

‘The Continuing Muddles of Monetary Theory: A Steadfast Refusal to Face Facts’

“Lionel Robbins was much concerned about the methodology of economic science. When he discussed the desirable relationship between theory and ‘reality’, two of the three examples that he presented where the theoretical analysis was not sufficiently based on a knowledge of historical fact were taken from monetary economics. Indeed, monetary theory has remained prone to such shortcomings ever since.

Amongst the worst are:-

- (1) IS = LM: the monetary authorities set the monetary base, and the interest rate is determined in the market;
- (2) The monetary base multiplier of bank deposits, and the role of reserve ratios;
- (3) The current three equation neo-classical consensus, which not only assumes perfect creditworthiness for all agents, but also an essentially non-monetary system, e.g. no need for banks;
- (4) The standard theory of the evolution of money.

Monetary economics can only get better, but it has a long way yet to go.”