

How Financial and Credit Markets Work, as Opposed to Goods Markets

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Abstract - Summary

The influences and consequences of the financial sector spilling over into the real sector mean that the real sector-not just the financial one-fails to align with the model predicted by the dominant neoclassical theory of Lucas, Sargent, Modigliani, and Friedman. In fact, this model does not exist; for if it does not exist in the financial sector, it cannot exist in the real sector either-unless one assumes the existence of separate worlds. Let us acknowledge the existence of information gaps, information asymmetry, and information inaccessible to other agents-concepts advanced by Akerlof, Stiglitz, and Shiller in opposition to Fama's views on the financial sector. Yet, if the financial market functions as described-operating independently of factors such as company value or stock fundamentals, and following its own logic that transcends information asymmetries and data regarding companies-can the neoclassical model truly be considered a model? Is it a benchmark, or a standard point of reference?

Keywords: Financial Markets, Credit Markets, Keynesian Economics, Monetary Theory, Financial Instability, Speculative Demand for Money, Liquidity Preference, Asset Prices, Credit Leverage, Market Equilibrium

Framing the issue

Does the utility-maximizing individual operate in the financial realm as well?

Let us consider two phenomena.

A) The first concerns the so-called speculative demand for money.

A speculator is an agent who buys when the price of a security is low and sells when the price is high. We attach no negative connotation to this.

Let us recap the fundamental aspects. A security-as is well known-is essentially a receipt for a loan made to a company or the State. It may have a face value (e.g., €1,000) and pay an annual coupon (e.g., €100). There is a primary market where newly issued securities are traded (bought by savers and sold by companies or the State) and a secondary market where previously issued securities are traded (savers buy them from other savers who had purchased them earlier).

While a security may have a face value of €1,000 and a coupon of €100, it also has a market price that can diverge from its face value. If someone who bought the security for €1,000 in 2025 wished to resell it on the secondary market in 2026, they might discover that the interest rate paid on newly issued securities had risen in the meantime. For instance, the State-due to economic or budgetary reasons-might be compelled to issue new securities with a higher interest rate (or yield) to entice savers to purchase them. If the holder of an "old" bond wishes to sell it in 2026, they cannot obtain the original purchase price; this is because if interest rates have risen-to 20%, for instance-it means that new bonds offer a 20% yield (i.e., €200) while still costing €1,000.

Consequently, bond buyers can choose between newly issued bonds yielding €200 per year and older bonds yielding €100 per year. Clearly, anyone selling the older bonds must offer a price discount; they must sell them for €500.

Thus, for the buyer, it makes no difference whether they purchase two previously issued bonds yielding €100 each at a price of €500 each, or a new bond priced at €1,000 that yields €200.

There is an inverse relationship whereby, when the interest rate rises, the price of a previously issued bond sold on the secondary market falls; conversely, when the interest rate falls, the price of the previously issued bond rises.

If the market interest rate falls rather than rises, the bond can be sold at a higher price, because newly issued bonds yield less than older ones; an inverse relationship exists between the interest rate and the price of previously issued bonds.

When the interest rate rises, the price of a previously issued bond sold on the secondary market falls; when the interest rate falls, the price of the previously issued bond rises.

What is the point here?

If speculators believe that the interest rates on bonds to be issued next year will rise, they will proceed to sell off (potentially en masse) their holdings of previously issued bonds.

In doing so, they:

- avoid the loss they would incur if they sold them next year at a price lower than their purchase price;
- can use the same amount of capital a year later to buy bonds with higher yields.

The point is that this process disregards the fundamentals of the companies that issued the bonds; the value of the bonds-whether issued by companies or the state-is independent of such fundamentals. It is linked to forecasts, psychological factors, and discretionary or conventional assessments.

After all, how does a speculator actually predict future interest rates? The underlying idea behind this choice is that each speculator forms expectations based on an interest rate they consider "normal": if the market interest rate exceeds this normal rate, the speculator expects the rate to fall in the future-meaning the price of previously issued bonds will rise-and thus prefers to hold bonds rather than money.

Conversely, a speculator will prefer to hold liquid money rather than bonds-and will demand money-if they believe the yield (the interest rate) will rise next year.

Each speculator forms expectations regarding a future interest rate-a rate deemed "normal"-and if the market rate is higher than this normal rate, the speculator expects the market rate to fall (meaning the price of existing bonds will rise); consequently, they prefer bonds over money. The reverse applies as well.

There is a link between the speculative demand for money and the interest rate: when the interest rate is low, many individuals prefer to hold liquid money rather than bonds because they consider an increase in the interest rate more likely than a decrease, expecting bond values to fall. Conversely, when the interest rate is high, many individuals prefer to hold bonds rather than money because they consider a decrease in the interest rate more likely than an increase, expecting bond values to rise.

The lower the interest rate, the higher the speculative demand for money (the amount of liquid money desired); the higher the interest rate, the lower the speculative demand for money.

All this occurs regardless of the specific value of the bonds or the companies involved, and-as we shall see-it has significant economic and macroeconomic consequences. Thus, the value, price, and volume of securities sales or purchases are linked to expectations-not to the so-called fundamentals of the securities.

Is the financial market inherently unstable?

Does it have an equilibrium?

Is it different from the goods market, where an equilibrium exists-or is at least more likely to exist?

To answer these questions, let us look at a second phenomenon.

B) The second phenomenon involves a comparison between the goods market and the financial market.

Let us simplify the example. I am drawing on a recent work (1).

Imagine a market for goods at the start of the week.

There are two traders-a baker selling bread and a farmer selling potatoes-located in a town square in such a way that they cannot see each other.

The baker is confident he can sell the same amount of bread on Monday as he did on Friday, so he sets the same price as the previous week.

The farmer, however, knows that the potato harvest has been substantial-more abundant than the last one. Consequently, he has brought more potatoes to the market and is offering them at a lower price.

