlying investment/savings nexus.

3.2 *The Troublesome Notion of the* (*Macroeconomic*) *Production Function*

In the *General Theory* Keynes (1936, 41) was explicit that:

In dealing with the theory of employment I propose ... to ... use ... only two fundamental units of quantity ... quantities of money-value and quantities of employment.

Moreover, in my own work, and in keeping with the previous discussion about the meaning of the terms real and nominal, I have argued that to be strictly accurate Keynes's notion of 'money-value' should be modified to '*real* money-value', that is, a sum of money deflated by an appropriate price index (Smithin 2018, 12-3). What is going on (to continue in the modern idiom) is that the level of real GDP is related to the level of employment, somehow measured. This is a verbal description of the construct that later came to be called a production function.

On this same subject, it also seems clear that Keynes was content to follow the lead of his teacher Alfred Marshall (1890), in adopting an essentially marginalist theory to explain the relationship between real wages and employment. *Cf.* the following quote (Keynes 1936, 17-18):

In a given state of organization, equipment and technique, the real wage earned by a unit of labour has a unique (*inverse) correlation with the volume of employment ... This is simply the obverse of the familiar proposition that industry is normally .. subject to decreasing returns in the short-period ... so that the marginal product in the wage goods industries* (*which the governs real wage*) *necessarily diminishes as employment is increased.*

Continuing to use the symbol Y for the modern concept of real GDP, and N for the level of employment, this implies a macroeconomic production function as follows:

$$Y = F(N). \qquad F'(N) > 0,\ F''(N) < 0 \tag{8}$$

The first derivative, which is the marginal product of labour or employment (MPN), is positive, while the second is negative, implying diminishing marginal productivity.

However, as explained elsewhere (Smithin 2018, 36-7), in my view questions of the specific functional form, and marginalism itself, are of decidedly secondary importance. For the purposes of a theory of employment, all that really matters is that the level of real GDP is taken to be related to (some measure of) labour input itself. For example, taking a cue from some of the American Post Keynesian economists, such as Weintraub (1959, 1961), Davidson & Smolensky (1961) and Davidson (2011) the simplest, most convenient, specification might be along the lines of:

$$Y = AN. \qquad A > 0 \tag{9}$$

Here the symbol '*A*' stands for the 'average product of employment (APN). I do not agree, however, with Keynes's statement (quoted above) that this sort of specification restricts attention only to the Marshallian short-period. On the contrary, if we assume as a first approximation that the *A* term is a constant, the specification 'automatically' generates an implicit growth theory. In effect, we assume that a just sufficient amount of 'investment' in machinery, managerial technique, technical knowledge, raw materials, *etc.*, is always going on. Such things may not, and may never be, genuinely quantifiable, but the '*A*' coefficient itself *is*.[58] In reality, the macroeconomic productivity of labour, as so defined, clearly does change over time. But again in empirical work there should really should be no difficulty in further investigating statistically what its main determinants are, and thereby relate the theory to the evidence. There is, for example, evidence that the *level* of labour productivity, measured by the ratio of real GDP to the number of persons employed as defined in the national income statistics, is positively related to the *rate* of real GDP growth (Atesoglu & Smithin, 2006, Collis 2018, Smithin 2022). This sort of specification, technically a 'mixed equation',[59] can thus easily be incorporated for later use in more detailed empirical and policy exercises.

As Keynes (1936, 41) had already said of his two fundamental measures:

The first of ... [*of these two magnitudes*] *... is homogenous, and the second can be made so.*

---

[58] This procedure, could not, of course derive a marginal productivity theory of the distribution of individual incomes, but such a theory is of little theoretical (or practical) interest in the real world. It is (or was) mainly of interest only to the practitioners of mathematical *microeconomic* theory in the universities. See Smithin (2023) for an alternative explanation of income distribution which I would argue is superior from the point of view of 'ethics'.

[59] For further discussion of the idea of a mixed equation (*i.e.*, one involving both levels and growth rates) see Grainger (1999) and Smithin (2022, 203-4).

Although it may not be possible thereby to assign individual estimates of the productivity of 'person hours' the result at the macroeconomic level is a definite quantifiable number. No doubt the definition of 'persons employed' will be based on arbitrary statistical conventions (how many hours worked in the week, or weeks in the year, *etc*.). Nonetheless, there is a definite numerical relation or association between that number, whatever it is, and the volume of real GDP produced. It does not really matter, that is to say, whether any given individual puts in maximum skill and effort, or slacks off entirely. *They all have to be paid*, and for economic system to be viable it will still have to generate sufficient (real) GDP to pay for all those real wages and still leave enough room for profit.

On the other hand, in *A Contribution*, Hicks (1950, 6-10) was clear that he wanted to move away from this sort of theoretical device, such as found historically in the work of both Keynes and Marx. Expressing a debt to the work of the Oxford economist R.H. Harrod (1939, 1948), cited above, Hicks was careful to state that:

[*One of*] *... the points I take from Mr. Harrod is his contention that the study of an expanding ...* [*i.e., growing*] *... economy proceeds much more conveniently in the form of a theory of output rather than a theory of employment ... A theory of the other type can be, and should be, a theory of employment; but it cannot be built around ...* [*that*] *... in the way Keynes's was.*

In practice, instead of using a production function in the form of $Y = F(N)$ or $Y = AN$ Harrod had actually used a version of what (half-a-century later) came to be called the '*AK*' production function (Rebelo 1991, Jones 1998):[60]

$$Y = AK. \qquad A > 0 \tag{10}$$

This brings back the dubious notion of capital. The A term now stands for the average product of 'capital' rather than labour, and K is supposed to stand for (some measure of) the capital stock. In my view this is *precisely* the point at which macroeconomic theory goes wrong. Unlike in equation (9) no coherent meaning can be given to the expression in (10). Once again, the problem is to be found in switching arbitrarily between a 'physical' notion of capital (some kind of agglomeration of machines, factories, raw materials, *etc.*) and the (real) money value of capital assets. There can be no bridging of this gap. If we try to think about how the various items of physical plant and equipment each contribute to production it is obvious there can be no aggregative measure of these different and incommensurable components. Moreover, on the other hand, the alternative measure, the real money value of the total capital stock is itself an endogenous variable. There is continuous re-valuation of this magnitude in response to all sorts of economic influences, such as expectations of future receipts, changes in

[60] The remarkable longevity of this construct was due to the problems encountered by the so-called 'new growth theory' of Romer (1986) and Lucas (1988) in providing a plausible explanation of long-term growth. From the point of view of those interested in this approach the older formulation eventually 'did the trick' and was revived in the 1990s.

interest rates, stock market fluctuations, changes in the level of real GDP itself, *etc.* In empirical work one would be required to regress a sum of real money values from the national account on a another sum of real money values that, in turn, are constantly changing based on momentary valuations of the stock of assets at any given time. This makes no sense, and has no relation to any physical/engineering idea of production. It is an entirely circular form of reasoning, which nonetheless (astonishingly to my mind) has usually passed without comment in much of the economics and econometrics literature. It is one of the main reasons why, from the mid-twentieth century to date, that literature has contributed so very little of lasting value. The 'philosophical mistake' that is being made here is an almost complete lack of attention to, or consideration of, the ontology of *capital*.[61]

In the textbooks, as is well-known to every unfortunate student of mainstream macroeconomics, these sorts of ideas about capital are often crystalized in the so-called 'neoclassical' production function:

$$Y = F(K, N). \qquad F'(K) > 0, F'(N) > 0, F''(K) < 0, F''(N) < 0 \tag{110}$$

This combines a diminishing MPN with a diminishing marginal product of capital (MPK).

It should have been obvious, however, that if the *AK* production does not 'work', this type of formulation cannot work either. There is a quote from Joan Robinson in the 1950s, and as previously cited by (Smithin 2018, 10) following Cohen & Harcourt (2003), which is prescient:

... the production function has been a powerful instrument of mis-education. The student of economic theory is taught to write Y = f(K, N) where N is a quantity of labour, K a quantity of capital and Y a rate of output of commodities.[62] *He is instructed to assume all workers alike, and to measure N in man-hours of labour; he is told something about the index-number problem in choosing a unit of output; and then he is hurried on to the next question, in the hope that he will forget to ask in what units K is measured. Before he ever does ask, he has become a professor, and so sloppy habits of thought are handed on from one generation to the next.*

This is the same point we have been making above.

Notoriously also the neoclassical production function has also been used to derive a complete marginal productivity of income distribution which, regardless of its continuing popularity in academia, should have been dismissed as untenable from the start. Keynes (1936), despite his seeming acceptance of the marginalist theory on the

---

[61] I take this notion of 'philosophical mistakes' from the title of a book by Mortimer J. Adler (1985) *Ten Philosophical Mistakes: Basic Errors in Modern Thought – How They Came About, Their Consequences and How to Avoid Them.*

[62] The original notation has been changed to conform with the usage in the present paper.

side of labour had this to say (in chapter 11 of the *GT*) about the complete theory.[63] Commenting on a passage from Marshall's *Principles of Economics* (1890)[64] he writes:

It is evident … that Marshall was well aware that we are involved in a circular reasoning if we try to determine along these lines what the rate of interest actually is.

In my own work, I have therefore thought it necessary to derive an alternative theory of income distribution - albeit one that is ultimately based on some other ideas of Keynes (1923) - this time from *A Tract on Monetary Reform*. Instead of a simple two-way split between the return to capital (whatever that is supposed to be) and labour, the focus is on three groups of identifiable economic *actors*, entrepreneurs, rentiers (Keynes's 'investing class' who depend on interest income), and workers. As already mentioned above, this theory is set out in Smithin (2023)[65] in a paper 'The ethics of income distribution', which is one of the companion pieces to this article.

3.3 '*Growth' Models: Harrod-Domar & Solow*

In this section we turn to a discussion of the Harrod-Domar growth formula itself and then also to the later (so-called) growth model of Solow (1956). Parallel to the simple formulation of the basic Keynesian system in (1) to (4) the Harrod-Domar growth formula can be derived by using (4) once again together with equations (12) to (14) that follow:

(12) $O = K/Y$ $(= 1/A)$

(13) $I = K_{+1} - K$

(14) $S = sY.$

Equation (12) is the definition of the capital/output ratio, and (13) is the definition of investment now conceived of as somehow being couched in 'physical' terms rather than money values. The future capital stock, K_{+1}, (the entry that will appear in the production function in a future period) differs from the existing capital stock, K, by precisely the supposed amount of investment in plant and equipment. Equation (13) is a proportional savings function (rather than the previous linear specification with an

[63] This particular chapter of the *GT* on the 'marginal efficiency of capital' (MEC) is not very easy to follow, and still less so were the textbook expositions of the *MEC* that appeared during the 1950s and 1960s. Nonetheless, it is apparent that Keynes is here grappling with the exactly the same sort of issues that are the subject of this section. Torrey Byles (2023, 31), in this *Journal*, argues that the MEC should rather have been called the 'marginal efficiency of money' (MTM).

[64] Keynes actually made reference to the 6th edition of 1910.

[65] Exactly one hundred years after the *Tract*!

intercept). Also note that as $s = 1 - c$ and $C_0 = 0$ we may alternatively write $C = (1 - s)Y$ or $C = cY$. Substituting (12), (13) and (14) into (4) will yield:

$$O(Y_{+1} - Y) = s/Y \tag{15}$$

And, as by definition the equilibrium growth rate is given by $y = (Y_{+1} - Y)/Y = (Y - Y_{-1})/Y_{-1}$ *... etc.,* what Harrod called the 'warranted' rate of growth, y_W, therefore turns out to be:

$$y_W = s/O \tag{17}$$

This, then, is the original version of 'Harrod-Domar' growth formula, which was supposed to take on a similar status in dynamic theory to that of the multiplier in statics.

But this warranted rate of growth is a very peculiar concept. It is 'warranted' in that it is a sort of benchmark for balanced growth, given the state of technology and the propensity to save. However, Harrod also apparently thought that it would be difficult to actually achieve balanced growth in practice. He made the additional argument that the system is highly unstable This is the famous 'knife-edge' in growth theory, as later described by Sen (1970, 15). The argument was that if the actual rate of growth turns out to be greater than the warranted rate, entrepreneurs will interpret this as requiring more capital investment, thus pushing the growth rate higher still. If the actual growth rate is less than the warranted rate, the entrepreneurs will mistakenly see this as requiring less capital investment, and the growth rate will fall still further.

