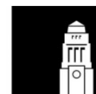
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<pt>Introduction: the theoretical legacy of Augusto Graziani

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<ab>Augusto Graziani (1933–2014) was one of the most eminent Italian economists of the twentieth century. He is internationally known as the founding father of the Theory of Monetary Circuit. His contributions to economic theory went beyond the circuit, especially in the early part of his career. They included both other theoretical areas (for example, a *critical review of Walras'*s general equilibrium model) and the analysis of *the 'uneven development' of the Italian economy*. Even his approach to *'circuitism'* was quite original and cannot be reduced to a special branch of post-Keynesianism. This introduction to the special section of ROKE on Graziani highlights some key points of his heretical thinking, and gives a quick summary of the papers that follow.</ab>

<kw>**Keywords:** Augusto Graziani, Keynes and Keynesianism, Marx and Marxism, Walras and Neoclassical Theory, Theory of Monetary Circuit

<jc>**JEL codes:** B30, B51

<a>1 MACRO-MONETARY FOUNDATIONS OF ECONOMICS

Augusto Graziani (1933–2014) was one of the most eminent Italian economists of the twentieth century. He is internationally known as the founding father of the Italian School of the Theory of Monetary Circuit (TMC hereafter), although this label is quite limited, both chronologically and theoretically, for two reasons. First, it neglects some of his most interesting earlier contributions, and second, even the later Graziani was pretty original in his theoretical and policy views. Yet the TMC represents the analytical nucleus of Graziani's economic thought after the mid 1970s (Graziani 1989; 2003).

While this approach is usually regarded as a mere variant of the post-Keynesian endogenous theory of money, it is inaccurate for two reasons. First, Italian 'circuitism' cannot be reduced to a mere criticism of contemporary neoclassical macroeconomics (notably, standard Keynesianism, Monetarism and New Classical Macroeconomics).

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Second, it arose also from a deep dissatisfaction with the other non-mainstream approaches, meaning traditional Marxism and the Neoricardian surplus approach, as well as the UK and the US post-Keynesianism. It is true, of course, that Graziani's reflection bears many resemblances to the post-Keynesian theory, especially to the 'horizontalist' approach. However, Graziani's intellectual legacy extends far beyond it. In fact, it contrasts with most of the received knowledge in orthodox and heterodox approaches in economics, including post-Keynesianism.

To understand Graziani's uniqueness, one has to understand his intellectual formation as well as his early contributions.[1] Trained in some of the most prestigious 'neoclassical' strongholds (including the London School of Economics and Harvard), Graziani had a first-rate knowledge of mainstream economics. This is shown by his writings on Walrasian instantaneous general equilibrium models (Graziani 1965). Contrary to some stories, Graziani was never a neoclassical economist, and his 'dissenting' research programme is clearly rooted in the 1950s and 1960s. This said, it is true that Graziani never questioned the logical consistency of the Walrasian system of equations and the neoclassical model of growth and distribution (particularly the flaws of the aggregate production function pointed out by Garegnani and Pasinetti, following Sraffa's 1960 book).

Paradoxically, Graziani even defends Walras as a better representation of markets – meaning a superior explanation to the (then in vogue) 'proportional' macro-models of growth. At the same time, Graziani challenges the basic assumptions of orthodox theory by rejecting the initial definition of the economic and social world as being populated by identical individuals, where consumers are sovereign, technology is exogenous and money is neutral. Large social or 'macro' groups matter, and corporate power is essential in a world of permanent imbalances and conflicts.

The impossibility of accounting for the process of money creation, circulation and destruction within Walrasian-like models, as well as the limited role of money in Marxist and Neoricardian theories, led Graziani to argue that the search for an alternative, macro-monetary foundation to economic theory had to be the priority, a search that went far beyond post-Keynesianism, both in its UK and US incarnations.

Graziani advocated the rejection of the dominant depiction of capitalist economies as 'village fairs' – to steal a vivid expression from Hyman Minsky – where production processes, if any, are of a cooperative nature and money is just an exogenous lubricant facilitating barter relationships between individuals with no sociopolitical identity.

[1] After the death of Graziani, Lilia Costabile has written extensively on Graziani's legacy (see Costabile 2014a; 2014b; 2015). Recently, Studi Economici published a monographic issue dedicated to Graziani, which opened with a very good paper by Domenicantonio Fausto (2014).

For Graziani, class division matters, and the dominance of firms (meaning industrial capitalists) over a fully developed capitalist society arises from their privileged access to bank credit to finance production plans (what Graziani used to call 'initial finance'). These plans are selected by the banking system, whereas non-bank financial intermediaries allow firms to recover the liquidity the firms themselves pushed in the economy through the payment of wages to workers. While each single worker (or wage-earner) may well wish to borrow from banks to fund consumption in excess of her available income, this is nothing but an indirect (final) finance to firms. In fact, the purchasing power of the working class considered as a whole is unaffected by any monetary flow, be it in the form of bank loans, nominal wages, or monetary transfers from the State.