Even though the two goods are not identical (bread and potatoes), this situation affects sales for both parties. Buyers notice that potatoes cost less than the previous week-both in absolute terms and relative to bread-so they buy more potatoes and less bread.

The baker is unaware of the bumper potato crop or the lower potato prices, but he notices that the demand for bread is lower than expected.

To avoid ending the day with unsold bread, he lowers the price of bread.

This decision boosts the demand for bread but reduces the demand for potatoes.

The farmer notices only the drop in demand for potatoes and, to avoid being left with unsold stock, lowers his price. At that point, demand shifts from bread to potatoes, leading to a further drop in the price of bread, which in turn causes another drop in the price of potatoes, and so on. It is a price war between unseen market participants-one that largely operates independently of the intrinsic qualities of the two goods-as the participants respond to demand signals.

Ultimately, a stable equilibrium is reached at a lower price level, with a lower relative price for potatoes, thereby clearing the excess supply.

In theory, absent external intervention, lower (or higher) prices stimulate a higher (or lower) quantity of demand.

Let us consider what happens if an unexpected event-a shock-disrupts this equilibrium.

A customer suddenly appears after equilibrium has been established and requests a large quantity of bread.

The price war reignites: the baker raises his price to avoid being unable to meet demand later in the day.

Consequently, buyers return to purchasing more potatoes, but the farmer also raises his price; this cycle continues until a new equilibrium is reached, characterized by a higher bread price than the previous week.

Since this yields higher profits, the baker-once he realizes over time that the customer who suddenly requested more bread (the shock or surprise) is a regular presence-will increase production.

Drawing on Keynes, this example illustrates that demand drives the process; supply and production follow.

In any case, the increased demand for bread has stimulated a rise in supply and production, triggering all the price and quantity determinants of endogenous rebalancing.

To return to our main point, however, this represents a schematic view of a goods market. This is a highly simplified model, as many factors come into play in the goods market-as evidenced by discussions surrounding so-called monopolistic competition: for buyers, it makes a difference whether they purchase from one company rather than another, even when buying raw materials.

There are various reasons: the force of habit, personal acquaintance, trust in product quality, proximity, knowledge of specific needs, the possibility of obtaining credit, brand prestige, the unique features of a model or product design, etc. (2)

But let us stick to the schematic example and move forward.

Does the financial market work the same way? Does it tend toward an equilibrium-or an endogenous rebalancing?

Many mistakenly answer in the affirmative (3).

In reality, this is not the case.

Indeed, having observed the first phenomenon, we should have grasped how different the financial market is-a place dominated by expectations rather than by the so-called fundamentals of securities.

But let us look deeper.

In the marketplace, there is a broker and a banker.

The broker lays out various types of securities on the counter, just as a baker would with different types of bread. Unlike the baker, however, the broker faces two prices.

There is the price at which he is willing to buy and the price at which he is willing to sell-the latter being slightly higher to cover business costs and ensure a profit. The broker quotes the same two prices used the previous week.

The banker, too, is interested in two types of transactions: raising funds (deposits) and deploying funds (loans). Unlike the farmer, he quotes two prices: the interest rate he is willing to pay on deposits and the rate he charges on loans. In this second case as well, the second price is slightly higher, so as to cover costs and ensure a profit.

Here, we discover that the financial market is unstable-not merely due to the presence of expectations, psychological factors, or the like, but also because of its own objective characteristics. Regardless, the core point remains: does the myth of equilibrium exist as a result of the rational intent of the agents involved?

The activities of these two types of participants reflect the varying habits and needs of the village inhabitants. Some are prudent and risk-averse, keeping their savings in bank deposits. Others have a higher appetite for risk and take out bank loans to purchase securities using leverage, aiming to profit from fluctuations in their value.

In reality, a village contains (at least) these two categories of people, and neither can be ignored.

The banker-aware that even a single unpaid loan would result in a loss far outweighing the interest income earned from the many successful loans-grants loans amounting to only a fraction of the value of the securities the clients intend to purchase.

This amount is expressed as a percentage known as the "loan-to-value ratio," which is set below 100 percent, meaning the loan is smaller than the market value of the securities.

Furthermore, the banker requires the securities to be pledged as collateral for the loan.

If, at any point, the price of the securities falls toward the loan amount, the banker demands that the borrower top up the collateral; if this does not happen, the banker proceeds to sell the securities, which drives prices down even further.

Conversely, if prices rise above their initial levels, the banker is willing to increase the loan amount; this enables the borrowing client to make additional investments, thereby pushing prices up further. The destabilizing potential of a collateral and mark-to-market mechanism capable of triggering and fueling upward or downward feedback loops is evident (as is the decoupling from the intrinsic value of the securities).

Let us assume that, following various operations involving the replenishment or sale of collateral or the granting of new loans, prices stabilize and an equilibrium is reached.

An unexpected event-a new development-occurs.

A new player enters the scene; having learned that the bakery is performing very well, they wish to purchase 100 of its shares.

Not bread, but shares. Let us assume the bakery has one billion shares in circulation, that the broker is willing to sell these shares at €1.01 each and buy them at €1.00, and that the banker consequently values each share held as collateral at €1.00.

Once this player (the "surprise" factor) has paid €1.01 and acquired the 100 shares, they leave.

However, the broker reflects on the increased demand for the stock and revises the prices previously offered to the public, declaring a willingness to buy at €1.01 and sell at €1.02.

The banker observes these events and realizes that both the bakery and the clients' collateral are now worth €10 million more.

Mark-to-market accounting has ensured that, following a transaction of just €101, additional accounting wealth has been created-thereby giving the bank the capacity to grant further loans totaling €10 million.

Let us assume that, driven by borrower demand, this potential translates into actual new loans of €1 million, which in turn are used to purchase yet more shares.