One gets the impression that this argument was regarded at the time as contributing to, or enhancing, the Keynesian system in one sense or another - essentially by asserting re-asserting the 'inherent instability' of the capitalist system. In fact, it was quite a bit different from Keynes's actual argument in the *General Theory*. The latter was rather along the lines that the economy could settle into a state of permanent depression and 'underemployment equilibrium', which could relieved by an increase in effective demand. A bad situation, but one of stagnation rather than volatility. Moreover, Harrod's argument about instability also seemed to require that the entrepreneurs focus primarily on short-term expectations (rather the long-term expectations emphasized by Keynes), and that they always form those expectations in a rigidly mechanical way. (Thus prefiguring to some extent the later debate about 'adaptive expectations' *versus* 'rational expectations'). Sen (1970, 14) later summed up the issue of 'Harrodian instability', as this problem is dubbed by Lavoie (2014, 398), as follows:

Harrod's model of instability is undoubtedly incomplete, but ... there are many ... ways in which ... [*it*] *... can be completed. Some confirm instability while others either eliminate it or make it conditional on certain actual circumstances. In general it will be fair to say that Harrod's instability analysis overstresses a local problem near the equilibrium without carrying the story far enough, and extensions of his model with realistic assumptions about the other factors involved tend to soften the blow.*

The significance of this for our present purposes is that if the knife-edge argument does *not* hold up, that is, if it possible to add some plausible equilibrating mechanism to the discussion, it explains why the Harrod-Domar formula makes a 'giant step' *back* from Keynes to return to the familiar worlds of classical economics and capital theory. The implication would be that the expression for *actual* long term growth might then be simply written as:

(18) $y = s/O.$

In short, we are now saying once again that an increase in the average propensity to save will increase the long term growth rate (as does 'technical progress' in the sense of a lower capital/output ratio). Savings again drives investment. There is no paradox of thrift.

Moreover, the stated purpose of Solow's neoclassical growth model, which eventually replaced the Harrod-Domar approach in the mainstream literature in the 1950s and 1960s (and remains a staple of the textbooks to this day), was to continue the rehabilitation of traditional views. Strangely, this particular 'growth model' does *not* actually determine the rate of growth, but rather the equilibrium capital/labour ratio. The growth rate itself would be determined by exogenous factors such as population growth or the rate of spontaneous technological change. This awkwardness arises because the key move made by Solow was to make the *former* ratio an endogenous variable by bringing back the neoclassical production function as described in equation (11). This was the preferred method of introducing more flexibility to the choice of production techniques. If we assume that (11) has constant returns to scale, and then divide through by the level of employment, N, the production function can also be rewritten as:

(19) $Y/N = F(K/N, 1) \qquad F'(K/N) > 0, \; F''(K/N) < 0$

Everything is thereby expressed in relative terms. To avoid any potential confusion, it is then possible to change the functional form to:

(20) $Y/N = f(K/N). \qquad f'(K/N) > 0, \; f''(K/N) < 0$

The original paper by Solow also assumed a proportional savings function and a proportional depreciation rate of the (physical) capital stock. Therefore, if s is the average propensity to save, δ stands for the depreciation rate, and upper-case Δ means 'change in', we have:

(20) $I/N = \Delta(K/N) + \delta(K/N)$

(21) $S/N = sf(K/N)$

Given the 'investment equals investment' identity, the steady-state capital stock $(K/N)^*$, which will be reached when $\Delta(K/N) = 0$, can thus be inferred from the solution to the equation:

(22) $$sf(K/N)^* = \delta(K/N)^*$$

In the end, this says nothing about the growth rate. But, what it does do, as with the Harrod-Domar approach, and exactly twenty years after the *General Theory*, and ten years after Keynes's death, is to even more firmly place us back in a thoroughly 'classical' world. To increase the steady-state capital stock, and thereby presumably the standard of living, it is necessary for the society to 'save more', *i.e.,* increase the average propensity to save.

4. Sir John Hicks and the 'Super-Multiplier'

Hick's *A Contribution*, which followed Harrod and also the work of Frisch (1933), was similarly intended as a exercise in dynamic theory, but one which maintained contact with the Keynesian static multiplier approach. Hence the notion of the *super*-multiplier. By introducing the 'acceleration principle' (Hicks 1950, 04-6) it might be argued that the induced investment required for an increase in the capital stock actually increases the quantitative effect of the multiplier.

From the definitions of investment and the capital/output ratio above we can derive the explicit investment function that Hicks called the 'accelerator':

(23) $$I = O(Y_{+1} - Y)$$

And, given definition of the growth rate, this might also be written as:

(24) $$I = Oy_{+1}Y$$

Now, however (and simply as a technical matter of notation) note that by sticking with the proportional savings and consumption functions we haverun out of sources of 'autonomous spending' to serve as exogenous variables in the multiplier. We need, therefore, to introduce a new variable, X_T, to stand for 'total autonomous spending' (public and private). The GDP breakdown can then be rewritten:

(26) $$Y = C + I + X_T$$

And the new value of the static multiplier turns out to be:

(27) $$\Delta Y/\Delta X_T = 1/(1 - c - Oy_{+1})$$

We can call this a *super*-multiplier because for positive rates of growth its numerical value is greater that the static multipliers that were given in equations (6) and (7) above. From this point of view, the analysis may therefore seem only to reinforce the Keynesian message. But remember that Hicks was trying to move the whole argument

into the realm of growth theory, and it is this move that exposes the underlying contradictions. What (27) suggests is that, against the background of a given long-run growth rate, a one-time only increase in the level of autonomous spending will lead to a similar one-time upward blip in the level of GDP. After that, we must presume that economic growth proceeds at the same *rate* as before – starting from the new higher level. But, next suppose we consider the effect not of a one-time increase on the *level* of spending but rather, in keeping with the dynamic long-run context, of a permanent increase in the ratio of (say) government spending to GDP on the ongoing growth *rate* itself. Because of the underlying reversion to broadly classical notions of how the economy works the results will be totally different as will be shown in section 5 to follow. At the end of the day, in such a world spending of any kind is ultimately thought to be 'bad thing' and saving is 'good'. Therefore, when one thinks about a permanent increase in the *spending* ratio this is never going to work out well. Logically enough, given the basic premises, it leads to *lower* not to *higher* growth. Robertson's 'hunted hare' has indeed come back to the same place.

5. Alternative Approaches to Economic Growth

In this section we go on discuss in more detail what I now see as being the two main alternative approaches to the theory of economic growth. As mentioned in the introduction these are a '*Keynes-type*' theory, which validates the three important propositions - that investment drives saving, that fiscal expansion leads to growth, and that a trade surplus leads to growth – and on the other hand a '*Classics-type*' theory which suggests the opposite. It was always going to be a mistake, therefore, for Hicks and others to revert to a Classics-type depiction of the production process, or to try to mix the two.

To be fair, Keynes did try his best to make clear to his audience the break with the classical tradition. For example, on the very first page of the *GT* (1936, 3) he states:

The object … [*of the title of the book*] *… is to contrast the character of my arguments and conclusions with those of the classical theory of the subject … which dominates the economic thought … of this generation, as it has for a hundred years past.*

And in a footnote he goes on to elaborate:

The 'classical economists' was a name invented by Marx to cover Ricardo and Mill and their predecessors, that is to say for the founders of the theory which culminated in … Ricardian economics. I have become accustomed ... to include in 'the classical school' the followers of Ricardo, those … who adopted and perfected the theory … including … J.S. Mill, Marshall. Edgeworth and Prof. Pigou.

Keynes was also quite candid about what he was trying to achieve in a letter to George Bernard Shaw (Keynes 1935, 40), written on New Year's Day 1935, as the *GT* was in preparation:

… to understand my state of mind … you have to know that I believe myself to be writing a book on economic theory which will largely revolutionise - not, I suppose, at once but in the course of the next ten years - the way the world thinks about economic problems. When my new theory has been duly assimilated and mixed with politics and feelings and passions, I can't predict what the final upshot will be in its effects on action and affairs. But here will be a great change, and, in particular, ***the Ricardian foundations of Marxism will be knocked away*** *… I can't expect you, or anyone else, to believe this at the present stage. But for myself I don't merely hope what I say - in my own mind I'm quite sure.* (emphasis added).

However, for better or worse, it is quite clear that this effort to delineate the lines of battle ultimately failed. To take just one example, one of the most influential groups of 'Post Keynesian' economists in the later twentieth century, who based their ideas the work of Keynes's Cambridge colleague Piero Sraffa (1951, 1960), were quite happy to accept the label of the 'Neo-Ricardian' school,[66] thus explicitly canvassing a rehabilitation of classical economics. And, at the same time I think it is also fair to argue, as I have done myself (Smithin 2013a, 2013b), that Keynes's own work, for various reasons, may not have actually succeeded in decisively making the break.[67] Nonetheless, this does not change the fact the two approaches are fundamentally different and cannot ultimately be reconciled.

To illustrate the two generic growth equations, revert to the full definition of real value-added on a flow of funds basis, and bring back the government sector and the foreign sector:

$$Y = C + I + G + (EX - IM). \tag{28}$$

Here we are primarily interested not in the level but in the growth rate of real GDP, given by $y = (Y - Y_{-1})/Y_{-1}$. From this starting point, the Keynes-type growth equation can be derived by the straight-forward device of specifying a lagged consumption function - yet another idea originally due to Hicks (1949, 179). If T again stands for total tax collection, we could write:

$$C = C_0 + c(Y_{-1} - T_{-1}), \qquad 0 < c < 1 \tag{29}$$

where C_0 is the intercept term in the consumption function, and c is the marginal propensity to consume out of (lagged) disposable income.

---

[66] As for the 'Ricardian foundations of Marxism', it may be noted that before coming to Cambridge Sraffa was active in Marxist intellectual circles in Italy, and was an associate of Gramsci (Roncaglia 2000, Sen 2003).

[67] For example, I don't think it possible to agree with Keynes (1936, 378) that ' … if our central controls … [establish] … [a] … volume of output corresponding to full employment… the classical theory comes into its own again from that point onward'.

Next, define the total autonomous expenditure of the private sector, X_P,[68] as:

(30) $$X_P = C_0 + I.$$

Using equation (3.5) in (3.4), dividing through by the lagged level of real GDP, re-arranging, and noting that $c = 1 -$ s (where s is the marginal propensity to save),we obtain;

(31) $$Y/Y_{-1} - (Y/Y_{-1})[X_P/Y + G/Y + (EX - IM)/Y] = (1 - s)[1 - (T_{-1}/Y_{-1})].$$

The ratio T_{-1}/Y_{-1} is the average tax rate t, and let $g = G/Y$, $x_P = X_P/Y$, $ex - im = (EX - IM)/Y$. The ratios g, x_P and $ex - im$ are government spending, total autonomous private sector expenditure, and the trade surplus respectively, as percentages of GDP. Therefore:

(32) $$(1 + y)[1 - x_P - g - (ex - im)] = (1 - s)(1 - t).$$

Finally, taking natural logarithms, using approximations such as $ln(1 - s) = - s$, and re-arranging, we obtain the Keynes-type growth equation we have been looking for. This is:

(33) $$y = (x_P - s) + (g - t) + (ex - im).$$

In *Beyond Barter* (Smithin 2022, 63) I summed up these important results as follows:

... real GDP growth will occur when [1] *... there is a trade surplus as a percentage of GDP* (*hence the expression 'monetary mercantilism'*), [2] *... the total autonomous spending of the private sector as a percentage of GDP is greater than the marginal propensity to save,* [3] *... there is a primary budget deficit as a percentage of GDP.*

These are not just accounting identities but genuine causal relationships. The ultimate exogenous variables are the parameters of monetary and fiscal policy at home and abroad, productivity shocks, national and international liquidity preference, *etc.* Equation (33) does not mean that growth cannot possibly occur in the presence of a budget surplus, a trade deficit, or a high propensity to save. It does mean, however, that if there is to be growth, at least one of the above terms must be positive, and large enough to outweigh the other two. This statement evidently runs directly contrary to the advice often given to policy-makers. They are usually told to aim for trade balance and to pursue a 'sound' fiscal policy. Failure to grasp the basic difference between 'monetary analysis' and a 'real analysis', (Schumpeter 1954, 276-80) thus continues to be a major weakness in the contemporary understanding of economic problems.

