Laidler's Monetarism

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> From the point of view of the non-academic observer whose main concern was the conduct of economic policy, Monetarism involved first a theory of inflation, second a theory of the cycle, and third, as a corollary of these, a recommendation for the conduct of monetary policy. Specifically, inflation was said to be explicable in terms of the rate of growth of the money supply, and the cycle, or more precisely its turning points, in terms of changes in that rate of growth.
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> Laidler 2004 [1990], p. 395.

To understand Laidler's work as a whole, we need to put ourselves in his shoes, and imagine what it was like to enter the profession during the years of Keynesian hegemony, when all of macroeconomics was supposed to be summarized by the simple two-curve IS-LM model, itself presumed to be an aggregative version of the Walrasian general equilibrium model, and when econometric estimation of multiple-equation versions of this simple model was seen as the epitome of empirical work in the field. With modern economic theory to guide their thinking, and modern computers to help them tie theory to the data, it seemed to many economists entirely possible that the business cycle could be conquered by science.

As an undergraduate at the London School of Economics, Laidler's first exposure to monetary theory came during the years when the famous Radcliffe Committee Report on the Working of the Monetary System (1959) was being prepared. The principal author of the Report was R. S. Sayers, a professor at the LSE and a man whose understanding of money stemmed from historical and institutional study of Bank of England operations since 1890 (Sayers 1936). Laidler remembers: "Debates about the effectiveness of monetary policy certainly penetrated the undergraduate teaching" (Ruhl

and Laidler 1998, 28).[1] These debates, in a sense, have been the theme of Laidler's work ever since.

In his money and macro classes the young Laidler learned the standard stuff, which basically meant Patinkin plus the Phillips curve. But on Friday afternoons, in the seminar of Lionel Robbins, he read the classics of 19th century monetary economics, including the classic debate between the Currency School and the Banking School. Here we find the origins of Laidler's subsequent two-track intellectual career, always with one foot in the Monetary Walrasianism that was the orthodoxy of his time, and the other one in the history of monetary thought. The dialectical tension between these two tracks would provide the energy for a long and productive intellectual career.

That dialectical tension was methodological (mathematico-statistical versus historico-institutional) but also substantive. Since Monetary Walrasianism emphasized the Currency School line, Laidler used his historical studies to explore the missing Banking School side of the debate: Smith, Thornton and Bagehot, Tooke, Hawtrey, the Radcliffe Report, and the late work of Sir John Hicks (Laidler 2004, Chs. 1, 3, 4, 10, 14, 15 [1981, 2003, 1972, 1993, 1989, 1994]). To the outside world, the two tracks of Laidler's intellectual career could easily look like two successive careers—econometrics when young, history when old--but this is to misunderstand the man.[2] The history of thought side took longer to mature, but it was very much a part of Laidler's internal dialogue from the very beginning.

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[1] See also Laidler's biographical essay "Economics as a way of life—a personal memoir" in Laidler (1997).
[2] Unfortunately, the publication of Laidler's selected essays in two separate volumes, one on Money and Macroeconomics (1997) and the other on Macroeconomics in Retrospect (2004), tends to suggest this misinterpretation.

Just so, when young Laidler continued on for graduate study at the University of Chicago, the two-track pattern continued with exposure to Milton Friedman's version of Monetary Walrasian orthodoxy on the one hand balanced by Earl Hamilton's course on the history of banking theory on the other hand. These were the years when Friedman was hard at work (with Anna Schwartz) on his Monetary History of the United States, 1867-1960 (1963) and Laidler's research assistance for that project exposed him to a way of doing empirical work that would sustain him through the first stage of his subsequent academic career. Although his dissertation (with Harberger) was in public finance, his first professional publications were all in money.

Starting his academic career at Berkeley, Laidler produced in quick succession two impressive empirical papers on money demand that were quickly published (1966, 1997 Ch. 1 [1966]). And at the same time he produced a draft of his first paper in the history of monetary thought, an appreciation of Thomas Tooke that was eventually published as "Thomas Tooke on Monetary Reform" (1972). What did he like about Tooke? It is Tooke's empiricism that comes in for highest praise. Although not perhaps the "painstaking piece of econometric research" (p. 68) that the standards of modern science would require, Tooke's understanding of how the banking system actually worked (specifically the flux and reflux of the note issue) was clearly superior to that of his intellectual opponents, who nevertheless managed to prevail in subsequent legislation (Peel's Act), as well as subsequent academic opinion.