The initial new demand for €100 worth of stock has thus generated an additional €1 million in demand. The process continues because this additional demand drives a new, more substantial rise in the stock price, triggering a second round of even larger loans, and so on.

After the arrival of this player (the "shock"), the bread market reaches a state of equilibrium. The arrival of a foreign investor seeking to purchase shares (a second shock) -combined with the possibility of debt-financed investment, collateral techniques, and mark-to-market accounting-creates a self-reinforcing spiral that results in a financial bubble destined to burst.

Had this new market participant sold 100 shares instead of buying them, a downward spiral-equally explosive-would have been triggered.

In either case, the securities market does not quickly find a new equilibrium; a mix of psychological and more objective factors makes it unique, driving it toward a breaking point.

Moreover, the financial market is intrinsically unstable-even more so than the market for tangible goods-precisely because the aforementioned mechanisms fuel it to a greater extent.

Yet this instability arises from the market's significance and the interconnections between different markets, including the market for goods. To move beyond theory: the phenomenon described above largely mirrors what occurred with subprime mortgages, where rising property values fueled further credit extended to homeowners.

The solution lies in sound regulations-not excessive ones, but good ones.

In this regard, I would point to the Italian Enlightenment thinkers-Antonio Genovesi, Pietro Verri, and Gian Domenico Romagnosi-who are discussed in the next chapter.

NOTES

(1) F. Spinelli and C. Trecroci. **Crisi finanziarie nella storia. Insegnamenti, Costi, Teorie, Fisiologia e Natura Strutturale**. Giappichelli Editore, 2026; E. F. Fama. **The Theory of Finance**. Holt, Rinehart & Winston, 1972; E. F. Fama. **Foundations of Finance**. Basic Books, 1976; R. J. Shiller. **Irrational Exuberance: Revised and Expanded**. Princeton University Press, 2016; R. J. Shiller. **Finanza e società giusta**. Il Mulino, 2012; G. A. Akerlof and R. J. Shiller. **Phishing. L'economia della manipolazione e dell'inganno**. Mondadori, 2024.

(2) At least until Marshall, the term "competition" was used rather vaguely; a perfectly competitive market structure was hypothesized, yet discussions had actually introduced different assumptions-specifically, markets characterized by a structure midway between monopoly and competition. However, this realization never fully took hold, even though the intermediate structure is the actual, existing one, whereas perfect competition is a sort of abstraction (a mythical creature). This awareness of actual reality (as opposed to an abstraction) never fully gained ground despite the aforementioned authors; furthermore, the concept of free enterprise continues to be identified-imprecisely-with (perfect) competition, whereas in reality, the outcome of a system operating on the principle of free enterprise is not perfect competition, but monopolistic competition. For a long time, economic theory conflated-somewhat imprecisely-the concept of free enterprise with that of competition; in reality, the typical outcome of a system operating on the principle of free enterprise was not perfect competition but monopolistic competition. An essential characteristic of the free enterprise system is the "attempt by every businessman to build his own monopoly, extending it wherever possible and defending it against others' attempts to expand their own monopolies" (Chamberlin)-perhaps by creating specific brands, such as "Champagne" to distinguish it from similar wine products. Consequently, Chamberlin's observations have cast doubt on the validity of the Smithian and Marshallian tradition, which equates perfectly competitive markets with ideal markets from the perspective of welfare economics goals (implying that this equation is, in fact, incorrect). Furthermore, the very desirability of a perfectly competitive market structure is questioned because it presupposes-and leads to-a homogenization of products and services, resulting in an undesirable uniformity. Excessive product standardization would be a consequence of competitive markets, and this is not considered desirable. As Chamberlin noted: "differences in buyers' tastes, desires, incomes, and locations, as well as differences in the intended uses of goods, all point to the need for variety" (cf. H. Landreth and D. C. Colander, **Storia del pensiero economico**, Il Mulino, 1996, pp. 740–741 for Chamberlin's quotes; cf. N. Boccella, C. Imbriani, P. Morone, **Analisi Microeconomica e scelte pubbliche**, Led Edizioni Universitarie, 2014).

(3) Samuelson. *Economics, An Introductory Analysis*. IV Edition.p.39.

THE GOOD LIFE

Adam Smith was already aware that the market-a form of relationship between individuals that was anonymous and driven by self-interest, and thus novel for his time-served a civilizing function. Market relations are impersonal, allowing us to satisfy our needs without relying on the benevolence or magnanimity of others-without depending for our daily sustenance on a state of subservience to a few benefactors (such as the aristocracy, the clergy, or great landowners, in the manner of vassals or serfs). As Smith noted, "each merchant or artisan derives his income from the patronage not of one, but of hundreds or thousands of customers; although he is to some extent bound to them all, in reality, he is not absolutely dependent on any single one." Yet, Smith was equally aware that the market could impoverish social relationships and -

consequently, breed unhappiness and loneliness. He fully understood that individuals pursue their own self-interest, but-as he stated in **The Theory of Moral Sentiments** (1759)-"however selfish man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him."

The massive expansion of markets over the subsequent two centuries is clearly revealing this effect-one that was merely a side issue for Smith but has now become central. For this reason, after briefly outlining the economic theorists who expanded upon Smith's initial ideas, my essay will present concrete examples of how goods and services markets operate. The aim is to demonstrate that the assumption of perfect competition-much like Weale's (1) assertion regarding the "will of the people"-is "an ideal that, if never put into practice, ceases to be an ideal and becomes a falsehood promoting an unattainable perspective."

After Smith, certain Italian Enlightenment thinkers-who have been unjustly overlooked-delves deeper into these issues.

In his work **Lezioni di economia civile** (1765–67), Antonio Genovesi articulated a vision of the economy as a sphere of civilization and a means of fostering civic progress to enhance people's "good living."

