Journal of Economic Literature
Vol. XXX (December 1992), pp. 2133–2188

Book Reviews

B Methodology and History of Economic Thought

The golden age of the quantity theory. By DAVID LAIDLER. Princeton, N.J.: Princeton University Press, 1991. Pp. xv, 220. $35.00. ISBN 0–691–04295–0. *JEL 92–0023*

This splendid little book surveys the development of monetary theory from about 1870 to 1914.

Laidler sets the stage for the main part of his story with an admirably well-balanced chapter summarizing the monetary orthodoxy of the British classicals as it had developed up through Mill, Jevons, and Bagehot. Classical theory had the value of commodity money determined by its cost of production. The difficulties with this conception were already recognized (but not clearly resolved) by J. S. Mill: The existing stock of the monetary metals is very large relative to the flow of output and the latter is produced at sharply rising marginal cost.

In monetary theory, the challenge to the neoclassicals became to produce a theory of the price level that would answer the obvious objections to the Classical theory. Alfred Marshall and Irving Fisher, two of the three main protagonists of Laidler's story, responded by providing theories in which the price level is determined by the supply and demand for money.

To Marshall, classical value theory had to be completed by adding a theory of demand so that short run movements of price could be explained. In monetary theory, the analogous task was to provide the Quantity Theory with a systematic explanation of the demand for money, i.e., of "the amount of commodities over which people . . . keep command in a ready form." Today's microtheorists tend to hold Marshall in no high regard. Here, he gets rehabilitated, albeit in a different field. Laidler has done an excellent job of piecing together his monetary theory, relying in particular on Marshall's (1871) manuscript that was published only 104 years later by Whittaker. The strong core of the Cambridge tradition in the field is already complete in that early work. The picture that emerges makes of Marshall one of the major figures in the history of monetary economics.

Marshall and his followers focused on the demand and supply of (commodity-convertible) currency. Bank money, in this analysis, is a substitute that reduces the demand for "money." Fisher worked with a definition of "money" that included bank liabilities, thus switching banking to the supply side of his quantity equation. Laidler is able to show that, in the hands of the masters, one apparatus was as good as the other in the analysis of virtually all problems. Yet, other readers may see here the beginnings of the ambiguities over outside and inside, exogenous vs. endogenous money that have continued to bedevil the quantity theory in our own day: Which "*M*" is it that the price level is proportional to in equilibrium? Does the theory give us license to pick some other monetary aggregate as might seem convenient in analyzing more "short run" problems?

The close agreement between Marshall and Fisher sometimes becomes a matter of surprise. The two models would seem to suggest different approaches to analyzing short-run variations in velocity, for instance. The Cambridge model starts from the question of what proportion of wealth will be allocated to cash-balances; one expects it "naturally" to develop along portfolio theoretical lines and to stress the interest elasticity of money demand in explaining changes in velocity. The Fisherian transactions model, on the other hand, predicated on the gradual evolution of payments technologies, points to expansions and contractions of credit as the "natural" explanation for such variations in aggregate demand. But, as Laidler makes clear, both schools concentrated on developing the analysis of the "credit cycle," whereas the portfolio approach only got its first impetus much later starting with Keynes' ideas on liquidity preference.

It is only today, a hundred years later, that the long predominance of the portfolio approach has left us unprepared to reexperience the credit cycle.

The third big name in the story is that of Knut Wicksell, whose style in theorizing strikes one as more "modern" than that of Marshall or Fisher. Wicksell constructed two prototypical monetary models; his "pure cash economy" was a quantity theory exercise while the conceptual experiment of his "pure credit economy" was in effect its complete antithesis. Both were to be understood as "imaginary cases" but actual monetary systems were to be analyzed by the judicious mixing of the two. In Wicksell's day, metallic currency was disappearing from everyday circulation, the issue of paper money was not yet monopolized by governments, and reserve requirements were not yet imposed on banks. There were good reasons for analyzing the case of a monetary economy about to slip its quantity theory anchor!

There is much else to recommend in this book. Most readers will come away with a better understanding of how economic knowledge evolves and how internal and external factors interact in that process. The progress of monetary theory in this era was far more governed by the internal logic of the intellectual enterprise than in the first half of the nineteenth century. But Marshall, Fisher, and Wicksell and their lesser contemporaries were also grappling with the institutional changes and the policy issues of their time and their theoretical work was done with such ends in view. One is struck by the lack of a very clear line between theoretical and applied analysis. The split came much later with the victory of the conception that "theory" is deduction from axioms. The monetary economics of Laidler's Golden Age was still made of whole cloth.

This book should be recommended reading for all graduate students in monetary economics. For my students, it will be required. They won't mind. Among its other virtues, it is a "good read."

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REFERENCE

MARSHALL, ALFRED. "Money" in *The early economic writings of Alfred Marshall*, 2 vols. Ed.: JOHN WHITTAKER. London: Macmillan, 1975.

Ricardo and the gold standard: The foundations of the international monetary order. By MARIA CRISTINA MARCUZZO AND ANNALISA ROSSELLI. Translated by JOAN HALL. New York: St. Martin's Press, [1986] 1990. Pp. x, 183. ISBN 0-312-05327-4. *JEL 92-0024*

This book examines both how Ricardo thought the gold standard operated and how it actually operated. The premise of the book is that it is not possible to understand either without a thorough understanding of the institutions of the gold and foreign exchange markets of the early nineteenth century. Thus the authors tackle the important but difficult task of integrating material from the history of thought (Ricardo's writings), economic history (the evolution of financial institutions), and international finance (theories of adjustment under the gold standard). This book will be of interest to readers from all three subdisciplines.

The structure of the book reflects its interwoven objectives. The first chapter discusses the sources for Ricardo's opinions on the gold standard. Chapter 2 describes the domestic financial system of the early nineteenth century, and Chapter 5 continues the history with a description of what international transactions were financed and by whom. In Chapters 3 and 4 the authors argue that Ricardo defined the value of money as the inverse of the price of gold rather than of the price level, and introduce his theory of balance-of-payments adjustment. Chapters 6 and 7 present a careful analysis of the operation of the London market for gold and bills of exchange, while Chapters 8 and 9 contrast Ricardo's theories with modern theories of balance-of-payments adjustment and those of Ricardo's contemporaries.

The authors are careful in the introduction to identify where their work departs from existing interpretations; viz., in arguing that Ricardo measured the value of money by the inverse of the value of the standard, which is itself invariant in value; by distinguishing between stable and unstable monetary regimes rather than, for example, between regimes of convertible