For the young Laidler, even if for no one else, these two lines of research were intimately connected. Tooke and the other founders of British monetary orthodoxy (see Fetter 1965) had distilled their wisdom largely from historical and institutional study

because that was the best scientific method available to them. Econometrics appealed to the young Laidler for its promise of engaging even more deeply with the data; it seemed to him just a more modern and scientific way of doing historical and institutional study. In time he would come to question his youthful faith in the promise of econometrics, and develop greater appreciation for the less technical but more direct engagement of an earlier intellectual style. But at the beginning of his career econometrics seemed to be a way of testing how well theory fit the facts, and as such a force for improvement of theory.

But Tooke was not just an exemplary scientist, he was also the leader of the Banking School. Reading Tooke made Laidler aware of the positive contributions of the Banking School approach to monetary matters, by contrast to the stream of American monetarism that, starting with Irving Fisher and continuing through Milton Friedman, developed the Currency School line. For the Banking School, the gold standard already provided the necessary long-run discipline for the monetary system, and that institutional fact allowed them to focus their attention more on how best to manage the elasticity inherent in credit. Their policy answer, the real bills doctrine, was plainly unsatisfactory but in other respects their analysis was plainly superior. The challenge for Laidler was to understand how the balance of discipline and elasticity that Tooke had sought for his own time could be achieved under very different modern conditions, to wit a system of apparently fiat national currencies without any inherent nominal anchor. The modern dominance of Currency School thinking reflected understandable concern about the problem of discipline in such a system, but missed the important dimension of elasticity.

Laidler's early engagement with Tooke's work thus marks the beginning of Laidler's doubts about the exogenous money model shared by Friedman and his critics.

Indeed, some hint of these emerging doubts can be seen even in Laidler's own painstaking econometric research. In the very first of his 1966 empirical papers, he is already testing his own non-Friedmanian theory of money demand: "This hypothesis states that transitory income and negative transitory consumption are added to money balances, so that their level at any time will depend upon all past levels of these transitory components" (1966, 56). Here is the origin of Laidler's later embrace of what he would call the "buffer stock" approach to monetary economics (Laidler 1997 Ch. 13 [1984]).

In 1966 however these were only doubts, not convictions. Like his mentor Milton Friedman, Laidler more or less accepted the theoretical framework of Monetary Walrasianism that had been developed by the Keynesians Patinkin, Tobin, and Modigliani, and like Friedman he determined to fight the monetarist battle on empirical grounds. The battle was not about laissez faire, since both sides agreed that money needed managing, but rather about the efficacy of monetary control for short term business cycle stabilization (the Keynesian view), as opposed to long term price level stabilization (the monetarist view). Thus did Laidler find his initial ecological niche as an empirical researcher focusing on the Demand for Money (Laidler 1969).

That first book can be read as an attempt to answer the challenge of the Radcliffe Report. Whereas the central message of the Report had been the instability of money demand, narrowly conceived, and the consequent challenge of central bank policy, Laidler took the central message of Friedman's monetarism to be essentially the opposite. As a theoretical matter the demand for money seemed to be a problem quite amenable to

applied price theory, and as an empirical matter it seemed to be a stable function well-described by a small number of parameters (Friedman 1956, 1959). To Laidler, Friedman's project thus seemed very much in line with the stream of neoclassical monetary economics that had been building on the foundations of British monetary orthodoxy ever since 1870 (as Keynes also). Possibly the Radcliffe Report was correct to emphasize the challenge of modern monetary management, but possibly also the tools of modern monetary economics could rise to that challenge.