He identified trust-or more precisely, "public faith"-as a precondition for economic development; this concept is absent in Smith, even though Smith, as previously noted, also viewed the market as a civilizing force. Genovesi believed that self-interest alone did not automatically ensure the market's proper functioning. He pointed to the example of Naples: despite being a highly populous nation (the Kingdom of Naples)-meaning there was no shortage of labor-with a mild climate, fertile land suitable for diverse crops, and excellent access to the sea for trade, it had not progressed at the same pace as other European nations or states within the peninsula. He attributed these poor economic conditions to a lack of civic morality among the population-specifically, the absence of that fundamental civic virtue rooted in mutual respect and a commitment to the common good.

Gaetano Filangieri maintained that public trust was humanity's primary resource for economic development; in **The Science of Legislation** (1780), he emphasized that without the cultivation of public trust, markets fail to develop and the economy stagnates.

Regarding the nature of trust, Genovesi stated: "The word **fides** signifies a cord that binds and unites. Public trust is, therefore, the bond uniting families in a shared life" (p. 751, 2005). He argued that happiness-specifically "public happiness," a term used synonymously with "civil economy"-was social in nature: one can be wealthy in isolation, but to be happy, two or more people are required.

In a similar vein-though with a slightly different approach-Pietro Verri, writing from Milan, highlighted:

- the role of virtues;
- wealth understood as a means rather than an end;
- commerce as a civilizing and pacifying force;
- trust and good faith as preconditions for the development of trade. He emphasized the role of "just laws for public happiness" and the importance placed on individual creativity and intelligence in the creation of value within goods. Gian Domenico Romagnosi, a jurist and economist, adopted "civilization" (**incivilimento**) as his guiding principle: a good government should aim not merely for economic growth, but for the civilization of the people. Prioritizing economic growth over civic advancement leads to social harm. According to Romagnosi, it is better to achieve less economic growth, provided it is shared by all (2).

The goal is for everyone to grow together-supported by good laws (where the word "supported by"-or "also"-is significant, implying both importance and the fact that laws alone are insufficient)-so that civic virtues and public trust can withstand the impact of unfolding economic interests. This is a highly topical argument-one need only consider Daron Acemoglu (3), Amartya Sen, and Shoshana Zuboff, to name a few recent authors whose theories cannot be explored in depth here.

Yet-with a touch of national pride-it can be said that the Italian Enlightenment, in a sense, addressed themes that are increasingly in vogue today.

This highlights the importance of rules and institutions, which are in turn shaped by transparency and the ability to understand the contractual terms offered by various market players.

These considerations align with insights from behavioral economics, suggesting the advisability of rules that clearly distinguish between different products. Indeed, "saying no to financial markets does not mean rejecting the market itself; it simply means refusing to commodify things that are not commodities-namely, money and credit" (4).

As a new guiding principle, we must simply "refuse to commodify things that are not commodities-namely, money and credit."

Work by professors Carl Schneider (University of Michigan) and Omri Ben-Shahar (University of Chicago)-who address the issue of information overload-merits serious consideration, particularly in the context of European societies (such as Italy's) that place a high premium on transparency. In short, information requirements-whether formal or otherwise-may prove inadequate for ensuring genuine protection. It is absurd to believe that an investor is safeguarded simply because certain disclosure obligations have been met. Ultimately, the investor may discover they are not protected at all and, in the event of a crisis, find themselves unwittingly and blamelessly caught up in it. The two American authors argue that disclosure requirements-increasingly common in all types of contracts, banking or otherwise-guarantee nothing on their own and can actually leave recipients more bewildered and less informed.

Mandatory disclosure of a wide range of information is considered one of the standard ways to ensure transparency. The underlying idea is that such disclosure increases the knowledge and awareness of the weaker party.

Mandatory disclosure is now a requirement across the board: from car rentals to the execution of complex legal instruments, mortgages, and so on. The authors highlight how "mandatory disclosure" is linked to the principle that more information is better than less; yet, they point out that it rarely yields benefits that outweigh the costs.

Does a flood of information, printed in tiny type, truly benefit the weaker party? Does it actually help them understand what they are doing, the nature of their obligations, or the general regulatory framework governing their relationship?

One suspects it is simply a standard operating procedure for regulators-one that may even preclude the adoption of more appropriate rules. In practice, this serves as a convenient alibi for regulators and the "stronger" contracting parties-especially since, ultimately, it fails to prevent litigation, as evidenced by various disputes arising from mortgage-related contracts. Regarding consumer credit, EU legislation mandates that the form provided to the consumer contain **only** the information prescribed by Directive 2008/48/EC. Quite apart from the fact that the legally required information is often already excessive for forming a genuine opinion and giving informed consent, one must also consider the issue of excessive voluntary information; in this regard, the French Court of Cassation (3rd Civil Chamber, June 26, 1991; **Bull. civ.* III No. 194*) aptly ruled that a plethora of information provided by a professional to a consumer was prejudicial, noting that such "informational profligacy" could be a telling sign of sales tactics that are "too zealous to be honest."

In implementation of the European Commission recommendation of March 1, 2001, for example, most Italian banks adopted a Code of Conduct regarding pre-contractual information for residential mortgages. Under this code, banks are required to provide customers-prior to the signing of the contract-with a standardized information document known as the ESIS (European Standardized Information Sheet). Furthermore, as of October 1, 2003, new national regulations concerning transparency in banking transactions and services came into force. As a result of these rules, banks must make an "information sheet" available to customers; this document must contain, among other things, the financial terms of the transaction and the governing contractual clauses. These regulations are useful but, as two American authors have noted, they do not provide a definitive solution. Consequently, it is unfair-as well as economically unsound-to expect parties who are effectively unaware of the situation to bear the consequences of a crisis; the banking system and the practice of saving have developed on a foundation of security and have consistently offered certainty, at least since 1926-the year the first banking law was enacted.