---

[68] This differs from X_T (total) above in excluding the government spending variable, which now enters separately.

How does the causal growth equation, above, relate to the familiar 'injections equals withdrawals' version of the GDP identity? This is:

(34) $$I + G + EX = S + T + IM.$$

Dividing through by Y, and introducing new notation such that $inv = I/Y$ and $sa = S/Y$, this yields:

(35) $$0 = (inv - sa) + (g - t) + (ex - im).$$

Comparing this expression to the growth equation it is clear that they are indeed consistent with one another. The reason is that the terms *inv* and *sa* are not the same as x_P and s. The sectoral balances must always sum to zero but this is not so for the growth equation.

For the purposes of comparison with the Keynes-type approach we can also derive a generic version of the Classics-type theory by going back to the Harrod-Domar literature and Hicks's *A Contribution*. As explained, these arguments relied not only on the assumption that it is possible to quantify the capital stock, but also that all firm spending on 'investment' adds directly to this stock. (In other words, they presume that none of it misfires or is simply disguised consumption spending, such as redecorating the boardroom, or buying a corporate jet). We can use this definition of investment, with the accelerator investment function and a proportional saving function, to obtain:

(36) $$O(Y_{+1} - Y) = s(Y - T) + (T - G) + (IM - EX).$$

Then, divide through by Y which, in lower-case notation, gives:

(37) $$y = s(1 - t)/O + (t - g)/O + (im - ex)/O.$$

This is the 'Classics-type' growth equation. However, when written out in full - which is *not* usually done (perhaps never?) - it gives strange results. Equation (37) says not only that an increase in the savings propensity leads to growth, but also that a budget *surplus* and a trade *deficit* lead to the same result. The argument that savings are needed for growth is made on familiar grounds. As we have already been arguing this may not be accurate - but traditionally it had at least some superficial plausibility. On the other hand, no real rationale is ever given for the other two propositions. (The theory also states that tax cuts lead to growth - also true in the Keynes-type case, albeit for different reasons).

In reality, the conventional wisdom on economic policy does not actively argue for a trade deficit, nor for a budget surplus *per se*. It simply takes for granted that budget balance ($g = t$) is a 'good thing' in itself and that trade balance ($ex = im$) is also good. For instance, the standard argument for free trade is that both sides benefit from the supposed 'gains from trade' even when exports and imports are equal. What tends to happen, therefore, is that the final two terms on the right-hand side (RHS) of (37)

simply disappear from the discussion. What then emerges is nothing other than the so-called 'supply-side' argument for economic growth, which came to prominence in the public policy debates of the 1970s and 1980s. The following expression, in fact, corresponds to the supposed 'natural rate' of growth canvased by the supply-siders:

$$y = s(1 - t)/O. \tag{38}$$

They argued that the growth can only be improved by (a) more 'thrift' (as always), (b) productivity improvements, or (c) tax cuts to provide incentives. But, no argument was offered as to why the seemingly perverse logic of actual budget *surpluses* and trade *deficits* should not apply.

Comparing equations (33) and (37) exposes the underlying problems with the classical approach to thrift. The latter is a *reductio ad absurdum*. The underlying world-view is that saving is always good, that it is the only route to virtue, prudence, and prosperity. But is so, why not take this idea to its logical conclusion and save 100% of money income? Then there would be no spending at all - and no economy. Therefore, to firmly establish these views about how austerity leads to economic progress it should surely have been incumbent on the supply-siders, mainstream economists, Austrians *et al.* to come up with some sort of solution to the paradox? However, they have never properly done so. Simply eliminating the offending terms does not achieve this. It is certainly true that the policy recommendations implicit in this construct have often been all too influential in practice, but they are only arrived at by totally confusing the separate concepts of demand (which must be terms of money) and supply (of actual things). Hicks's concept of the super-multiplier, by giving different results in the static context than in dynamic (growth) theory, provides one very prominent example of what can go wrong.

7. Conclusion

One of the most unfortunate mistakes (in my opinion) that Keynes made in the *General Theory* (1936, vii) was to *not* 'stress technical monetary detail' as much as he has done in his earlier book *The Treatise on Money* (1930). In the introduction to the *General Theory* he admitted:

... whilst is it found that money enters the economic scheme in a peculiar manner, technical monetary detail falls into the background.

But, the lack of detailed attention to role of money as a social institution, to its specific role in production (as opposed to merely in trade on the model of barter exchange), and the role of credit creation in the generation of monetary profits, have all played large roles in the failure of the discipline macroeconomics to properly get off the ground. It was fatal to revert to traditional modes of thinking about the 'real economy' with emphasis on (what academics tend to think of as) the 'practical' issues of engineering, logistics, management, technical innovation, *etc*., - important as these

things undoubtedly are. This way of thinking is incapable of proving any useful insights into the social ontology and economic sociology of the system.

The item that is labelled 'investment' starts life as referring to a sum of money (real purchasing power) which can then be spent on a number of different things, including orders for machinery and suchlike. In this guise it does genuinely represent effective demand (the proper domain of macroeconomics) and specifically effective demand in terms of money. This by does not mean that we can think of demand side as being entirely disconnected from the physical and material. Social relations, although immaterial, are nonetheless equally 'real' and can, and do, have causal effects on the material world itself. Simply put, effective demand can, and does, stimulate the production of actual *things* to satisfy the demand. The most important issue is, rather, that production takes time. The 'things' do not exist as yet. They will do so in due course, but only after the production process has taken place. This is presumably why Keynes talked about a monetary theory of *production*.

What is surely not reasonable, however, is re-imagine the (essentially monetary) notion of savings such that somehow those goods which *do* currently exist, and were originally destined for consumption, can also be 'saved' (that is, not consumed), and converted without effort into investment goods. But this *is* essentially what is supposed to happen in orthodox theory. The intelligible notion of financial investment gets transformed into the 'things in themselves' (a pun on Kant, forgivable in the pages of a philosophy *Journal*?) even *before* any new production is stimulated. Instead of being a sum of money, the term *I* and S are thought of a collection of existing things with actual physical properties which are nonetheless interchangeable and can be directly added an existing stock of other physical things also with determinate properties, without any delay or difficulty. This is incoherent. We asked to imagine that the public physically saves by (*e.g.*) eating less food, and then a mathematical economist waves a magic wand to convert the unconsumed edibles into machinery. It is easy to make 'savings' precede 'investment' in the algebra, but the production process itself is thereby ignored. In the actual financial and economic world the logic is quite otherwise. 'Loans create deposits' not the other way around. The eventual production of the new machines (or whatever) is the outcome of the preceding financial process. The role of finance is to provide the money to stimulate the actual *production* of new things which do eventually satisfy the demand.

Hicks's attempt, more than 70 years ago, to reconcile dynamic economic theory and the static multiplier provides an instructive case study. On the other hand - by directly contrasting the 'Keynes-type' dynamic theory with the alternative generic 'Classics-type' theory - as set out above[69] - we are able to provide a consistent view on such questions as the paradox of thrift, monetary mercantilism, and the role of fiscal policy in generating effective demand.

Acknowledgements

[69] And previously in such sources as Smithin (2013, 2018, 2022).

I would like particularly to thank Niko Block for comments on, and several helpful discussions of, the topics discussed in this paper.

References

Adler, M.J. 1985. *Ten Philosophical Mistakes: Basic Errors in Modern Thought – How They Came About, Their Consequences and How to Avoid Them*. New York: Macmillan Publishing Company.

Atesoglu H.S. & J. Smithin. 2006. Real wages, productivity, and economic growth in the G7, 1960-2002. *Review of Political Economy* 18: 1-11.

Bell, S. 2001. The role of the state and the hierarchy of money, *Cambridge Journal of Economics*. (As reprinted in *Concepts of Money: Interdisciplinary Perspectives from Economics, Sociology, and Political Scienc*e, ed. G. Ingham, 496-510, Cheltenham: Edward Elgar, 2005.)

Burstein, M.L 1995. *Classical Macroeconomics for the Next Century*, manuscript, York University, Toronto.

Byles, T. 2023. The ontology of money: where neoclassical economics went wrong, *Aurora Philosophy Journal* 2(1): 21-38.

Domar, E. 1946. Capital expansion, rate of growth, and employment. *Econometrica* 14: 137-147.

Cohen A. & G.C. Harcourt. 2003. Whatever happened to the Cambridge capital controversies? *Journal of Economic Perspectives* 17: 199-214.

Collins, R. 1986. *Weberian Sociological Theory*. London: Routledge.

Collis, R. 2018. *Three Essays on Monetary Macroeconomics: An Examination of the Soundness of the Alternative Monetary Model and Monetary Policy in Canada.* PhD thesis in Economics, York University, Toronto.

Davidson, P. 2011. *Post Keynesian Macroeconomic Theory, Second Edition*: *A Foundation for Successful Economic Policies for the Twenty-First Century*. Cheltenham: Edward Elgar.

Davidson, P. & E. Smolensky. 1964. *Aggregate Demand and Supply Analysis*. New York: Harper & Row.

Fletcher G. 2000. *Understanding Dennis Robertson: The Man and his Work.* Cheltenham: Edward Elgar.

Frisch, R. 1933. Propagation problems and impulse problems in dynamic economics. In *Economic Essays in Honour of Gustav Cassel* (As reprinted by Frank Cass & Co, 171-206, London, 1967).

Godley, W. & M. Lavoie. 2007. *Monetary Economics: An Integrated Approach to Credit Money, Income, Production and Wealth.* London: Palgrave MacMillan.

Grainger, C. 1999. *Empirical Modelling in Economics: Specification and Evaluation*. Cambridge, Cambridge University Press.

Harrod. R.F. 1939. An essay in dynamic theory. *Economic Journal* 49: 14-33.

Harrod, R.F. 1948. *Toward a Dynamic Economics*: *Some Recent Developments of Economic Theory and their Application to Policy*. London: Macmillan.

Hicks, J.R. 1937. Mr. Keynes and the Classics. *Econometrica.* (As reprinted in *Money, Interest & Wages: Collected Essays on Economic Theory, Volume II,* 100-15, Oxford, Basil Blackwell, 1982).

Hicks, J.R. 1949. Harrod's dynamic theory. *Economica*. (As reprinted in *Money, Interest & Wages: Collected Essays on Economic Theory, Volume II,* 173-92, Oxford, Basil Blackwell, 1982).

Hicks, J.R. 1950. *A Contribution to the Theory of the Trade Cycle*. Oxford: Clarendon Press.

Hicks, J.R. 1985. *Methods of Economic Dynamics*. Oxford: Oxford University Press.

Humphrey. T.M. 1983. Can the central bank peg real interest rates? *Federal Reserve Bank of Richmond Economic Review*. (As reprinted in *Money, Banking and Inflation: Essays in the History of Economic Thought,* 35- 43, Cheltenham, Edward Elgar, 1983.)

Ingham, G. 1996. Money is a social relation. *Review of Social Economy* 54: 243-75.

Ingham, G. 2000. 'Babylonian madness': on the historical and sociological origins of money. In *What is Money?* ed. J. Smithin, 16–41, London: Routledge.

Ingham, G. 2004. *The Nature of Money.* Cambridge: Polity Press.

Jones, C.I. 1998. *Introduction to Economic Growth*. New York: W.W. Norton and Company.

Kalecki, M. 1967. *Studies in the Theory of Business Cycles. 1933-39*. Oxford: Basil Blackwell.

Kalecki, M. 1971. *Selected Essays on the Dynamics of a Capitalist Economy 1933-1970*, Cambridge: Cambridge University Press.

Keynes, J.M. 1923. *A Tract on Monetary Reform*. London Macmillan.

----------. 1930. *A Treatise on Money*, vol. 1. (As reprinted in *Collected Writings* V, ed. D. Moggridge, London: Macmillan, 1971.)

