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Book Review: The Demand for Money: Theories and Evidence

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"The Demand for Money: Theories and Evidence", By David E. W. Laidler International Textbook Company. Scranton, Pennsylvania. 1969. XIII, 128, pp. $2.00.

The special attribute of this slim volume is a presentation and evaluation, at purportedly an advanced undergraduate level, of some recent well nigh entirely American literature in which empirical demand functions for money are estimated. Even though the author has been active in this research, this is not a 'do it yourself' guide to the estimation of such demand functions; anyone who wants to undertake such research or who wishes to instruct by having students replicate studies will need to look elsewhere for help. As this is a book about these research studies, it does not contain serious expositions or critiques of the research efforts.

To be of value as a teaching instrument, a volume about research findings needs to imbed the findings in a framework of analysis and ideas. The formal model the author uses is the conventional IS-LM apparatus. In this volume, until well nigh the final pages, the validity of this model as a framework for analysing macroeconomic problems is not questioned; when questioned the deeper issues are evaded.

In particular the liquidity trap and the speculative demand for money are treated as problems in the interest elasticity and stability of the 'demand for money', defined as a function of some interest rate and some income or wealth variables. As is well known this is a questionable interpretation: on an alternative interpretation the speculative demand for money in the Keynesian framework determines not money holdings but the price level of the stock of capital goods. Liquidity traps exist when increasing (decreasing) the amount (within some bound) of money via the banking process is ineffective in raising (lowering) the market price of

the existing stock of capital sufficiently to increase (decrease) the pace of investment. Thus the validity of the liquidity preference approach can only be evaluated within a model which allows for two price levels (or alternatively two sets of interest rates). The entire argument in this volume is advanced within the assumption that there exists one and only one price level (or set of interest rates).

Monetary economics, perhaps more so than other branches of economics, is essentially institutional. Changes in velocity, the lag pattern between policy actions and system response, the endogenous reactions of money supply, and the spectrum of money substitutes are all determined by the institutional set up and its evolution. Rapid velocity changes, which lead to high and low level liquidity traps, are associated with significant institutional changes. The identification of the cyclical deviation from longer term relations in terms of such institutional changes and an analysis of the impact of these institutional changes upon system characteristics is an essential problem of monetary theory and a major determinant of the demand for money. Such material is foreign to this volume.

Thus the volume is a presentation on a once over lightly basis of a very special approach to how money affects system behavior: even as an undergraduate textbook it might be labeled naive.

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