Not long before its collapse, even Lehman Brothers was considered reliable based on its information documents; indeed, in a single day-and with remarkable timing-the rating agency Fitch downgraded the firm from A+ (good reliability) to D (default).

Moreover, the banking sector itself listed the American bank's bonds among low-risk/low-yield securities-characterized by a credit risk rating better than A and very limited market risk (specifically, a weekly price fluctuation of no more than 1%). ...and as our own case law seems to have acknowledged.

After all, responses to phenomena that evolve over time are themselves variable and depend on the assumptions held by practitioners. If one subscribes to the neoclassical economic model, one is likely to believe that financial costs are inversely correlated with investment: a reduction in the cost of capital (such as a drop in interest rates) would suggest a strong investment response from a specific company or from businesses in general.

Any increase in inflows from abroad-such as emigrant remittances or international aid-would lead one to expect a rise in domestic investment.

However, an economy constrained by investment demand might find that investment actually responds to something else: profitability in the goods market.

When entrepreneurs are discouraged (for instance, by corruption)-resulting in depressed expectations-a Keynesian or an institutionalist (operating within an appropriate organizational framework) would argue, conversely, that the primary concern is whether they can retain the returns on their investments, while the availability of funds is a secondary issue.

For someone outside the neoclassical school of thought, an increase in remittances or international aid suggests a potential consumption boom rather than an overall rise in domestic investment. Answering questions about "the effect of A on X" depends on the respondent's cultural perspective and the prevailing organizational framework (for example, a minimum wage hike might lead some to predict a drop in employment or consumption, while others might foresee increased demand that drives employers to hire more staff, despite the higher costs).

NOTES

(1) Albert Weale. **Il mito della volontà popolare** [The Myth of the Popular Will]. Luiss University Press. 2020, p. 34.

(2) For economic history, see C. Beretta, **Introduzione all'economia neoclassica** [Introduction to Neoclassical Economics], EDUCatt, Università Cattolica, 2011; L. Becchetti, L. Bruni, S. Zamagni, **Principi di economia. Un testo di economia civile** [Principles of Economics: A Civil Economy Text], Il Mulino, 2025, p. 41 et seq.; G. Liotti and M. Musella, **Economia politica. Da Smith a Keynes** [Political Economy: From Smith to Keynes], Giappichelli, 2022; R. Faucci, **Breve storia dell'economia politica** [A Brief History of Political Economy], Giappichelli, 2010; H. Landreth and D. C. Colander, **Storia del pensiero economico** [History of Economic Thought], Il Mulino, 1996; for a critique of certain recent approaches to political economy, see M. Gallegati, **Il mercato rende liberi e altre bugie del neoliberismo** [The Market Sets You Free and Other Lies of Neoliberalism], Preface by F. Saraceno, Luiss University Press, 2021.

(3) D. Acemoglu and R. A. Robinson, **Why Nations Fail: The Origins of Power, Prosperity, and Poverty** (Italian edition: **Perché le nazioni falliscono**), Il Saggiatore, 2013; T. Piketty and M. Sandel-who wrote the recent **Uguaglianza. Che cosa significa e perché è importante** [Equality: What It Means and Why It Matters] (Feltrinelli, 2025) -would likely agree; cf. T. Piketty, **Natura, Cultura e Diseguaglianze. Una prospettiva comparativa e storica** [Nature, Culture, and Inequality: A Comparative and Historical Perspective], La nave di Teseo, 2026; as well as numerous other essays, such as M. Desmond's **Povertà in America** [Poverty in America], La nave di Teseo, 2024.

(4) See M. Amato and L. Fantacci, **Come salvare il mercato dal capitalismo** [How to Save the Market from Capitalism]. Donzelli 2012; it adds: "Credit is not a commodity but a relationship" (p. 14).

(5) Ben-Shahar, Omri & Schneider, Carl E. "The Failure of Mandated Disclosure" (March 2010). U of Chicago Law & Economics, Olin Working Paper No. 516.

(6) see "Consorzio Pattichiari" list of low-risk/low-yield bonds; Court of Venice ruling of November 5, 2009, with a note by F. Guariniello. "The Unforeseeable Event and the Intermediary's Disclosure Obligations: The Lehman Brothers Bankruptcy-A Case Testing the Limits of Ordinary Diligence," in **Diritto Bancario**, March 10, 2010; Court of Rome, Civil Section III, ruling no. 12766 of June 12, 2013, which held that the purchase of Lehman Brothers bonds was classified as a reliable investment up until September 15, 2008; Court of Pordenone ruling no. 898 of November 8, 2013, aligning with the prevailing case law that deems the bankruptcy unforeseeable and cites major rating agencies-which regarded the bank as highly reliable, -

assigning it an overall “A” rating category characterized by low risk and high reliability regarding coupon payments. Cf. Ray Dalio, **Principles for Navigating Big Debt Crises** (Hoepli, 2020), regarding the crises of the 1920s, 1930s, and 2008, and how predictions-even those from prominent figures and institutions-were flawed; and regarding how certain frameworks, such as the gold standard, could negatively impact crisis resolution by exacerbating the situation (see pp. 117–118 on the statements made by Thomas Lamont of J.P. Morgan and the renowned economist Irving Fisher on the eve of the 1930s crisis; pp. 126–127 on the gold standard and the constraint it placed on Fed action; p. 179 on what was written-whether unrealistically, irresponsibly, without proper information, or simply because the event was unforeseeable-regarding the Fed, the equivalent of our ECB...). ...August 2007, when the mortgage market was already collapsing-as evidenced by the events of August 9 involving BNP Paribas, France’s largest bank. Leaving aside the words of US President Hoover-which one might ironically term “prophetic”-who, in the early stages of the Great Depression and following the market close on the famous “Black Thursday” (the 24th), declared that “the fundamental business of the country, that is, production and distribution of commodities, is on a sound and prosperous basis” (see J.K. Galbraith, **The Great Crash**, Rizzoli, 2005), one can look at the 2007–2011 crisis to see similar behaviors-even among authorities who ought to have been fully informed and responsible for oversight. Take, for instance, the Treasury regulators regarding the situation of “Fannie” and “Freddie”-the nicknames for two mortgage institutions whose shares subsequently plummeted (see Ray Dalio, **Principles for Navigating Big Debt Crises**, p. 202). US Treasury Secretary Paulson stated, “We were prepared for bad news, but the magnitude of the problem caught us off guard.” Meanwhile, the FHFA (Federal Housing Finance Agency)-the regulator for Fannie and Freddie-had issued a formal report (not merely verbal statements) just a couple of weeks before their collapse, asserting that they were sufficiently capitalized, in addition to having repeatedly approved their accounting practices.