----------. 1933a. The distinction between a co-operative economy and an entrepreneur economy. (As reprinted in *Collected Writings* XX1X, ed. D. Moggridge, 76-87, London: Macmillan, 1979.)

----------. 1933b. A monetary theory of production. (As reprinted in *Collected Writings* XX1, ed. D. Moggridge, 408-11, London: Macmillan, 1973.)

----------. 1935. Keynes-Shaw correspondence. (As reprinted in *Collected Writings* XXVIII, ed. D. Moggridge, London: Macmillan, 1982.)

----------. 1936. *The General Theory of Employment Interest and Money*. (As reprinted by Harcourt Brace: London, 1964.)

Lavoie, M. 1992. *Foundations of Post Keynesian Economic Analysis*. Cheltenham: Edward Elgar.

Lavoie, M. 2014. *Post Keynesian Economics: New Foundations*. Cheltenham: Edward Elgar.

Lucas, R.E. 1988. On the mechanics of economic development. *Journal of Monetary Economics* 22: 3-42.

Mandeville, B. 1723. *The Fable of the Bees: Or Private Vices Publick Benefits.* (As reprinted by Liberty Classics, Indianapolis, 1988.)

Mankiw, N.G. 1992. *Macroeconomics*. New York: Worth Publishers.

Marshall, A. 1890. *Principles of Economics*. London: Macmillan.

Rebelo, S. 1991. Long-run policy analysis and long-run growth. *Journal of Political Economy* 99: 500-21.

Robertson, D.H. 1934. Industrial fluctuation and the natural rate of interest. *Economic Journal*. (As reprinted in *Essays in Monetary Theory,* 83-91, P.S. King, London, 1940).

Romer, P. 1986. Increasing returns and long-run growth. *Journal of Political Economy* 94: 1002-37.
Roncaglia, A. 2000. *Piero Sraffa: His Life, Thought and Cultural Heritage*. London: Routledge.
Samuelson, P.A. 1948. *Economics: An Introductory Analysis.* (As reprinted by McGraw-Hill, New York, 1997).
Schumpeter, J.A. 1954. *History of Economic Analysis*. (As reprinted by Routledge, London & New York, 1994.)
Sen, A. 1970. Introduction. In *Growth Economics,* ed. A. Sen, 9-40, Harmondsworth, Penguin.
Sen, A. 2003. Sraffa, Wittgenstein, and Gramsci. Journal of Economic Literature 41: 1240-55.
Serrano. 1995. *The Sraffrian Multiplier.* PhD thesis in Economics, University of Cambridge.
Smithin J. 2013a. *Essays in the Fundamental Theory of Monetary Economics and Macroeconomics.* Singapore: World Scientific Publishing.
Smithin. J. 2013b. Keynes's theories of money and banking in the *Treatise* and *General Theory*. *Review of Keynesian Economics* 1: 242-56.
Smithin, J. 2014. Economic growth: free trade, public finance, and the paradox of thrift. *Review of Keynesian Economics* 4: 456-63.
Smithin, J. 2018. *Rethinking the Theory of Money, Credit and Macroeconomics: A New Statement for the Twenty-First Century*. Lanham MD: Lexington Books.
Smithin, J. 2022. *Beyond Barter: Lectures in Monetary Economics after 'Rethinking'*. Singapore: World Scientific Publishing.
Smithin, J. 2023. The ethics of income distribution., *Aurora Philosophy Journal* 2(1): 95-110.
Solow, R.M. 1956. A contribution to the theory of economic growth. (As reprinted in *Growth Economics,* ed. A. Sen, 161-92, Harmondsworth, Penguin, 1970).
Sraffa, P. 1951. Introduction. In *The Works and Correspondence of David Ricardo*. ed. P. Sraffa xii-xxvi, Cambridge: Cambridge University Press
Sraffra, P. 1960. *Production of Commodities by Means of Commodities*: Cambridge: Cambridge University Press.
Weintraub, S. 1959. *A General Theory of the Price Level, Output, Income Distribution and Economic Growth*, Philadelphia: Chilton.
Weintraub, S. 1961. *Classical Keynesianism, Monetary Theory, and the Price Level*, Philadelphia: Chilton.
Zelmanowitz, L. 2016. *The Ontology and Functions of Money: The Philosophical Foundations of Monetary Institutions.* Lanham, MD: Lexington Books.
Zelmanowitz L. 2020. *The Representational Theory of Capital – Property Rights and The Reification of Capital* Lanham, MD: Lexington Books.

Aurora Philosophy Journal, Vol. 2, No. 1, pp. 95-110

Monetary Policy and the Ethics of Income Distribution

John Smithin
Aurora Philosophy Institute & York University

1. Introduction

This paper is about the ethics of income distribution. What constitutes a fair or ethical distribution of income, and how might monetary policy (which typically means setting or influencing the interest rate that commercial banks pay on loans of central bank base money in the overnight market[70]) contribute to this? It seems self-evident that the level of interest rates, in general, has a direct impact on the distribution of income, and that the level of the 'policy rate of interest', in turn, has a direct impact on other rates, even though this is invariably glossed over in the economics textbooks, and in most discussions of inflation.

In the fairly recent past I have begun to argue (Smithin 2020, 2021, 2022) that the 'near-optimal' setting of the *real* policy rate of interest (in a regime with a flexible exchange rate, or with a 'fixed-but-adjustable' exchange rate) is actually *zero*. What I mean by the 'real' policy rate is the nominal policy rate (the actual percentage rate quoted) *less* the currently observed rate of inflation. This 'zero real policy rate' (ZRPR) will achieve as close an approximation as is possible to a fair distribution of income, in a particular sense. The sense in which a ZPRP is 'fair' is that the so-called 'rentiers' (those whose incomes arise solely from interest payments on existing wealth) do not share in the income generated by current productive activity. Nonetheless, the real value of existing financial capital is preserved. Such a policy also has the virtues of transparency and simplicity. In my view, it will also promote financial stability, inflation stability, higher growth, full employment, higher real wages, *etc., etc*. In short, it would be a good thing from many points of view. The concept of 'fairness' invoked here is similar to, but not identical with, that attributed by Lavoie and Seccareccia (2016) to Pasinetti (1981).[71] A ZRPR is less generous to the recipients of interest income) than was Pasinetti, but far more so than was Keynes (1936, 376) who quite literally advocated the 'euthanasia of the rentier', meaning that the nominal rate of interest rate on money, as such, should itself be zero.

How would a ZRPR be implemented in practice? When I googled the 'Bank of Canada' on the current date (in early June 2023) the first page of the website informed

---

[70] In Canada this interest rate used to be called simply the 'overnight rate', now on the Bank of Canada's website it is literally called the policy rate. The equivalent in the USA is the so-called 'federal funds rate'.

[71] On the definition provided by Lavoie & Seccareccia (2016) Passinetti's 'fair' rate of interest would have '… the nominal rate of interest … equal to the growth of labour productivity less the rate of inflation'.

us that the 'policy interest rate' is 4.5% and that 'total CPI inflation' is 4.4%. According to the ZRPR rule, therefore, at the next meeting of the open market committee the policy rate should have been *cut* to 4.4%.[72] Simple as that. And, if everybody knows this rule, there would be no surprises and no uncertainty.

People may well quibble about whether or not the CPI (consumer price index) is the best measure of inflation for this purpose, and there might be a case, for example, for choosing an index with a more comprehensive coverage of the various components of GDP (gross domestic product). As a practical matter I doubt that this is a particularly important issue. The choice of index has a significant performative role as long as a choice *is* made, and the authorities stick to it. That is the main thing.

2. Comparison of the ZRPR with the Zero Interest Rate Policy (ZIRP)

A ZRPR is a different thing than the 'zero interest rate policy' (ZIRP), which is the monetary policy favored by the advocates of 'modern money theory' (MMT), a group of heterodox economists prominent in the policy debate in the USA. As with Keynes, their view is that the nominal policy rate of the central bank should be zero. Both a ZRPR and a ZIRP are examples of what Rochon and Setterfield (2012) have called a 'park it' approach to interest rates, as opposed to an activist monetary policy. The difference, quite clearly, is simply whether it is the real, or the nominal, policy rate that is supposed to be set at zero. On this topic, see also the discussion by Watts & Pantelopoulos (2022).

I would say that there are two main reasons for preferring a ZRPR to ZIRP. This first is that a nominal interest rate peg at any level - not just zero - leads to instability in the inflation rate (which can go in either direction), whereas a ZRPR is conducive to inflation stability. The stability issue is also related to the question of income distribution - but, over and above that and most importantly, the contrast has very unfortunate implications for efficacy of the monetary policies that are currently pursued by real world central banks. They do, in fact, typically engage in a nominal interest rate peg (not necessarily at zero) eight times a year, between open market committee meetings. To that extent, therefore, they are wittingly or unwittingly contribution to instability. We should also note that inflation stability is not synonymous with 'low' inflation (it might be stable a high level). Nonetheless, a stable inflation rate whether high or low is also a good thing as, at least, it will be predictable. Low inflation *per se* is beyond the scope of the central bank alone, at least without doing serious damage to the real economy. This, unfortunately is something that real world policy-makers, given their obsession with 'inflation targets', have never seemed to be able to appreciate. If low inflation really is desired (why?) then other types of policy must be pursued. There must be policy co-ordination with fiscal policy,and other types of financial policy.

---

[72] In the event, though, the B of C actually increased the policy rate when the time came! For more details see fn. 4 below.

More directly related to our present concerns is the fact that a ZRPR also promotes the putatively fair distribution of income, whereas a ZIRP is incapable of achieving this result. That is the main focus of the current discussion.

3. Real *versus* Nominal Interest Rates & Inflation

Let i stand, in general, for a nominal interest rate, and p for the currently observed inflation rate. Thus, the *expected* real interest rate, r^e, one period forward, which plays a prominent role in neoclassical economic theory, is given by:

$$r^e = i - p_{+1.} \tag{1}$$

For the purposes of discussing income distribution, however, we are primarily concerned with what is called the *ex-post* or 'inflation-adjusted' real rate, r:

$$r = i - p. \tag{2}$$

As for the rate of inflation itself, elsewhere (Smithin 2022, 74-7) I have shown that in equilibrium this will be given by:

$$p = p_0 + w - a. \tag{3}$$

Where p_0 is an inverse measure of the state of Keynesian 'liquidity preference' (LP), w is the natural logarithm of the gross average (economy-wide) real wage rate, and a is the natural logarithm of average (economy-wide) labour productivity.

4. Interest Rate Relationships

Let the term m_0 stand the mark-up between commercial bank deposit and lending rates, m_1 for the pass-through coefficient between the central bank policy rate and the prime lending rate of the commercial banks, and i_0 for the nominal policy rate of interest. As explained by Kam & Smithin (2012) and Smithin (2022, 77-8), the monetary policy transmissions mechanism may therefore be represented as:

$$i = m_0 + m_1 i_0. \qquad m_0 > 0,\ 0 < m_1 < 1 \tag{4}$$

We can then use the simple device of subtracting the observed inflation rate, p, from both sides of the expression. This will give:

$$i - p = m_0 + m_1 i_0 - p. \tag{5}$$

Thus, if r_0 stands for the real (inflation-adjusted) policy rate of interest the relationship between the real rate of interest and the inflation rate is given by:

(6) $$r = m_0 + m_1 r_0 - (1 - m_1)p.$$

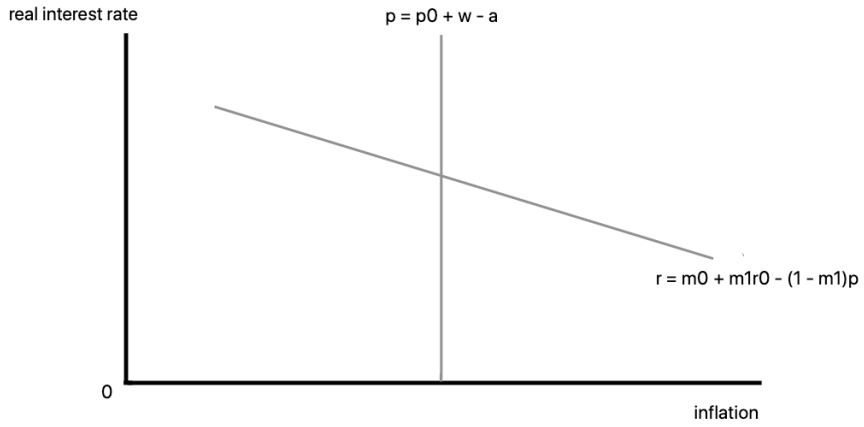
In the past equation (6) has been known as either the 'Mundell-Tobin effect' or the 'forced saving effect', and for our purposes the most important thing to notice about it is that it implies a negative relationship between the inflation rate and the real rate of interest. This is actually a fundamental relationship in monetary theory and was (sometimes) important in the history of economic thought. However, it is almost totally neglected in contemporary mainstream economics.