In the British environment where Laidler moved after his initial Berkeley appointment (to Essex, then Manchester) the Radcliffe Report was interpreted not as a challenge but rather as a decisive repudiation of monetary orthodoxy. Fiscal policy, not monetary policy, was the main tool for economic stabilization and sociological explanations of wage inflation were all the rage. In this context, Laidler's ambition to revive monetary explanations of inflation earned him the label of monetarist, a label he decided to accept and thereafter wore proudly (Laidler 1975). In the US context, by contrast, Laidler's gradualist "Manchester monetarism" might have placed him among the monetary Keynesians, such as Tobin and Modigliani, even though Laidler was never as convinced as the Keynesians of the potential for short term fine tuning using monetary policy.[3] But neither classification captures the man very accurately. From a larger historical perspective, Laidler's monetarism was simply a modern version of the 19th century quantity theory of money that had provided the broad framework within which Currency School and Banking School advocates argued their case. At the start of his career, Laidler seems to have understood Monetary Walrasianism (specifically the IS-LM

[3] The harsh review of Laidler (1969) by Hyman Minsky (1972) suggests how Laidler's monetarism was viewed from the perspective of one of the few American radical Keynesians, albeit a friend and colleague from Berkeley days.

model) as a similarly overarching framework within which similarly important argument could take place.

But, as I have said, a seed of doubt had been planted by Tooke, and soon enough that seed would be nourished by the work of Brunner and Meltzer (1971). As early as 1973, in a paper titled "Information, Money and the Macroeconomics of Inflation," Laidler is explicitly moving away from Friedman and toward Brunner and Meltzer.[4] Here we see his first explicit embrace of the "buffer stock" view of money demand, by contrast to Friedman's money-as-a-durable-consumer-good view. Equally important, we see his embrace of disequilibrium, by contrast to the Walrasian equilibrium approach adopted by both Friedman and his Keynesian interlocutors.

Laidler himself presents this intellectual shift as a consequence of his Popperian empiricist commitments—the data revealed to him the inadequacy of existing theories, suggested the source of that inadequacy, and hence proposed a line for fruitful future theoretical development. But there is more to it than that. Brunner and Meltzer provided for Laidler a line more continuous with Tooke and the classic 19th century literature than anything offered by modern Monetary Walrasians of any stripe. Brunner and Meltzer's discussion of the supply of money (not just demand) and the process of credit expansion (not just the eventual equilibrium position) provided Laidler with a modern analytical framework within which the classic questions could be discussed. In 1973, his doubts became convictions.

The consequence of this intellectual shift was that, as Milton Friedman's monetarism rose in prominence during the 1970s, Laidler found himself increasingly in

[4] Laidler has written that he considers this paper to have been his best (Laidler 1997, 115). Be that as it may, it certainly represents a key turning point in his own intellectual development.

opposition not only to the Keynesian fine-tuners, but also to his own monetarist mentors and colleagues. On the surface, the problem was that empirically the demand for money did not show the degree of stability required to support Friedman's strong policy advocacy of a constant money supply growth rule. "[T]he case for governing monetary policy by long-run rules is impossible to sustain in the face of careful consideration of the influence of institutional change on the behaviour over time of the demand for money function" (Laidler 1982, 35). Similarly, "the belief …that the demand for money in the aggregate economy can be modeled in the long and short runs 'as if' money was a consumer durable good, is fallacious" (Laidler 1982, 42).[5]

But these theoretical and empirical problems with money demand were in fact only symptoms of a deeper problem that came more and more to the forefront as the New Classical Macroeconomics of Robert Lucas and his colleagues took center stage. Laidler's own "Manchester monetarism" had in fact never assumed market clearing (nor had the Keynesian IS-LM model that he had used to express it) while Friedman's monetarism had explicitly drawn such a connection. Says Friedman (1968, 8): "the 'natural rate of unemployment' is the level that would be ground out by the Walrasian system of general equilibrium equations." This asserted connection between monetarism and Walrasianism proved to be unsupportable, as Frank Hahn (among others) has pointed out, but Friedman's metaphorical Walrasianism nevertheless played a crucial role in preparing the ground for the more thoroughgoing analytical Walrasianism of the New

[5] It would be an interesting exercise in the history of economic thought to investigate how Laidler's changing views are reflected, or not, in the four editions of his textbook on the Demand for Money (1969, 1977, 1985, 1993).