Keynes's monetary doctrine

Why address certain aspects of Keynes’s monetary doctrine, given that he is usually remembered more for his theory-or at least his precepts-regarding fiscal policy?

In reality, Keynes offered various precepts and approaches concerning fiscal matters (one might recall the controversies of the 1930s surrounding the actions and attitudes of the British Treasury, particularly regarding the gold standard).

However, the **General Theory** contains relatively few references to fiscal theory; instead, the reconstruction of the monetary framework presented there exerts a significant influence on both economic growth and economic crises.

As Siro Lombardini (1) noted some years ago, neither the assumption that workers receive full-employment income nor the assumption of flexible prices is sufficient to ensure economic growth.

Indeed, money allows uncertainty to affect consumer behavior in two ways:

- through a change in the forms in which consumers hold their wealth: they may decide to cope with heightened uncertainty by converting non-monetary assets into liquid funds, resulting in a rise in interest rates that hinders the growth of investment;
- through an increase in saving and the consequent rise in the proportion of wealth held in liquid form.

Therefore, even flexible prices cannot achieve the desired outcome-given the specific way money operates-unless one assumes that substantial reductions in interest rates can counteract the effects of increased uncertainty on the level of liquid funds held by households.

The neoclassical theory criticized by Keynes actually maintained that, provided prices are flexible, the system is capable of seizing every available opportunity. Keynes, on the other hand, presents arguments based on two factors: the possibility that money creates an excess of aggregate demand or an insufficiency of effective demand (the former arising from banking system behavior that can trigger excess demand), and the behavior of entrepreneurs, which-under certain conditions-can lead to a pathological expansion of investment (a view shared by Minsky; essentially, the purchasing power generated by the production of goods is not fully utilized to purchase them, as savers increasingly prefer to hold a portion of their wealth in liquid form). Furthermore, Keynes’s work links to price rigidity-and specifically to the effects of interest rate rigidity-giving rise to the famous “liquidity trap.”

If the interest rate has fallen to a level deemed exceptionally low by all market participants—a perception driven by conventions and psychological factors—and is thus considered unsustainable, any attempt to lower the rate further by increasing the money supply is bound to fail; indeed, the additional money is entirely absorbed by savers at the existing interest rate. Such interest rate rigidity can thus prevent the increase in investment needed to generate a level of aggregate demand capable of employing the entire available workforce.

It is therefore useful to examine Keynes's monetary doctrine (2) —perhaps even more than his fiscal theory—precisely because of the insight it offers into the functioning (or malfunctioning) of the economic system.

This reconstruction of Keynes's thought will not be limited to **The General Theory** (1936) but will extend the analysis to the earlier **A Treatise on Money** (1930). It will also incorporate references to contemporary authors and phenomena—some distinct, others illustrating how Keynes's theses have evolved and remain dominant in actual economic reality, regardless of whether one considers them desirable. An author like Jesús Huerta de Soto would certainly challenge the desirability of certain approaches in his works (3), yet the prevailing reality is Keynesian—or perhaps has even gone beyond Keynes's original description. De Soto's approach—which advocates for a 100% bank reserve requirement—not only stifles the entrepreneurial efforts of banks and financial operators (who are, after all, entrepreneurs themselves) but also fails to account for reality. It overlooks the fact that while risks are inherent in any entrepreneurial activity (including banking), the remedy is not to turn those engaged in such activities into mere "bookkeepers," but rather to regulate their operations—within reasonable limits, it must be stressed—in light of the undeniable benefits they offer.

Keynes begins by distinguishing between two classes—workers and entrepreneurs—driven by opposing aims: the former (worker-consumers) act to maximize utility and maintain, at the very least, a stable standard of living; the latter (entrepreneurs) are driven by the motive of enrichment—that is, the goal of achieving greater monetary wealth.

This may be a somewhat simplified view, given that the two categories are often not so sharply divided or opposed today; nevertheless, one could say that any single individual—acting as a worker-consumer—primarily pursues the first objective, whereas, when acting as an entrepreneur, they pursue the second.

As Hyman Minsky (4)—one of Keynes's most faithful interpreters—later noted, the activity of the entrepreneur (or indeed of any individual who might also be a consumer but is acting in an entrepreneurial capacity) is not merely to combine productive resources to create a finished product (a view seemingly implied, at least in Italy, by Article 2082 of the Civil Code); rather, it is to employ money to generate a greater amount of money. For the entrepreneur, the primary resource—the starting point for any undertaking—is the availability of an adequate amount of liquidity. The ultimate outcome—the yardstick of success or failure—is the amount of liquidity regenerated at the end of the production cycle. The entire life of the enterprise should be viewed as a monetary circuit that begins and ends with money. Under capitalism, it is the actions of the enterprise that set the entire market in motion: if entrepreneurs do not decide to initiate production—by purchasing labor and creating goods—nothing gets moving, since workers, possessing nothing but their own labor (and unable to access the capital needed to transform from workers into entrepreneurs), would have no work to perform.