The point is that the real wage of the working class is defined by autonomous decisions (about both the level and the composition of output) made by the firms, together with banks. Higher workers' monetary income flows can only lead to a higher unit price of consumption goods when firms' investment plans exceed workers' voluntary savings. Thus, inflation is not only a signal of an ongoing conflict over the distribution of income in the 'market' of labour power, but also the way in which the corporate sector compels workers to fund ex post its planned investment (through forced saving). When government deficit spending is included in the analysis, it is one of the most important means to 'monetise' firms' real profits. More than that, as in Schumpeter, inflation matters through the changes in relative prices and relative distribution of resources, within the capitalist class: among firms, and between the firm sector and the banking sector.

This result is strengthened by the consideration that, for Graziani, firms' debt to workers is fictitious. The interest bill paid on securities is, like the wage bill, money going to households, which eventually flows back to firms either through the commodity market or the financial market. The only uncertainty is the degree of liquidity preference of workers. Notice, however, that a higher liquidity preference leads to a higher debt of firms towards banks, not workers.

Similarly, the ownership of capital goods through shares is fictional, because workers do not have any true control over corporate governance and the decisions of firms. This allows Graziani to show that the distributive results of Kalecki's basic model are unaffected by the consideration of workers' saving decisions. The only real portion of output going back to workers is the real wage decided by firms, conditional on the state of the (non-market) social conflict among classes – as if the propensity to consume was unitary.

Unlike the interest paid on securities held by workers, the interest paid by industrial capital (the firm sector) to financial capital (the banking sector) is a real cost. The

conventional determination of the bank interest rate determines the allocation of the surplus between these two fractions of the capitalist class.

In Graziani's theoretical scheme, the effectiveness of government spending (and taxation) is affected crucially by the reaction of the firms. Should firms not wish to modify their production plans following a change in the fiscal (or monetary) policy stance, then no effect on the level of real income and distribution would materialize. In Graziani's vision, or at least in the most radical rendition of it, consumer sovereignty is completely tipped over and replaced with an outright producer sovereignty.[2] The dominance of firms over capitalist societies can only be reduced by a direct intervention of the State in the economy, meaning the direct provision of goods and services to divert resources from the corporate sector to the working class.

Such a Marxian flavour is further strengthened by Graziani's advocacy for (a macro-monetary interpretation of) the labour theory of value. The point is that the value of capital, for the capitalist class as a whole, cannot arise from exchanges within the industrial sector – it would be an instance of profit upon alienation, and the profits of some firms would match the losses of other firms. Since the only possible 'external exchange' for the capitalist class is the purchase of labour power from workers, it is only to the extent that capitalists use labour power within the production sphere that they can realise a surplus value in the form of a monetary profit. The latter arises from the social surplus labour, that is, from the difference between the total living labour time spent by workers and what they get back as paid necessary labour time objectified in the form of real wages (Graziani 1982; 1983; 1986; 1997a; 1997b).[3]

Notice that not only was a new macro-monetary foundation of economics necessary for Graziani, but it was also to be grounded in the hidden 'Marxian' line of research – as he himself explicitly defined it – that originates in the second (1885) and third (1894) volumes of Marx's Capital (1885 [1978]; 1894 [1981]) and that stretches from Wicksell's Interest and Prices (1898) to Schumpeter's The Theory of Economic Development (1911 [1934]), and then to Keynes's Treatise on Money (1930), borrowing also from Kalecki (1971). The Italian School of the TMC may well be regarded as an attempt to recover, develop and refine the above line of study (see Bellofiore 2005). While its analytical structure is akin to other heterodox approaches in economics (notably, the 'old' Cambridge School of economics and the most recent post-Keynesian approaches), Graziani's work possesses a number of distinctive features. We think that the very valorisation of these differences, through an open debate with other heterodox

[2] This provides the rationale for the single-period horizon of the benchmark TMC framework, where the real supply of goods is given and the unit price of output is defined by the market clearing condition (see for example, Sawyer and Veronese Passarella 2015; Veronese Passarella 2016).

[3] This neglected aspect of Graziani's thought has been recently rediscovered and stressed by Bellofiore (2013) and Veronese Passarella (2016).

approaches, is one of the main challenges that the new generations of TMC economists should be taking on in the next few decades.[4]

<a>2 THE STATE OF CURRENT DEBATE

The collection of papers included in this special issue originates from a session in honour of Augusto Graziani at the 11th Stor.E.P. Conference, held in Bergamo, Italy, on 26–28 June 2014. Although this is not meant to provide a fully fledged alternative macroeconomic model, theory or policy, the papers can all be regarded as attempts to question the dominant approach in economics, while driving the TMC beyond its own original boundaries.