From equations (3) and (6) we can put together a simple formal model jointly explaining the equilibrium determination of the real interest rate as well as the inflation rate. This gives the solution for the real rate of interest as follows:

(7) $$r = m_0 + m_1 r_0 - (1 - m_1)(p_0 + w - a).$$

The real rate of interest depends positively on the real policy rate of interest, positively on liquidity preference (negatively on the inverse measure of LP), negatively on the real wage rate, and positively on labour productivity.

Figure 1: *An Equilibrium Theory of the Real Rate of Interest and Inflation*



The equilibrium can also be depicted in graphical form as in **Figure 1**. As suggested, if the central bank is behaving sensibly, it will be trying to stabilize the real policy rate at some given level, preferably zero. However, if the central bank neglects this advice (which it usually does)[73] and either makes a deliberate change in the real policy rate or

[73] As already mentioned above, in early June 2023, I wrote a piece for the *Monetary Policy Blog*, edited by Professor Louis-Phillipe Rochon. In it, I suggested that that the

passively allows such a change to happen, these 'policy errors', as I think it is fair to call them, will be reflected in changes in real interest rates generally.

5. The Functional Distribution of Income

If the symbol k stands for the natural logarithm of the average economy-wide entrepreneurial mark-up factor, then a basic equation for the functional distribution of income, in equilibrium, is:

$$k = a - r - w. \tag{7}$$

Here, as before, a is the natural logarithm of average labour productivity, r is the average, economy-wide, level of the real rate of interest, and w is the natural logarithm of the gross average real wage rate.

Next let us suppose that we have some basic data from the national income and product accounts of a certain economy, in a particular year, as follows:

Real GDP = Y = 1 trillion constant dollars

Employment = N = 10 millions persons

Labour share of income = 55%

For the sake of theoretical consistency with the two companion pieces to this article (Smithin 2023a, 2023b), we will take it that the various money magnitudes in this set of accounts refers to actual flows of funds - that is, transactions in which money has actually changed hands during the accounting period - rather than the imputed values usually provided by statisticians in the various real world jurisdictions.[74] This being said we can then calculate:

Bank of Canada should *cut* its policy rate of interest to 4.4% in pursuit of a ZRPR). Then, on 07.06.2023 some friends, who pay more attention to the mainstream media (MSM) than I do - not in itself a very difficult task - texted and/or messaged me with the news that the B of C had actually *raised* the rate to 4.75%. I believe that the appropriate response on the internet is LOL? Not a huge surprise, though, Canadian monetary policy has been a '… (insert epithet of choice here) …' seemingly since I first set foot on these shores on 02.09.1975 (and probably well before). They have been ignoring my advice all that time.

[74] This has to do with the issue of the 'stock-flow consisten[cy]' of the national accounts data (Lavoie 2014, 264-9). As to the application of these ideas using imperfect real-world data recall the discussion about inflation and performativity in the last paragraph of section 1 above.

Average labour productivity = Y/N = 10,000

Average real wage rate per employed person = 5,500

And taking natural logarithms we will have:

$a = ln(Y/N) = ln(10{,}000) = 9.2$

$w = ln(\mathrm{W/P}) = ln(5{,}500) = 8.6$

The obvious next step would be to work out some measure of the average real rate of interest in the economy as a whole. This, however, is not such an easy task as it might sound. In simple illustrative theoretical models, such as that above, the interest rate concept employed can be treated in a very straightforward manner. As did Keynes (1936, 163) long ago, in the *General Theory*, in such a context it is eminently sensible to write and speak about 'the' rate of interest in some sense. However, if on the other hand, the task is to make an empirical estimate of rentier incomes in the economy as a whole, and at all terms to maturity, that is a different question entirely. Collis (2018) recently addressed this problem in a doctoral thesis, and provides a detailed discussion of the various alternative procedures by which such calculations may be attempted. According to Collis, one of the most promising of these methods is to use data for 'total property income' (including all of bonds, equities, real property, *etc.*) which is then compared to 'total wealth' - to thereby arrive at an estimate of the overall percentage rate of return to 'wealth'. In Collis's view, this provides the most reliable estimate that we have of the balance of forces at work as between wealth-owners, entrepreneurs, and labour in real world political-economic systems. For present purposes, therefore, and to cut a long story short, let us provisionally accept this argument and suppose that the necessary calculations have worked out to a value of $r = 0.15$. That is:

Average real rate of interest $= r = 0.15$

This figure of $r = 0.15$ is, of course, likely to be an exaggeration. This is a relatively high number as compared to the real world estimates of writers such as Collis himself or, for example, those of Thomas Piketty (2014) in the latter's well-known *Capital in the Twenty-First Century*.[75] The only consideration in using a relatively high number such as this is simply that it is convenient to use in the illustrative numerical calculations of income distribution (most of which involve logarithmic transformations) that will follow. It is not suggested that this particular number is likely to be empirically realistic, or that it would be useful in specifying transversality

[75] On the work of Piketty see, in particular, the two commentaries by Pressman (2015, 2022). Is important to note that Piketty's version of 'r' actually includes both of $r + k$ in the present notation. In Piketty's work there are really only two 'classes' that are taken into account (as in Marx).

conditions in macroeconomic models (Scarth 2022, 180-3). But to proceed accepting the suggested numbers as our baseline, the implication of our data is that the natural logarithm of the average, economy-wide, entrepreneurial mark-up factor is $k = 0.45$:

(8) $$k = a - r - w = 9.2 - 0.15 - 8.6 = 0.45.$$

Note also that the equation for income distribution can easily be re-written as:

(9) $$a = k + r + w.$$

… which can then be 'normalized', as this procedure is called in mathematics, by dividing through by the term 'a':

(10) $$1 = k/a + r/a + w/a$$

What is the meaning of these ratios? In the past I have used the term '(*ln*)shares' to describe them (Smithin 2022, 167). The key point about them is that they always add up to unity. In this particular instance, therefore, the (*ln*)shares work out to:

(11) $$1 = 0.05 + 0.02 + 0.93$$

firm(*ln*)share rentier(*ln*)share wage(*ln*)share

Due to the mathematical properties of logarithms, small changes in the (*ln*)shares always translate into much larger changes in the percentage distributive shares. For example, the (*ln*)share of labour in this case is 0.93, whereas we know that the actual labour share in the raw data was 55%. Nonetheless, this way of putting things is useful in defining what is actually meant by the various normative concepts that arise in the discussion of the functional distribution of income.

6. The Concepts of Exploitation and Usury

Consider, for example, the familiar Marxian notion of *exploitation*. In the present context and using our current notation we can now see that 'exploitation', in this Marxian sense, will occur whenever $k + r > 0$. However, if both interest and profit are eliminated we have $k + r = 0$, and the 'workers' receive the whole of the product. This, therefore, would be a case where the whole value of the output accrues to those who are (or rather, were supposed by Marx to be) the actual producers.

(12) $$a = w.$$

Similarly, given the initial assumptions about fairness made above, we are also able to define the concept of *usury*, which was a staple of the historical literature on money

and banking. The word 'use' is an archaic synonym for interest, and the notion of usury would come into play whenever the rate of interest charged on loans on money was deemed to be excessive in some sense. Historically, for example, so-called usury laws were passed in several jurisdictions limiting the amount of interest that could be charged for any financial transaction. In order for this sort of concept to be operational there evidently has to be some method of determining what is, and what is not, excessive. In the present context it can be argued that 'usury' occurs when $r > 0$, and that there is no usury when $r = 0$. In the latter case there would indeed be a fair distribution of income as we have defined this term, and:

(13) $$a = k + w.$$

The total income available would thus be divided solely between the entrepreneurs and the workers - who are ones who have actually contributed to current production - although the specifics of the share-out have yet to be decided. Contrary to Marxism the key economic function of entrepreneurship is recognized as well as that of labour. Both groups are thought to be entitled to *some* share of current income. The entrepreneurs are included but the rentiers do not participate. The underlying idea is that the mere possession of 'money' in and of itself does not entitle rentiers to any increase in their real money holdings, unless there is some actual contribution to current productive activity. There cannot be further accumulation unless the wealth-holder is willing to take on some sort of additional risk. On the other hand, because the real rate of interest is non-negative, the rentiers are still able to preserve the real value of any *previously accumulated* monetary and financial holdings. Admittedly, this may well raise further questions about the original sources of their income and the legitimacy of those sources. If the original income sources were indeed either wages or entrepreneurial profit, the ethical argument would be watertight. However, to the extent that their past income was, in fact, acquired by either usury or financial speculation this would clearly raise difficult issues of political economy for any transitional regime.

7. Is the Optimal Market Real Rate of Interest (on Money) Zero?

Based on the above discussion the answer to this question is probably ***YES.*** To explain, note that if $r = 0$, and with $a = 9.2$ and $w = 8.6$ as before, the average entrepreneurial mark-up factor will increase from 0.60 to from 0.45:

(14) $$k = a - r - w = 9.2 - 0.0 - 8.6 = 0.6$$

The (*ln*)shares now work out as follows:

(15) $$1 = 0.07 + 0.00 + 0.93.$$

firm (*ln*)share wage (*ln*)share

Meanwhile the worker's (*ln*)share remains unchanged. One group has gained, another has lost nothing, and a third group (the rentiers) have lost all their income. Again, this

is 'fair' in as much as both the entrepreneurs and workers have participated in current production whereas the rentiers have not. There is no reason, therefore, why the rentier group should share in the benefits. (As has already been stressed their existing wealth, if legitimately earned, arises from past production, and the real value of that amount of wealth does not change). In the particular case we considering here all of the extra benefit has gone to the entrepreneurs. Clearly, the actual split between workers and entrepreneurs could still be contested, but both groups always get *something* (unlike in Marx).

This next level of conflict, between the entrepreneurs and workers over the precise size of the mark-up, can be considered 'fair game'. It will be decided by such things as collective bargaining and labour legislation, and by a host of other policy initiatives which may, or may not, deliver more, or less, of the proceeds to labour. Whatever the final resolution, however, the *k* term itself can never be reduced to zero, as this would render the whole system unviable. There would then be no incentive for the entrepreneurs to initiate production and no economy.

Therefore, based on our argument about fairness, it does seem that a zero real market rate of interest would be optimal. It is true that, starting with a brief statement in my *Controversies in Monetary Economics* (Smithin 1994) thirty years ago, and subsequently in many other places, I have usually argued central banks should pursue a monetary policy that sets a target for the real policy rate of interest a 'low but still positive' level. Given the transmissions mechanism of monetary policy under normal circumstances this would also feed through to a relatively low real market rate of interest on money - but not actually zero. The underlying basis for the argument was, first, that low(er) real interest rates, even if not zero, do promote economic growth. Second, as already stated, that any real target for the real policy rate of interest, even if greater than zero, would at least stabilize the inflation rate. Such statements, therefore, were always meant to be taken in the spirit of 'pragmatic' policy advice. Before now I have not usually given any precise quantitative estimate. But, the ethical arguments just introduced can and do bring a further, more precise, dimension to the notion of 'optimality' for the market rate.

Another complication in the present context is that, strictly speaking, the rule that the real rate of interest should be zero should apply (specifically) to the risk-free real deposit rate at the commercial banks. Note, however, the that algebraic definition of *r* in equation (6) also includes the commercial bank mark-up between deposit and lending rates. It could be argued that this represents the return to the *activity* of bank lending rather than interest or 'use' as such, and, in reality, is thus a special case of entrepreneurial profit. This value of making this point is that it does serve to bring out the general *in*validity of the argument that if the real deposit rate is zero that would eliminate the supply of (financial) capital. In itself the existence of the spread is sufficient to show that the banks are indeed being compensated for their credit creation activities. In any event in the illustrative calculations to follow (which are based on previous work) the distinction is neglected. In practice, this makes only a minor difference to the value of the hypothetical aggregate mark-up for non-financial business firms.