This characterization seems valid for the diverse non-profit sector—including non-profit enterprises—as well, even though the discussion cannot be expanded upon here: the increased amount of money generated at the end of the cycle serves—in this case too—not only to cover costs (financing, labor, manufactured goods, raw materials, etc.) but also to be reinvested in the organization itself or used for freely chosen purposes (such as social objectives)—yet only after money has been deployed to generate a larger sum, as Minsky describes.

Schematically, the stages of the economic circuit are as follows:

- a) initial financing: the entrepreneur secures the liquidity needed to launch the production process;
- b) the labor market: considering firms in the aggregate—rather than as individual, specific entities—they purchase only labor; the purchase of other resources, such as raw materials or intermediate goods, constitutes a transaction between firms and can therefore be disregarded. At this stage, negotiations between firms and workers determine the volume of employment and the money wage (not the real wage, as will be seen);
- c) technical production process: firms create the production combinations required to transform labor and intermediate goods into finished products;

d) sale of the product: the initial capital reverts to its liquid form through the sale of the product. Just as firms in the aggregate purchase nothing but labor, so too, when selling the product, their only potential buyers are worker-consumers; since workers do not employ capital goods, firms can sell nothing but consumer goods. Through this sale, firms recover only that portion of the total wages paid out that workers have allocated to consumption;

e) securities market: firms cannot sell the capital goods they have produced to workers; however, they can sell them interest-bearing securities representing those very capital goods. By issuing securities, firms also recover the share of money income that workers have allocated to savings, enabling them to repay the credit received from their financiers and thus close the production cycle. Naturally, if firms intend to start another production cycle, they must reuse the same financial resources by asking their financiers to renew the financing. If this renewal takes place and the production cycle repeats, the finance available to firms becomes-as Keynes argues-a revolving fund that is continuously replenished and continuously extinguished (5).

Having briefly outlined the stages of the economic circuit, let us examine the functions Keynes assigns to money in each of the aforementioned phases.

Keynes departs from the view prevalent in his time, which regarded exchange as a form of barter; according to this view, the difficulties inherent in barter necessitated a shift toward using a single commodity for payments-one that would serve as a medium of exchange, a measure of value, and, consequently, a store of value. Over time, various commodities succeeded one another: from salt, livestock, and precious metals to minted coin, legal tender representing minted coin, inconvertible money, and bank money, leading up to the present day. For Keynes, this perspective considers an economic system where exchange involves goods that have already been produced-a scenario typical of an economy of self-producers or, as he terms it, a "cooperative economy."

In a capitalist economy-or what he terms an entrepreneurial economy-exchanges of goods for goods (exchanges between individual firms) do occur; however, the quintessential exchange-the one that defines the economic process and, above all, initiates it-is the exchange of labor for money.

Firms purchase labor-specifically, the labor power required to carry out the production process-thereby setting production in motion. In the exchange between labor and a monetary wage, the worker provides their labor services, whereas the business sector has no goods to offer in return; indeed, labor is purchased precisely for the purpose of producing goods. When the business sector acquires labor power, the only thing it can offer in exchange is money-provided by the banking system-which is essentially (barring minor exceptions) credit obtained from that banking system (or, as one would say today, from the financial system, including the so-called "shadow" financial system).

This marks a departure from the traditional view of the economic process as a system of simultaneous exchanges and acknowledges that, in a capitalist system, the economic process is an economic circuit unfolding in successive phases; this paves the way for a different hypothesis regarding the origins of money. In ancient societies, money originated from barter; in a capitalist society based on enterprise and wage labor, monetary circulation arises not from barter, but from credit.

Credit guaranteed by institutions (both public and private) would subsequently give rise to instruments capable of circulating between economic agents and, ultimately, to minted money. Keynes rejected the theory that money originated from the refinement of barter, embracing instead the theory that money arises from the guarantee or imposition of state power (adopting the state theory of money-associated with G.F. Knapp-which is dominant today).

What does this entail?

We shall see shortly.

Let us analyze the various stages.

A-Initial financing.

The process begins when the entrepreneur secures initial financing, which serves as a pivotal element ("The investment market may show signs of congestion due to a lack of liquidity, but never due to a lack of savings," states Keynes (6)).

The entrepreneur can obtain liquidity-as Fisher argued in 1911-because money creation originates with certain actors who, through direct production or exchange, have come into possession of gold; thanks to this holding, they can obtain a corresponding amount of legal tender which, when deposited in a bank, forms the basis for the well-known phenomenon of bank deposit multiplication.

The entrepreneur can secure liquidity either directly from a private lender, by placing securities with entities possessing liquidity, or by borrowing from the banking sector.

However, Keynes also proposes another scenario-one he prefers.

The entire process of liquidity creation can take place within a pure credit economy.

In such a system, bank money circulates without any backing from gold reserves or legal tender. This is the scenario abhorred by de Soto.

In a pure credit economy, only bank money exists; it circulates among economic agents, moving from one bank deposit to another via the transfer of checks or similar instruments, without the use of cash.

In this situation, the banking sector-unconstrained by reserve requirements-can create money with virtually no limits or costs. The banking sector (including the so-called shadow banking sector) can create money because there is no commodity money (such as gold or silver) that the private sector can produce itself, nor any legal tender produced by the State. In the case of pure credit, liquidity is created by banks granting credit to businesses; consequently, every instance of liquidity creation gives rise to an equivalent debt owed by the businesses to the banks. Keynes's observations might well be described as prescient, given the era in which they were made.

This system embodies the principle that "bank lending creates bank deposits," rather than the other way around.

Keynes rejected the ideas put forward by Fisher (in his 1911 book **The Purchasing Power of Money**), according to which the money supply originated from banks acquiring a certain amount of gold, bank deposits were created as a result of gold reserves, and-fundamentally-the credit granted depended on bank deposits ("deposits create bank lending").

