

REVIEW OF
*THE INTERNATIONAL MONETARY
SYSTEM AND THE THEORY
OF MONETARY SYSTEMS* by Pascal Salin
(Northampton, Mass.: Edward Elgar,
2016, 261 pp.)

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Except for some minor issues, previous reviews of the book (Dorobat 2017; Cutsinger 2017/18) have been overwhelmingly positive and for good reason. The book under review is the fruit of several decades of economic thinking, professional research, writing and teaching of its author Emeritus Prof. Pascal Salin of the Université Paris-Dauphine and past president of the Mont Pèlerin Society. Since Salin discovered the Austrian School of Economics in the late 1970s he has been a consistent critic of Keynesian theorizing and in this reviewer's opinion Salin's critique and rejection of Keynesianism most probably constitutes one of the most distinctive and original aspects of his approach in general and of the book under review in particular.

Salin is today a self-avowed "hard-core Austrian," who believes, however, that on specific topics it is possible to build bridges with other approaches, particularly with authors like Milton Friedman and Robert Mundell, but also with authors like James Buchanan and Gary Becker. Salin has not always been a "hard-core Austrian". The book under review presents in several respects a substantial departure from his earlier *Économie Internationale tome premier Économie Financière* (Salin 1974) which was a textbook of international monetary economics based on a thorough knowledge of the mainstream literature and mainstream – including Keynesian-style – analytical tools. Salin's transformation started in the late 1970s when he started reading Hayek and subsequently also Mises, Rothbard and other Austrians.

The present volume presents an integrated theoretical perspective on the workings of the international monetary system from an

Austrian perspective, carefully avoiding any contamination by Keynesian-style fallacies. As the author himself explains in the introduction, the book is intended to provide readers with a good understanding of the economic principles and economic problems of international monetary economics, while drawing on sound general economic theory.

Adopting an almost exclusively theoretical perspective, Salin guides his readers through a logical progression to the intricate and sometimes arcane propositions of international monetary economics. The first two parts of the book discuss the basic statements and analyses in the field. Salin begins the book by introducing core theoretical propositions in economics – the concept of nation, methodological individualism, exchange, and equilibrium – then he introduces core concepts in monetary theory and international monetary systems – money demand and money creation, monetary systems, and exchange rate regimes.

The second part of the book focuses on the balance of payments. Salin begins by analyzing the balance of payments from an accounting perspective. From this perspective, the balance of payments is simply an accounting identity. For instance, expenditures on imports are counterbalanced by the sale of financial instruments, such as bonds. Subsequently, he explores the concept of the balance of payments from an intertemporal perspective, employing an analysis that is reminiscent of that found in many microeconomic textbooks' treatment of intertemporal exchange. In conclusion the implications of the accounting and economic approaches are explored.

Salin completes the discussion in Part II with an insightful analysis and critique of balance-of-payments – or external equilibrium – policies. In general, the so-called external equilibrium policy is doomed to failure because it is based on an a priori and arbitrary definition of equilibrium and disequilibrium. A negative trade balance, for example, is not representative of a situation of disequilibrium if it is the result of exchanges freely made by individuals and of their choices between present goods, financial assets (future goods) and money. Since this balance is desired, it cannot be modified, except by exercising coercion. For Salin this is another occasion to emphasize that the economic policy prescriptions inspired by the Keynesian tradition are based on a serious

intellectual error. The justification for the erroneous idea that a trade deficit is regrettable and that a trade surplus is desirable (so that one ought to try to act to achieve it) derives from the Keynesian belief that a trade deficit reduces aggregate demand. But Salin, along classical lines and much in the tradition of Say, rejects the distinction between aggregate demand and aggregate supply which is drawn from the Keynesian tradition, and which unfortunately leads to the belief that it is possible to increase overall demand at will and then, as a result, to obtain an increase in the aggregate supply, which can only be an illusion.

Moreover, the balance of the trade balance is determined simultaneously with the balances of the balance of financial assets and the monetary balance, and not 'independently'. The complementarity between the different balances of a balance of payments reflects the fact that individuals choose between holding present goods, future goods (financial assets) or money.

Salin also rejects the conventionally assumed relationship between the balance of the trade balance and the exchange rate in the sense that there is no reason to believe that the trade deficit – incorrectly believed to be a disequilibrium phenomenon – will cause a depreciation of the national currency against the foreign currency (in the case of a floating exchange rate regime) or that a depreciation or a devaluation of the national currency will result in a positive change of the balance of the trade balance.