At this stage in the exposition it may be appropriate to note that there is a definite family resemblance here between the above argument and the rules of so-called 'Islamic banking' (Arnold 2104). The latter is usually understood to be a code of conduct for bankers who wish to comply with certain religious requirements in their business dealings. In this sort of discourse (as in the notion of fairness in the present paper) there is, also, a basic or underlying presumption that charging interest for loans of money is somehow unethical, as opposed to the receipt of income earned from entrepreneurial profits and wages. Rules are therefore set down for business and financial dealings whereby, in one way or another, interest charges are avoided entirely. (Similar ideas have also been present historically in many other religious traditions beside that of Islam. The latter is simply a convenient modern example much discussed in the contemporary news media, including the financial and business media). Another example, but with less contemporary relevance, would be that of medieval Catholicism in the scholastic period.

The objective of avoiding interest charges altogether is not exactly fulfilled in the current argument because it is not always possible to avoid a nominal interest charge. Evidently if a real interest rate (any real interest rate) is to be set to zero, the corresponding nominal interest rate must be equal to the inflation rate. The nominal interest rate, then, will have to be positive whenever the inflation rate itself is positive. The main difference from the overtly religious arguments is once again whether it is a nominal or real interest rate that is set to zero. Nonetheless, with a zero real rate there would still be no real income received by the rentiers regardless of the inflation rate. The final result therefore would seem to be well within the spirit, if not the letter, of the several religious proscriptions.

In the case being considered here, to achieve a zero real *market* rate of interest, including the bank mark-up, requires that the target for the real *policy* rate should not be zero but will adjust according to:

$$r_0 = [(1- m_1)/m_1)]p - (m_0/m_1). \tag{16}$$

How, then, to square this idea with the proposal of a ZRPR, referring specifically to the policy rate? The point is, quite simply, that it might well be difficult to achieve this non-zero target in practice because it would require reliable estimates of the parameters m_0 and m_1. This leads to the suggestion that the ZRPR might be a 'near-optimum', an argument to be further discussed in section 10 below.

8. Is the Optimal Nominal Policy Rate of Interest Zero?

On the other hand, it can be show that the alternative proposal to a ZRPR, that of a ZIRP - setting the nominal policy rate of interest at zero -is definitely *not* optimal, neither from the point of view of income distribution, and as already mentioned, nor stability. As far as the ethics of income distribution is concerned a zero nominal interest rate will *not* be neutral in its effects. A ZIRP is unable to achieve a fair distribution of income in the sense in which we have been using that term.

Consider first an inflationary case, and suppose that at the current point in time the inflation rate happens to be 14%, or $p = 0.14$. Also, recall that the real rate of interest is given by equation (6) above. By assumption the central bank is following a ZIRP and therefore $i_0 = 0$. Equation (6) will thus reduce to:

(17) $$r = m_0 - p.$$

The effective real rate of interest on money is therefore equal to the commercial bank mark-up *minus* the inflation rate. With $p = 0.14$, and if the commercial bank mark-up is given by (say) $m_0 = 0.02$, we will have:

(18) $$r = 0.02 - 0.14 = -0.12.$$

The market real rate of interest is negative at -12%. Given $a = 9.2$ and $w = 8.6$, the natural logarithm of the average/aggregate entrepreneurial mark-up factor is thereby increased to $k = 0.72$:

(19) $$k = a - r - w = 9.2 + 0.12 - 0.86 = 0.72.$$

… and the relative (*ln*)shares will work out to:

(20) $$1 = 0.08 - 0.01 + 0.93.$$

firm (*ln*)share rentier (*ln*)share wage (*ln*)share

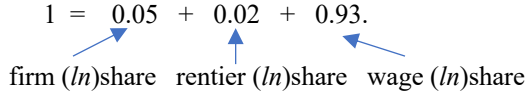
In terms of the functional distribution the firms are gaining, and the workers are still holding their own, but the rentier (*ln*)share has now actually turned negative. What is actually happening (to borrow a typical expression often used in mainstream or neoclassical economics) is that 'resources are being transferred' *from* the holders of financial capital *to* business firms. In effect, the business firms or entrepreneurs are 'profiteers' from inflation, just as described by Keynes (1923, 5-32) in the relevant passages from the *Tract on Monetary Reform* - when discussing the effects of inflation during WW1 and its aftermath. And, what is worse from the wealth-holder's perspective, it is clear that the situation will continue to deteriorate as time goes by. This inflationary case, therefore, is what will eventually to the practical real world version of Keynes's (1936) later idea of the 'euthanasia of the rentier'. As against Keynes, however, from the point of view about fairness outlined above, this outcome cannot be held to represent an ethically defensible position.

Next, consider the alternative deflationary case. Suppose now that the price level is currently *falling* at a rate of 16% per annum ($p = -0.16$). In this situation, even though the nominal interest rate remains zero, the real market rate of interest on money will now be positive once again. It increases to the relatively high level of $r = 0.18$. The average entrepreneurial mark-up will therefore fall to $k = 0.42$:

(7.22) $k = 9.2 - 0.18 - 8.6 = 0.42.$

The (*ln*)shares will turn out be:

(7.23) $1 = 0.05 + 0.02 + 0.93.$



In this case, resources are being transferred *to* the holders of financial capital *from* business firms. Rather than the 'euthanasia of the rentiers', this is the opposite. It is an example of a process I once called the '*revenge* of the rentiers' (Smithin 1996). Again, the situation is only going to get worse, but this time from the point of view of Main Street. The boot is on the other foot. It is business that will eventually be euthanized, and with it the entire economy.

9. The Essence of Deflation and Depression

As a final exercise one which in my view has important implications for the real world phenomena of deflation and depression let us explore the deflationary case a bit further. Suppose that the rate of deflation continues to increase and proceeds to an order of magnitude above 60% or so. At this dire stage the average business mark-up actually turns negative. All firms both in the aggregate, and on average, will then be making losses. With (e.g.) exactly a 68% rate of deflation, for example, we will have:

(24) $k = 9.2 - 0.70 - 8.6 = -0.10.$

This is the very essence of the process of deflation and depression/recession. It exactly what happened in the severe episodes of deflation and depression that were seen in the 1930s, for example, and to a lesser extent even on several occasions in our own times.

Taking the inflationary and deflationary cases together, the conclusion must be that neither a ZIRP, nor a fixed nominal policy rate in general, is the optimal setting of the monetary policy instrument. It cannot be optimal neither from the point of view of income distribution nor from that of macroeconomic stability. Far from it. If the nominal policy rate of the central bank is set at zero (or any other nominal value) 'anything can happen'. We can get either a 'South Sea Bubble, as in the 1720s, a 'Great Depression', as happened two hundred years later in the 1930s - or anything in between, as has happened too often in our own times.

10. The 'Near-Optimality' of a ZRPR

In practice, and as mentioned, it may not be possible to achieve a zero real market rate of interest on money for a variety of reasons (including Keynesian liquidity preference). However, for positive starting values of *r,* we can say at least that the ZRPR is a 'near-optimum'. That is, it will achieve the closest possible approximation to the

distributionally neutral value of zero (for the market rate) in any given set of circumstances. Suppose, on the contrary, that the starting value of the real policy rate is currently non-zero, *e.g.,* $r_0 = 0.03$. The actual real rate of interest in the marketplace will then be given by:

$$r = m_0 + m_1(0.03) - (1 - m_1)p \tag{25}$$

On the other hand, under a ZRPR we would have $r_0 = 0$. The real rate of interest on money would then be:

$$r = m_0 - (1 - m_1)p \tag{26}$$

The positive term $[m_1(0.03)]$ disappears. Equation (26) is therefore closer to the presumed optimum of $r = 0$ than is equation (25).

11. Conclusion

It has been argued that the optimal real rate of interest on holdings of money, that which will provide a 'fair' distribution of income, is zero. There would then be zero rentier income in real terms but this would not be the actual 'euthanasia of the rentier'. If this such a state of affairs were attainable it would also largely eliminate speculation in the financial markets – based, as this is, on expectations of real interest rate *changes*.

Even if a zero real rate on money may be difficult to achieve in practice, a the simple alternative of zero real policy rate (ZRPR) - set by the central bank - does represent a goal that is achievable, and would provide an approximation to the distributional optimum. It will also minimize financial speculation, to the extent that is practicable, if not eliminate it entirely. This paper has shown that question of the fairness or ethics of income distribution is, or should be, a key issue in the political economy of monetary macroeconomics. Nonetheless, it all too frequently slips 'under the radar' in the course of the actual macroeconomic policy debate.

A further point that can be made is that, with this sort of monetary policy in place, the way would then be open for those expansionary policies on the fiscal side that would increase the economic growth rate and reduce the effective unemployment rate.[76] What is perhaps not generally understood, however, is that these same expansionary polices will also have an impact on income distribution. Specifically, and contrary to the views of several contemporary schools of economic thought, there is actually a positive relationship between the economic growth rate and the average level of real wages (Atesoglu & Smithin, 2006, Collis 2018, Smithin 2018, 2022) which is going to further affect the spilt of income between the working class and the firms of entrepreneurs. We

[76] These statements remain subject to the caveat that for any policy, - monetary, fiscal, or otherwise - to work, there must either be a floating exchange rate regime, or else the nominal exchange rate should be 'fixed-but-adjustable'.

have already argued that this type of 'class conflict' in the economic sphere is actually fair game.[77] In the real world (in spite of the repeated assertions of mainstream or neoclassical economic textbooks there is no marginal principle, or any such thing, to dictate precisely what the share of each group should be. To some extent, therefore, the division of the proceeds is always going to be up for grabs to be determined by collective bargaining, *etc.* The key point is simply that the firm or entrepreneur share cannot drop to zero as advocated in Marxism. As long there is some sort of reward to the entrepreneurship the system will continue to function. Indeed, in more favourable circumstances - for example, if productivity is also increasing along with the economic growth rate and the level of real wages - the aggregate or average mark-up achieved by business firms may even be increasing. If new wealth can be created (if there can be additional production) the economic system is not necessarily a zero-sum game,

Continued economic prosperity, in and of itself, may well therefore be considered *essential* for an ethical income distribution. But, unfortunately, this seems to run very much counter to the fashionable arguments that one very often sees nowadays for lower growth – and ironically on both the right and left of the contemporary political spectrum - for their different reasons.

[77] Notice, however, that this refers primarily to class conflict within the private sector. I would say that the case of the public sector unions is a different matter entirely (including, it must be said, the claims of 'entitled' university professors).

References

Atesoglu H.S. & J. Smithin. 2006. Real wages, productivity, and economic growth in the G7, 1960-2002. *Review of Political Economy* 18: 1-11.

Collis, R. 2018. *Three Essays on Monetary Macroeconomics: An Examination of the Soundness of the Alternative Monetary Model and Monetary Policy in Canada.* PhD thesis in Economics, York University, Toronto.

Kam, E. 2005. A note on time preference and the Tobin effect. *Economics Letters* 89: 137-42.

Kam, E. & J. Smithin 2012. A simple theory of banking and the relationship between the commercial banks and the central bank. *Journal of Post Keynesian Economics* 34: 545-49.

Keynes, J.M. 1923. *A Tract on Monetary Reform*. London: Macmillan.

Keynes, J.M. 1930. *A Treatise on Money*: vol 1: *The Pure Theory of Money*. (As reprinted in *Collected Writings* V, ed. D. Moggridge, London: Macmillan, 1971.)

Keynes, J.M. 1936. *The General Theory of Employment Interest and Money*. (As reprinted by Harcourt Brace: London, 1964.)

Lavoie, M. & M. Seccareccia 2016. Income distribution, rentiers, and their role in capitalism. *International Journal of Political Economy* 45: 200-23.

Pasinetti, L. 1981. *Structural Change and Economic Growth*. Cambridge: Cambridge University Press.