The first paper, by Mario Pomini, focuses on Graziani (1965)'s examination of the neoclassical general equilibrium model. While Graziani rejected the charge of inconsistency against the Walrasian system of equations, he reckoned that economic dynamics is basically a process of structural change. As such, it can hardly be captured by an instantaneous equilibrium model. He proposed a dynamic reformulation of the Walrasian system that shows the same logical structure of the endogenous growth literature that flourished in the 1980s–1990s. Thus, on one hand, Pomini's paper sheds light on one of the least known aspects of Graziani's work. On the other hand, Pomini's paper allows a retracing of the coherent, but somewhat unconventional, evolution of Graziani's economic thought.

It is worth noticing that, while the influence of Keynes on Graziani is apparent, Graziani had a rather different appreciation of the 'two Keynesianisms' that dominated the macroeconomic debates until the early 1970s, notably the Neoclassical–Keynesian Synthesis (or IS–LM Keynesianism, mutating into the Patinkin–Clower–Leijonhufvud debate), on the one hand, and the various strands of post-Keynesianism on the other. Yet, and with the partial exception of the Cambridge School influenced by Kalecki and by the Treatise on Money, these Keynesian schools were both grounded in The General Theory (1936 [1973]), where the main function of money (regarded as an exogenous stock created by the State) is to act as a store of value when optimism fades away. Graziani, by contrast, emphasised the need to explain how money (regarded as an endogenous flow created by commercial banks) is created, circulated and destroyed

[4] For a detailed account of the recent 'circuitist' debate, we refer the reader to the collections of essays included in Arena and Salvadori (2004), and Fontana and Realfonzo (2005). See also Messori and Silipo (2012), in Italian, which is mostly about Graziani's writings on Italian economic development and economic policy. Unfortunately, the collection of articles edited by Messori and Silipo (2012) is quite silent about Graziani's interventions after the mid 1970s which were based on his monetary circuit approach.

during 'normal times'. Consequently, he focused instead on the Treatise on Money (1930) and other 'heterodox' monetary writings of Keynes.

For the same reason, Graziani's approach looks very different from the current 'imperfectionist' or New Keynesian mainstream macroeconomics. This is true even with the replacement of the LM curve with an interest-rate rule (and hence the residual determination of money aggregates), which may well be regarded as an implicit recognition of the soundness of the TMC view. Similar considerations apply to the growing interest of New Keynesian economists in the role of financial institutions and relationships along the business cycle. The very connection between the financial structure of a capitalist economy and its real structure is the topic of the second paper of our collection, authored by Guglielmo Forges Davanzati. The author focuses particularly on the link between the state of credit market and labour market conditions, meaning employment levels and the wage rate. The proposed model amends Graziani's benchmark single-period framework to allow capitalists to hold an initial stock of money. It is argued that the employment level ultimately depends on changes in aggregate demand, which, in turn, depends critically on credit market conditions. The case of Italy is considered to support the theoretical model with some empirical evidence.

In a sense, Forges Davanzati's amendments bring the TMC positive analysis back to a more traditional (post-)Keynesian approach. Similarly, the paper by Massimo Cingolani brings TMC normative aspects closer to the standard Keynesian policy, based on demand-side government interventions. While we have questioned this purely Keynesian rendition of Graziani's thought, we reckon this open issue demonstrates that the debate around the intellectual legacy of Graziani has just got started. The link between Keynes's and Graziani's approaches is not the only contentious aspect of the TMC explored in this symposium. Other controversies concern the link between the micro and the macro levels of Graziani's analysis, and the consistency of the TMC with the pivotal role that financial markets and intermediaries have been playing in the last few decades. Focusing on the first issue, Cingolani recovers Graziani's claim that economists should engage with macrofoundations of microeconomics rather than microfoundations of macroeconomics. It is starting from this methodological premise that Cingolani argues that long-term State intervention is necessary to stabilise the output growth rate and the unemployment rate in today's financially sophisticated capitalist economies.

Finally, the paper by Malcolm Sawyer addresses one of the recurring criticisms of the TMC, notably the alleged inconsistency of the benchmark model with the increasing dominance of financial markets, agents and motives. Sawyer argues that the key features of the TMC remain relevant and indeed central to a monetary analysis. While some aspects of financialisation may well be incorporated into the benchmark TMC

model, the latter still provides a framework within which the detailed analysis of a specific economy can be located. From this perspective, the main strength of the TMC is not to give dissenting economists an already-made alternative macroeconomic model, but rather to provide them with a flexible accounting scheme within which an analysis of the impersonal laws of the movement of a monetary economy of production can be made.

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