The third and largest part of the book contains nine chapters that cover a broad range of topics. This part, beginning with a discussion of money creation in hierarchical monetary systems and inflation, also delves into issues of international monetary equilibrium, the formation of international prices, the working principles of fixed exchange rate systems and flexible exchange rate systems, the monetary approach to the balance of payments and the monetary approach to exchange rate variations, and ending with a discussion of the concept of devaluation. It contains the core of Salin's analysis of international monetary systems.

Salin devotes an entire chapter (chapter 12) to a detailed explanation of why inflation is always and everywhere a monetary phenomenon in the sense there is no inflation without an increase in the relative abundance of money, that is, a decrease in its relative scarcity

(112-119). This highly relevant discussion supports Salin's subsequent analysis of the processes of transmission of money creation between monetary systems (chapter 16, 137-149) and its impact on international monetary equilibrium (chapter 17, 150-163), both under fixed exchange rates. Chapter 16 contains an insightful comparison of the model of the monetary approach to the balance of payments – favored by Salin – with two other models: the Hume model and the traditional Keynesian model, and also examines the international transmission process under different monetary systems (non-hierarchical versus hierarchical systems; 100 per cent versus fractional reserves). Chapter 17 examines the formation of international monetary equilibrium under fixed exchange rates under various assumptions regarding real growth and monetary growth rates, under the simplifying assumption of a world composed of two countries. As Salin points out, however, the lessons which are drawn from this analysis can easily be transposed to other situations, for example in studying the working of a currency area comprising several countries, the currencies of which are linked by fixed exchange rates but being in a situation of flexible exchange rates with the rest of the world. Salin's analysis in chapter 17 makes use of conceptual tools devised by Robert Mundell and thus presents an innovative alternative to the analysis in terms of the IS and LM curves better known from macroeconomics textbooks.

A particular strength of the book that is illustrated not only in chapter 17 but also throughout various other sections of the book relates to Salin's demonstration that the range of potential monetary systems is broader than is commonly understood by most readers. For example, Salin distinguishes between hierarchical monetary systems wherein commercial banks hold deposits with a bank that is above them, like a central bank, and non-hierarchical, or decentralized monetary systems wherein no central monetary authority exists. His taxonomy makes clear that alternative monetary systems could, do, and have existed despite the prominence of hierarchical monetary systems.

In fact, monetary systems can be categorized along several dimensions, and it can thus be shown that there is, at least potentially, a considerable diversity of monetary systems, even considering only a few criteria such as: hierarchical nature or not, public or private

nature, convertibility guarantees at fixed rate or not, coincidence between a monetary area and a national area or not. Each of these characteristics – possibly by combining them with others – determines the system of incentives for the producers of money and, therefore, the working of monetary systems.

The present monetary organization of the world is based on a particular combination of characteristics: the monetary systems are monopolistic, national, public, and hierarchical. None of these characteristics is necessary for the proper functioning of a monetary system and may even have a potentially harmful character. In the field of international monetary economics, it is traditional to focus on the debate between advocates of fixed exchange rates and advocates of flexible exchange rates, but without calling into question the monopolistic, hierarchical, national, and public nature of the systems involved. Salin's approach presents a welcome innovation in international monetary economics by considerably broadening the theoretical perspective in this respect.

Chapter 17 also reiterates the clearly heterodox opinion in monetary economics that deflation is not only unproblematic, but beneficial (118-119), an insight to which Salin returns throughout the book (41-42; 157-158; 226), highlighting the unconventional but quite defensible idea that, contrary to widely held ideas, deflation is preferable to inflation.

In Part IV, Salin includes sections devoted to the very long-term evolution of monetary systems and to the working of fixed rate systems without an international currency. He concludes his investigations with a brief analysis of monetary policy, monetary crises, and monetary integration in Europe. In chapter 23 on monetary integration in Europe Salin again connects with the work of Robert Mundell, in particular the contribution on optimal monetary areas (Mundell 1961) – which is acknowledged as “path-breaking” – but in a more critical vein. Salin rejects the definition of an optimal monetary area as the area inside which economic adjustment is optimal, adjustment being evaluated through the usual concepts concerning the impact of fiscal and monetary policies on employment, inflation, and the balance of payments. An “optimal currency area” cannot be defined as an area of optimal macroeconomic adjustment. In agreement with Friedrich Hayek's concept of competition as a *discovery*

procedure Salin proposes a different approach of the optimal monetary zone, based on the individual perception of gains and costs brought about using various currencies. A policymaker or an economist cannot legitimately decide from outside that some situation is optimal or not. It must be revealed by acting people. The chapter certainly offers the necessary conceptual tools useful to those who want to contribute from an Austrian viewpoint to current debates on monetary reform in Europe.

Summarizing, Salin has fully succeeded in painting a clear and concise picture of the most central and important issues in international monetary economics, in several respects considerably going beyond more conventional presentations.

References

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