Piketty, T. *Capital in the Twenty-First Century*. Cambridge, MA: Harvard University

Press.
Pressman, S. 2015. *Understanding Piketty's Capital in the Twenty-First Century*. New York: Routledge.
Pressman, S. 2022. How and when to balance the budget? In *Debates in Monetary Macroeconomics*: *Tackling Some Unsettled* Questions, eds. S. Pressman & J. Smithin, 69-91, New York: Palgrave Macmillan.
Rochon, L-P. & M. Setterfield. 2012. Models of growth and inflation with conflict inflation. *Journal of Post Keynesian Economics* 34: 497-520.
Scarth, W.M. 2022. Does a current account deficit indicate bad economic policy? In *Debates in Monetary Macroeconomics*: *Tackling Some Unsettled* Questions, eds. S. Pressman & J. Smithin, 173-191, New York: Palgrave Macmillan.
Smithin, J. 1996. *Macroeconomic Policy and the Future of Capitalism: The Revenge of the Rentiers and the Threat to Prosperity*. London: Routledge.
Smithin, J. 2018. *Rethinking the Theory of Money, Credit and Macroeconomics: A New Statement for the Twenty-First Century*. Lanham MD: Lexington Books.
Smithin J. 2020. Interest rates, income distribution, and the transmissions mechanism. *European Journal of Economics and Economic Policies* 17: 381-98.
Smithin, J. 2021. The methodology for assessing interest rate rules: a reply. *European Journal of Economics and Economic Policies* 18: 286-92.
Smithin, J. 2022. *Beyond Barter: Lectures in Monetary Economics after 'Rethinking'*. Singapore: World Scientific Publishing.
Smithin, J. 2023a. The political economy of capital flows, real exchange rate dynamics, and the foreign debt position in sovereign monetary systems, this *Journal*.
Smithin, J. 2023b. The Hicksian super-multiplier, 'capital' theory, and social ontology: fundamental problems in both mainstream and heterodox macroeconomic theory, *Aurora Philosophy Journal* (2)1: 69-94.
Watts, M. & G. Pantelopoulos 2022. Should monetary policy be subject to rules? In *Debates in Monetary Macroeconomics*: *Tackling Some Unsettled* Questions, eds. S. Pressman & J. Smithin, 23-45, New York: Palgrave Macmillan

Aurora Philosophy Journal, Vol. 2, No. 1, pp. 111-120

Mexican Monetary Policy: To Stabilize Inflation or the Financial System?

Noemi Levy Orlik
Aurora Philosophy Institute & Universidad Nacional Autónoma de México

Abstract

Money is a peculiar instrument that has been present since the beginning of human history, a peculiarity that has evolved, and since capitalism emerged has presented itself as it is, especially in its latest phase. Money is a debt regulated by the state and can create liquidity through various forms. Capitalist operations require liquidity, but liquidity by itself cannot cause economic growth. In this context, monetary policy, dominant in public policy, can deter economic growth, without generating it. In this context, we analyze Mexican monetary policy in a highly complicated period, including the pandemic. We conclude that the Mexican central bank policy of following the movement of the US Federal Reserve interest target, with the implicit objective of stabilizing the exchange rate, attained financial stability and controlled inflation but at the cost of an overvalued exchange rate and increased domestic financial margins. The only way out of this situation is to expand economic growth based on *domestic* finance, and this requires fiscal and industrial policy.

1. Introduction

The main theme of the current issue of this *Journal* is the relationship between economics and philosophy and Alla Marchenko and John Smithin (2023) have asked the question whether 'philosophy is part of economics or is economics part of philosophy'? They think it is the latter rather than the former. In particular, as economics is preeminently a *social s*cience it must be recognized, first and foremost, that the ontology of the social world is different from that of the natural world, the world of the 'brute facts', as this has been labelled by the philosophers G.E.M. Anscombe (1958) and John Searle (1995).

The other papers in this collection have emphasized such things as the ontology of money, the ethics of income distribution, and some key questions of political economy, particularly those having to do with the international financial system at this time of great flux in geopolitics. These include the apparently changing (declining?) international role of the US dollar, the rise of a multipolar international environment with new trade groupings such as the BRICS (Brazil, Russia, India, China, South Africa) and others, and the choices that will need to be made by developing economies such as Mexico.

This paper will look at the practical consequences of taking such a philosophical outlook on economic issues, focusing on the case of recent monetary policy in Mexico.

Contrary to the usual stance of mainstream or neoclassical economics - that money is 'neutral' and only affects inflation - it seems very clear that in practice this is not so. The conduct of monetary policy has very important implications for the welfare of the citizens.

In what follows, section 1 discusses Mexican monetary policy since the targeting of interest rates was enforced (2008) with objective of attaining an inflation gap of 3% - 1%. In section 2, recent developments in Mexican monetary policy are reviewed, focusing on what happened prior, during, and in the aftermath of, the pandemic. This analysis reveals that a new political regime took office in December 2018 with the promise to deconstruct neo-liberal economic policies. However, in terms of macroeconomic policy, and particularly in relation to monetary policy, the Mexican central bank retained its autonomous status and continued to follow the monetary policy of the US Fed, moving the Mexican target interest rate in the same direction. Section 3 reviews the results of Mexican monetary policy in terms of inflation, foreign direct investment, and the wage share, from where it is highlighted that inflation in the aftermath of the pandemic was lower than in other Latin American economies who were doing better before the crisis, and wages increased in real terms. Section 4 addresses the question of who are the winners and losers of this process. The answer is clear-cut, the dominant class, *i.e.,* capitalists, retain the highest share of returns, and even though inflation is less high than in other Latin America economies, and the distribution of income did not actually get worse, it remains very highly concentrated. More importantly wages, even though they have increased, are still extremely low even by Latin American standards. Section 5 deals with the issue of how to go forward. The last section contains the main conclusions of the paper.

1. Mexican Monetary Policy

Mexican monetary policy operates through an autonomous central bank and, although its mandate is to control the money supply to contain inflation, it uses the target interest rate as an operational instrument. The implicit objective of the target interest rate is to stabilize Mexico's financial system and, in this way, influence inflationary expectations. Thereby, the *Banco de Mexico's* (BANXICO) immediate objective is to stabilize the exchange rate, that, coupled with high interest margins with respect of US interest rates, attracts foreign financial inflows (foreign direct and portfolio investment). Therefore, the financial system did stabilize on the basis of higher interest rates and stable (overvalued) exchange rates, which would neutralize foreign inflation and in this way control domestic inflation and reduce foreign debt interest payments. Mántey (2011) shows that since globalization took place in the financial markets, the stabilization of the exchange rate has been BANXICO's intermediate objective, with the control of inflation its final aim.

In the neo-liberal period, Mexico's insertion into the world economy took place through assembly manufacture, a low value-added activity, which turned exports into the country's economic growth engine. However, this came along with a premature de-industrialization process, economic dependence on intermediate and capital goods imports, as well as final goods. In this period, not only the structural current account

deficit deepened, but also Mexican prices turned highly dependent on world-wide inflation.

The positive balance of payments on financial account was the counterpart of the structural current account deficit that, in the period of capital globalization and internationalization, modified the financial circulation. International credits were displaced by foreign investment, which became the realm of large multinational corporations. In this institutional setting, big corporations not only led investment spending, organized production in the dynamic sectors, and created formal jobs, but also attracted foreign financial inflows, which provided liquidity to the Mexican economy.

In this period large Latin American corporations (*multilatinas*) were created, displaying high financial activity *via* mergers and acquisitions, and operating through international financial centres rather than domestic institutions. In this context, Mexico's exchange rate acquired a key position.

The Mexican economy developed a dichotomous relation with big corporations that, on one hand, offered low production costs (meager wages and salaries, reduced tax rates, and lax rules regarding environmental deterioration) and, on the other, operated on the basis of high rate of interest margins with respect to the US rate of interest with stable, or even appreciated, domestic currency exchange rates. The higher interest margin with respect to the US rate of interest limited the development of Mexican financial institutions. So, despite the growing foreign investment inflows, the Mexican capital market did not deepen or widen, since large corporations operated *via* international financial centres.

2. Recent Developments

Based on these conditions, BANXICO followed the US Fed's monetary policy trajectory. Specifically, BANXICO, between 2018 and 2023, increased the objective rate of interest every time the FED announced that the US target rate will go up. This policy supposedly guaranteed Mexico´s financial system stability and, in this way, transnational corporations saw Mexico as an attractive site to operate, securing the growth of the dynamic export sectors and liquidity to face the current account deficit and foreign debt payments. A main result of the policy of Mexico's central bank is the stabilization of the peso-dollar exchange rate, which contributed to the containment of domestic inflation as did the external debt interest payment reduction. Additionally, Mexico became an attractive economy for the operations of foreign capital.

Prior to the pandemic (2018.1 - 2020.3) the relationship between the target interest rate of BANXICO and the FED was on average 4.3 percentage points, it increased to 21.1 percentage points during the pandemic (2020.4 - 2022.4) when the US target rate dropped to levels close to zero. In the post-pandemic period (2022.5 - 2023.3) the target rate relationship shrank on average to 3.1 percentage points because of the relatively rapid recovery of the US target rate. In other words, when the Fed's target rate falls, BANXICO replicates the movement, but much more slowly, and when the US target

rate rises, the domestic interest rate differential falls, because of the speedy recovery of the Fed's target rate.

The average differential between the Mexican and the US short-term interest rates (measured by CETES-364 day of average yields weighted in annual percentages and the U.S Treasury security market yield at a 1-year constant maturity, quoted on investment basis) in the pre-pandemic period was relatively low (3.7 percentage points). During the pandemic period it jumped to an average of 18.6 percentage points and dropped to 2.7 percentage points in the post-pandemic months. For its part, the average spread of long-term Mexican and US rates (measured by 10-year Udibonos, weighted average rate of return, in annual percentages, and the market yield on U.S Treasury securities 10-year maturity, quoted on an investment basis) is much lower in all the periods analyzed. Based on the above, it can be inferred that the large financial inflows take place in short-term instruments which, in part, explains the Mexican capital market weakness.

Regarding the exchange rate, in general terms, it was relatively stable between 2018.1 - 2023.4, despite the drastic 2020 GDP drop and the high inflation since 2021. During the pandemic (2020.3 - 2022.4) there was a slight depreciation of the Mexican peso-dollar exchange rate, with values close to 20 pesos per US dollar, with a maximum of 24.3 pesos *per* US dollar in April 2020. In the post-pandemic period, the exchange rate returned to its previous levels, with minimum value that oscillated around 18 pesos *per* dollar and below.

Hence, a second conclusion is that over the last four years, despite the pandemic crisis, the peso remained relatively stable, and even appreciated in the last period This, in part, is due to the Mexican central bank's rate of interest policy.

3. Inflation, Foreign Direct Investment, and the Wage Share

Regarding Mexico's and other Latin American countries inflation trends, three phases can be detected during 2018 - 2023. The first is located before the pandemic (2018 - 2019) with higher inflation trends in Mexico and Brazil in relation to Chile. The second is situated in 2020, the first year of the pandemic, with an upward trend led by Brazil followed by Mexico and Chile. The third phase, takes place between 2021 and 2022, characterized by the 'return to normality' combined with geopolitical conflicts (the Ukrainian war and the Sino-American confrontation). In this period, the inflation trend accelerated, especially in Chile and Brazil in comparison to Mexico, partly explained due to peso appreciation.

A closer look at Mexico's inflationary process indicates that core inflation is less volatile than non-core inflation. Core inflation is explained by the evolution of commodities and service prices, the former relatively stable in the period prior to the crisis; increasing in the initial months of the pandemic, reaching maximum values between October and November 2022, declining from then onwards. Inflation in the service sector dropped throughout the crisis and recovered in the second quarter of 2022, with slower rates. Non-core inflation declined sharply before the pandemic and surged in the post-crisis period, fuelled by agricultural goods with price containment in

the energy sector, achieved through public subsidies in gasoline prices. This partly explains the reduction in Mexican inflation compared to the other countries analysed.
An additional aspect of this analysis is the volume and composition of foreign investment (FI) whose main function is to guarantee liquidity for the Mexican economy. The participation of foreign direct investment (FDI) in foreign investment (FI) dominates throughout the period (2018 - 2022), with percentages above 70%, and it ranges between 2.8% (2018) and 2.4% (2022) with respect to GDP. The main components of FDI are reinvested earnings (47% on average) that declines after 2021, followed by new investments which, on average, represented 38% of FDI, surging to 43% and 50% in 2021 and 2022 respectively. Foreign portfolio investment (FPI) is less significant and more unstable, dominated by debt securities and low shares of equity and investment fund shares. FDI for debt securities is mostly exercised by the general government, although between 2020 and 2021 it had significant reductions, followed by state-led companies.