Classicals.[6] Quite apart from its evident lack of empirical grounding, the New Classical assumption of continuous market clearing left no room for money even in theory. As Laidler would say, "Money does in the world what markets do in our theories."[7]

The rise of New Classical Macroeconomics thus was not Monetarism Mark II (as James Tobin termed it) but rather the very antithesis of what Laidler always understood monetarism to be about. In the American historical context, monetarism had risen up as a corrective to the extreme anti-quantity theory views of the arch conservative J. Laurence Laughlin, who had at the beginning of the century used his platform at the University of Chicago to promote an extreme version of the real bills doctrine.[8] How ironic then, that Milton Friedman's Chicago School monetarism should have paved the way for a restatement of much the same discredited idea in the paper of Sargent and Wallace "The Real Bills Doctrine and the Quantity Theory: a reconsideration" (1982). Just as Laughlin had misappropriated Tooke in the monetary debate leading up to the founding of the Federal Reserve System (Mehrling 2002), so now were the New Classicals misinterpreting Tooke's message for the modern age, and Laidler felt compelled to respond (Laidler 1984). But the problem was not just a misreading of Tooke. The problem, Laidler decided, was with Walrasianism itself.

Thus Laidler found himself keeping company increasingly with the critics of the Walrasian turn in macroeconomics, not just Brunner and Meltzer, but also Axel

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[6] Much the same could be said about the role of the metaphorical Walrasianism of the Keynesian IS-LM model.

[7] Laidler Festschrift, August 19, 2006. This verbal quotation is just a more compact version of what Laidler has often expressed in print. For example, "money is a social institution which is a substitute for, and not a complement to, the Walrasian market, so that conventional general equilibrium theory and monetary economics do not mix" (1997, xxii)

[8] The book of Lloyd Mints (1945) is the locus classicus of the old Chicago School reaction to Laughlin, and a common thread linking the old Chicago School of Simons and Knight to the new Chicago School of Friedman and Stigler. This link is the grain of truth in Friedman's otherwise overstated claim to have been continuing an oral tradition at Chicago.

Leijonhufvud and Charles Goodhart, Robert Clower and Peter Howitt, the late work of Hicks, as well as post-Keynesians such as Hyman Minsky, Victoria Chick, and Paul Davidson. Laidler's monetarism was always about understanding the world, and if the economics profession was set on embracing a theoretical construct that abstracted from this monetary reality, so much the worse for the economics profession. Like his hero Tooke, Laidler would continue Taking Money Seriously (1990) even as his intellectual opponents prevailed in subsequent legislation and in the court of academic opinion, at least in the United States.[9]

Non-Walrasian monetary theory was what needed doing, but Laidler himself lacked the analytical tools to push that agenda very far. He turned instead to the analytical insights already available in the history of economic thought, insights he had been mining himself ever since reading Henry Thornton with Lionel Robbins as an undergraduate. Laidler's new insistence on history of economics as a way of doing economics put him in good company with Jacob Viner, Frank Fetter, and Don Patinkin. Although he engaged with and supported others who worked on the history of economics, he never viewed such work as comprising a subfield of economics, and that perhaps explains his occasional lack of attention to the secondary literature (noted by Dimand). Laidler reads old economics in order to gain insights for today. By watching how economists adapted to changing circumstances, he hopes to derive clues and inspiration about how we can do the same for our own modern changing circumstances.

A monetarist among Keynesians in his early career, Laidler's opposition to temporary orthodoxy was born of neither ideological anti-state conviction, nor starry-

[9] Here a full appreciation of Laidler would require treatment of his extensive work as an advisor to the Bank of Canada, as well as Laidler's many other policy interventions.

eyed faith in unfettered markets. Instead, his disequilibrium monetarism was an alternative road branching out from origins in the pre-World War I development of neoclassical monetary economics (Laidler 1991) and the interwar literature on money, the cycle and unemployment (Laidler 1999). For the post World War II period it turned out to be a road not taken by the profession at large, at least not yet. Laidler's metaphorical non-Walrasianism can be understood as preparing the ground for a more thoroughgoing analytical non-Walrasianism yet to come.

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