

**Referee's report on  
"Solving the paradox of monetary profits"**

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**I. General**

This paper aims at explaining how, at a macroeconomic level, monetary profits can be a positive magnitude, although, in a monetary-circuit framework, firms have to apply to a bank in order to obtain "initial finance" for any production processes, whose output will then have to be sold to reimburse (at best) the whole amount of bank credit obtained for workers' compensation on the factor market.

This issue has yet to be solved within monetary-circuit theory, despite several attempts, in the 1980s and more recently, by a number of authors (only a part of whom are indeed quoted in the paper under review here). The paper has therefore a potential contribution to deliver on this open issue, which has to be solved on logical rather than mathematical grounds. In this regard, the author's analysis does not seem up to the task, as it delves in too technical details, from a mathematical point of view, neglecting logical arguments in a number of crucial analytical steps in monetary macroeconomics.

The next section points out a number of analytical shortcomings, which the author could dispose of quite easily to make a revised version of the paper publishable in *Economics*.

**II. Contents**

1. On page 1, the author correctly argues that "attempts by Graziani and subsequent Circuitist authors" in order to explain "the creation of monetary profits [...] have to date been a failure". The author, however, is wrong in claiming that "this failure was not due to any weakness in the underlying vision of a pure credit economy". In fact, monetary-circuit authors following Graziani have been unable to date to explain the purchasing power of money logically. This is so much so that they assume, indeed, this purchasing power, in a *petitio principii* as a matter of fact. The first logical task of any monetary economics theory, indeed, would be to explain logically the nature of money and its purchasing power. Unfortunately, this remains to be done, both in orthodox and non-orthodox economic analyses (see Rossi, 2007, for a rare exception in this respect).
2. On page 1 (last paragraph), the author claims that "the topic of the creation of fiat money (and the relationship between credit and fiat money) [has to be left] to a later paper." This is wrong: unless monetary macroeconomics is able to address the logic of money and credit, separating these two things as their essence is not the same, the theory of money and the working of banking systems will remain to be discovered, and will be based on behavioural, rather than structural, understanding. This means, in fact, that money and banking have to be grounded on macroeconomics rather than on microeconomics, the former having to be based on *macroeconomic* foundations, which also remain to be discovered in the "dismal science", and which no technical (that is, mathematical) treatment will ever allow us to discover essentially.
3. On page 2 (second paragraph), the author rightly sets off the monetary-circuit model "with the banking sector extending a loan of  $\$A$  to the firm sector". This, however,

does not mean, as the author pretends, that this amount “of credit money [is] stored in the  $F_D$  [standing for firm deposit] account”: as Graziani (1990, p. 11) himself in fact pointed out, “no one would borrow money from a bank before a payment comes due [...] since there would be no point in borrowing money and paying interest on it while keeping it idle”. The circular flow between the banking sector and any given firm  $F$  is pointless, unless a payment has to be made in favour of another agent, say wage earners. To quote Graziani (1990, p. 11) again, “[m]oney therefore *only comes into existence the moment a payment is made*. At that moment, in one and the same act, money is created, the borrower becomes a debtor to the bank and the agent receiving a payment becomes the creditor of the same bank”. This is the right point, in the monetary-circuit approach, from which the author’s analysis ought to start, to explain, first, the nature of money as distinguished from credit, and secondly, how it is possible for the set of firms as a whole to earn a monetary profit.

4. On page 2 (last paragraph), the author suddenly considers “equilibrium conditions” for the whole “financial system”, after analyzing (though briefly) what is in fact the result of a double-entry book-keeping set of rules which, essentially, boil down to an array of accounting identities. This is another major flaw of both orthodox and non-orthodox economic analyses, for they all fail to consider that macroeconomic flows have to be logically explained referring to identities – rather than (dis)equilibrium conditions – because they are the unavoidable result of double-entry book-keeping records within banks’ ledgers.
5. On page 6 (first paragraph after Figure 4), the argument that the author provides has to be expanded, and clearly linked to the following paragraph. The flow and stock dimensions of money or monetary magnitudes ought to be spelt out more clearly, as this is crucial in any monetary macroeconomic analysis. In this regard the author has still to get rid of a physical conception of money in an era where money has been in fact fully dematerialized and amounts to mere book-entry figures in a bank’s ledger. Reimbursement of a bank loan cannot but destroy the relevant deposits that resulted from the corresponding loan, as all this boils down to a set of mere book-keeping, or double-entry numerical items. This critique also applies to the last paragraph of page 12, as well as to the section entitled “The revolving fund” on page 13.
6. On page 25 (last sentence), the author concludes that the model put to the fore in the paper “provides an excellent foundation for explaining the processes that led to the Global Financial Crisis.” This might be true (or false), but in any case does not rest on the analysis presented in this paper, which (if any) explains monetary profits and never addresses the causes (or the processes) leading to the Global Financial Crisis. To be sure, the latter never enters the paper under review here.
7. Generally speaking, the paper is quite well written but needs to be polished up and a number of typos have to be removed before publication.

All in all, the paper cannot be published as it stands, but a revised version of it might be publishable, provided that the author considers the above indicated points in revising the research work under review here.

### **III. Reference (not quoted in the paper under review)**

Rossi, S. (2007), *Money and Payments in Theory and Practice*, London and New York, Routledge.