Finally, it is interesting to note that, in the midst of the pandemic crisis, the wage-share in GDP increased (since the fourth quarter of 2020), reducing the gaps between wages, gross mixed income, and gross operating surplus. Hence, in this difficult context workers income participation in GDP increased.

From the above can be concluded that BANXICO's strategy of following the Fed's target interest rate movements did give stability to the Mexican financial system, characterized by a relatively stable exchange rate that even appreciated since late 2020 and the first half of 2023. The combination of a peso-dollar stable exchange rate, with price subsidy policies, especially in the energy sector, prevented inflation from getting out of control, and it even dropped compared to other Latin American economies.

A third effect is that the foreign capital inflows into the Mexican economy were maintained throughout the entire period, mainly through FDI that stimulates exports and employment. Finally, even in this context, the wage participation in GDP increased.

4. Winners and Losers?

The economic policy pursued since 2019, headed by a government based on a centre-left alliance whose main slogan is ‘First the Poor’, did not really modify the distribution of income and wealth. The capitalist class, wealth owners and entrepreneurs, did not lose their profit share, and although minimum and industrial wages increased, they remain low, and more importantly there is a large informal labour sector. Therefore capitalists continued to be the winners.

Moreover, the domestic ruling class continued their alliance with foreign capital, backed by government subsidies, without risking their capital in new productive adventures. This set of conditions generated big profits, even higher in comparison to developed economies (see Kaldor 1959), which resulted in reduced economic activity and productivity rates in comparison to the leading western economies. This condition worsened in the globalized period under the dominance of the export-led model (Cimoli & Rovira 2008) with the novelty that the entrepreneurial class assumed a rentier-like

behaviour through the creation of big corporations (*multilatinas*) that expanded *via* mergers and acquisitions, with reduced linkages with their parent company based in Mexico. Meanwhile multinationals based in Mexico dominated the dynamic productive sectors and export activity, and were highly dependent on intermediate and capital imports, subsidised with low production costs (low wage costs, reduced taxes, *etc.*).

Although the working class continued to be the main loser, the centre-left alliance showed that things can be done differently. Before the pandemic, in 2019, the Mexican government put in place social programs that made income transfers to the poor, the elderly, and young people with no jobs, which managed to stop the expansion of extreme poverty even during the pandemic.

Additionally, the ruling class subsidized demand during the lockdown months in exchange for not laying off workers, which was not met by the Mexican government, and direct help was given to the people in need. This prevented the government from running fiscal deficits to support rich people. Big corporations also were obliged to pay current and unpaid taxes of past periods, and tax evasion and elusion was stopped. The most revealing feature was that in the midst of the pandemic the Mexican government managed to negotiate higher minimum wages with the private sector, and in September 2021 enforced outsourcing reform that limited labour subcontracting practices.

From the above can be concluded that, although the wealth and income distribution was not improved the well-being of poor people improved despite the economic recession generated by the pandemic. More importantly, that there is space for social reforms in favour of the poor within the neo-liberal paradigm.

5. Going Forward

The big question is how to continue? Clearly, the Mexican rate of economic growth is insufficient, income distribution is still poor, and the size of the informal sector is still very big. Monetary policy to guarantee financial stability is not meant to promote economic activity, even more so in open economies such as Mexico. Stable and overvalued exchange rates are a double-edged sword. On the one hand, financial flows are attracted, financial stability is attained, the current account deficit can be meet, inflation is limited, and interest payments are lessened. But, on the other, interest rates are higher than in international financial centres. Therefore, as financing, especially for small and medium size firms that depend on bank credits, and with capital markets that are shallow and narrow, is done through international centres in foreign currency, this increases Mexican financial dependence on the dollar. Therefore 'financial stability' is costly.

What to do? Definitively domestic economic activity needs to be reignited, and the only way to stimulate economic activity is through raising investment spending. Public spending (Kalecki 1933) or the 'socialization of investment' (Keynes 1936), along with industrial policy, are key factors in this context. The central government needs to guarantee the basic infrastructure for private investment to take place. New features that need to be enhanced to limit rentier entrepreneurial behaviour are to reduce private sector subsidies and generate conditions for the private sector to compete in terms of

increasing productivity rather than reducing labour costs. An important lesson from the successful East Asian countries is that foreign investment needs to transfer production know-how and operate with advanced technology (Amsden 2004, Chang & Grabel 2014). Therefore, Mexico's supposed 'comparative advantage' of low-cost labour need to be eradicated and economic growth needs to take place on the basis of increased productivity.

Another important feature is that industrial policy cannot rely only on big foreign or domestic corporations, small and medium-sized enterprises need to be included and their production processes need to be based on high productivity, rather than low labour costs. These firms can either become the supplier of big corporations or domestic market producers Mexico (and Latin America in general) cannot repeat the ISI experience that Fajnzylber (1983, 1990) characterized as a 'truncated industrialization' explained in terms of the 'empty box'. This highlights two noxious features of the process, namely low technological development and highly unequal income distribution. On this basis, Fajnzylber suggests that an 'endogenous technological nucleus' is fundamental to achieve self-sustained economic growth and development.

Obviously, industrial policy needs to go hand by hand with a 'loose' financial policy, especially for the small and medium-sized enterprises, and large corporations must operate through domestic financial institutions, mainly through the Mexican stock market.

A final remark is that once economic activity does take off, things like financial system stability, and stable and overvalued exchange rates, will eventually lose their importance in promoting Mexican economic growth.

6. Conclusion

In this paper it is argued that money and, more generally, liquidity are key features of the capitalist system that need to be available for economic growth to take place. This is entirely consistent with the arguments about social ontology, ethics, and political economy that have been made in the other contributions to this issue of the *Journal*.

Money and liquidity are endogenous and non-neutral, meaning that no entity can have ultimately have control over them, *i.e.,* central banks. Monetary policy thus operates through the rate of interest, a condition that became obvious in the period of financial globalization, and in 'normal' periods, the central bank's determination of the short-term nominal rate of interest modifies the entire schedule of returns (Keynes 1930). In terms of finance, big corporations have no limits because they resort to internal funds or other rentier capital (Kalecki 1939). Therefore, in capitalist economies, the rate of interest modifies the distribution of income and, in this way, productive activity. But there is no direct link between changes in interest rates and investment.

A second important feature of the period of financial globalization was that economic policy relied almost entirely on monetary policy, repudiating fiscal and industrial policy, even in periods of economic crisis. Mainstream economics claims that

market mechanisms operate better than government spending. Kalecki (1943) argued that although full employment policies may increase the capitalist rate of profit, there are political issues that limit the scope of government economic intervention.

In this context, what happened in the Mexican economy from 2019 onwards has been analysed, highlighting two important phenomena that occurred in this period. A centre-left government took office for the first time in 70 years, and the world's economic activity was paralyzed in 2020 by the pandemic.

The Mexican central bank's operations did not change substantially from previous periods. It continued to be autonomous and followed the Fed's interest rate monetary policy. The main benefit of this policy was the stabilization of the Mexican peso despite the economic recession and in that way the financial system attained stability, strengthening foreign capital operations in the Mexican economy. This became very important in the aftermath of the pandemic, particularly in terms of the geopolitical conflict between the West (US and Europe) and China, which generated the US strategy of 'near shore'. In this context, Mexico plays a central role due to the Mexican – US integration of production resulting from the previously existing and current trade agreements (NAFTA and USMCA) and its geographic location.

The negative effect of the Mexican central bank's monetary policy has been that during periods of recession (2020 – 2021), the interest margin rose and most of the financial flows took place through short-term instruments. The US - Mexico long-term margin is relatively small, provoking the capital market to remain shallow and narrow; therefore, long-term movement takes place in the international market in dollar debt denominations, increasing Mexican financial dependency.

Thirdly, exchange rate stability is a double-edged sword since it can neutralize foreign inflation's impact on Mexican prices, reduce foreign interest payments, and, on the other hand, reduce the value of Mexican economic activity in the rest of the world. The way to reduce reliance on exchange rate stability is to fortify economic activity.

Fourthly, within the neo-liberal framework, there is some space to improve the economic well-being of poor people, so long as there is a political determination to pursue different economic results.

Acknowledgements

Noemi Levy Orlik is Full Professor in the Facultad de Economia, UNAM, Mexico City. This paper is part of the research project Papiit IN 303823-UNAM. Underlying data and charts are available from the author on request. I want to thank John Smithin for his helpful comments on this paper.

References

Amsden, A. 2004. Import substitution in high-tech industries: Prebisch lives in Asia! *Eclac Review* 82: 75-89

Anscombe, G.E.M. 1958. On brute facts. *Analysis* 18: 69–72.

Cimoli, M. & S. Rovira. 2008. Elites and structural inertia in Latin America: an Introductory note on the politics of development. *Journal of Economic Issues* LXII: 327-47.

Chang, H-J. and I. Grabel. 2014. *Reclaiming Development: An Alternative Economic Policy Manual* (*Critique Influence Change*). Place?: Zed Books.

Fajnzylber, F. 1983. La industrialización trunca de América Latina. In *Cincuenta años de pensamiento en la CEPAL*, vol. II, 817-852, Santiago, Chile: Fondo de Cultura Económica.

Fajnzylber, F. 1990. Industrialización en América Latina: de la 'caja negra' al 'casillero vacío': comparación de patrones contemporáneos de industrialización. *Cuadernos de la CEPAL* (60) 176.

Kaldor, N. 1959. Problemas económicos de Chile. *Trimestre Económico* 26: 170-221. Fondo de Cultura Económica, México.

Kalecki M. 1933. Determinants of profits. (As reprinted in *Selected Essays on the Dynamics of a Capitalist Economy 1933-1970*, Cambridge: Cambridge University Press.)

Kalecki, M. 1939. Entrepreneurial capital and investment. (As reprinted in *Selected Essays on the Dynamics of a Capitalist Economy 1933-1970*, Cambridge: Cambridge University Press.)

Kalecki, M. 1943. Political aspects of full employment. (As reprinted in *Selected Essays on the Dynamics of a Capitalist Economy 1933-1970*, Cambridge: Cambridge University Press.)

Keynes, J.M. 1930. *A Treatise on Money*, vol. 2, *The Applied Theory of Money*. (As reprinted in *Collected Writings* V1, ed. D. Moggridge, London: Macmillan, 1971.)

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

Mántey, M.G. 2011. La política de tasa de interés interbancaria y la inflación en México. *Investigación Económica* LXX. http://dx.doi.org/10.22201/fe.01851667p.2011.277.37320

Marchenko, A. & J. Smithin. 2023. Is philosophy is part of economics or economics is part of philosophy? *Aurora Philosophy Journal* 2(1): 1-20.

Searle, J.R. 1995. *The Construction of Social Reality*. New York: The Free Press.

ISSN 2816-394X (Print)
ISSN 2816-3958 (Online)

The Aurora Philosophy Institute is a non-profit organization, federally incorporated in Canada since July 2019, dedicated to philosophical research and ideas. Our programs promote philosophical ideas and concepts which we feel will have practical results in the areas of community outreach, education, public policy, and research.

Let us draw your attention to our logo above. This is the ***Tree of Life*** which is a widespread theme or archetype in many of the world's mythologies, religions, and philosophical traditions. We think that this is an excellent fit for philosophy.

***Founding Directors*:**

ALLA MARCHENKO
JOHN SMITHIN

Website: www.theapi.ca
E-mail: auroraphilosophyi@gmail.com
YouTube: www.youtube.com/c/AURORAPHILOSOPHYINSTITUTE

ISSN 2816-394X (Print)
ISSN 2816-3958 (Online)