Keynes held that while metallic reserves act as a constraint on the expansion of deposits (at least when a mandatory reserve ratio is in place), arguing that reserves create loans confuses the constraint with the cause. A distinction must be made between two types of liquidity: metallic money (or the legal tender representing it) and bank money-that is, deposits. Discussions regarding the relationship between loans and deposits refer to the circulation of bank money.

Since bank money is created exclusively by banks, no entity could make a deposit without a prior act of bank money creation by the bank; no deposit can be made unless it is preceded by the granting of credit-that is, a loan. It is, therefore, loans that create deposits.

Keynes devoted Book I of **A Treatise on Money** to this subject.

The aforementioned conclusion has significant economic implications.

Fisher's theory viewed the money supply as exogenous-meaning the monetary base (gold or legal tender) directly determined the economy's total liquidity. In the modern world, where legal tender is decoupled from the gold standard, this would imply that the economy's liquidity could be directly controlled by monetary authorities through changes in the quantity of legal tender. Conversely, the theory that loans create deposits leads to a different conception of the money supply. If the initial step in creating bank money is the granting of a loan, then the creation of liquidity occurs only if-and to the extent that-there is a demand for liquidity from the productive sector. The existing money supply becomes an endogenous variable, determined by the needs of the productive sector-over which authorities can exercise only indirect control through the imposition of reserve requirements.

Given that it is the banking system that creates the liquidity used by the productive sector (albeit within the limits and constraints set by reserve requirements, which are often minimal), it follows that the banking sector-or the "shadow banking" or financial sector in general-is the only one to which firms can turn for initial financing.

Firms intending to secure new financing to launch a productive activity must necessarily turn to the banking sector (or an equivalent entity) as the creator of money.

If firms do not turn to the banking sector, they can launch their activities by approaching other agents (such as other firms, rentiers, or savers in general) to obtain existing liquidity.

However, this would accelerate the velocity of circulation through the payment of an appropriate interest rate. In reality, since the velocity of circulation can only be increased to a limited extent, it is the banking sector-or similar institutions-that can finance the expansion of productive activities.

Keynes foresaw these conclusions, even if he did not articulate them clearly.

In **A Treatise on Money**, the function of the banking system was addressed with clarity.

In his subsequent **General Theory**, the decision to address issues such as short-term problems and demand fluctuations distracted Keynes, leading him at times to treat the money supply as an exogenous variable-a given quantity. While he may have done this to simplify his reasoning, it had consequences: if the money supply is treated as a given, the entire issue of liquidity creation and the functions performed by the banking system is excluded from the analysis; furthermore, any fluctuation in productive activity is financed not through the creation or destruction of liquidity, but solely through fluctuations in the velocity of circulation. Consequently, in response to criticisms pointing out inconsistencies between the **Treatise on Money** and the **General Theory**, Keynes later argued that a firm's initial financing could be provided either through bank credit or by drawing on pre-existing liquidity-facilitated by a rise in interest rates (7).

This view is unassailable when the system already possesses a certain amount of liquidity whose velocity can be increased; however, in reality, it is the banking system that creates liquidity.

Moreover, this approach is open to criticism if it implies that the provision of liquidity by banks can always be replaced by the transfer of money from existing holders; such a view tends to downplay the banking sector's most authentic function-creating money for the sphere of exchange-as explained in the **Treatise on Money**.

B-Decisions regarding production

Once the necessary financing has been secured, firms use it to hire labor and manage the production process. At this stage, they must decide on the level and composition of output.

For Keynes, what enables firms to carry out production is precisely the liquidity initially obtained from the banking system (or, more generally, from a lender): it is the availability of money that grants the firm autonomy and the power to manage the production process.

What is the extent of this power?

Does the business sector-despite having the immediate power to determine the volume and composition of supply-remain subject to the market's final approval? Or should the autonomy conferred by money be viewed as absolute-meaning that production decisions made by firms will always, regardless of circumstances, be validated by the market? In the former case, the power money grants firms would be short-lived-illusory rather than real; in the latter, it would constitute genuine power to determine the content of the entire economic process.

A Treatise on Money and **The General Theory** offer differing answers, reflecting a significant complexity.

Both works converge on the conclusion that the availability of liquidity-enabling entrepreneurs to set the volume and structure of output-represents not merely a fleeting managerial prerogative, but a genuine capacity to definitively determine the structure of production: a form of entrepreneurial sovereignty standing in contrast to traditional consumer sovereignty. Is Keynes anticipating some of the conclusions later reached by Galbraith? Consider Galbraith's **The New Industrial State**, where he critiques the theory of firm behavior and supply-side theory: those charged with controlling firms are managerial figures who constitute the corporation's "technostructure," and firms-operating within what is termed the "accepted sequence"-have reached a point where they control their markets and go even further, shaping consumer behavior and pre-forming the social attitudes of the very people they ostensibly serve; social habits are thus molded by the technostructure.

It is worth noting that when Keynes addresses this issue, he considers the business sector as a whole rather than the individual firm competing against others. At the level of the individual firm, illusions and failures are possible, given the ironclad rules of competition. However, looking beyond individual firms-adopting a macroeconomic perspective and investigating the internal mechanisms that dictate the survival rules of a capitalist economy-the analysis changes for Keynes, the founder of macroeconomics.

In **A Treatise on Money**, since Keynes's focus was on explaining the succession of economic fluctuations rather than the problem of prolonged stagnation, no consideration is given to the possibility-which would later become the crux of the issue in **The General Theory**-that the monetary circuit might be interrupted by a liquidity trap. This situation arises when economic agents (entrepreneurs, speculators, financiers) prefer holding their resources in liquid form over any other use.

For the sake of simplicity, let us assume that all monetary income received is spent in full, with the understanding that sums allocated for consumption are spent on purchasing goods, while sums allocated for savings are spent on securities issued by the firms themselves (such as shares, equity stakes, or other instruments).

This assumption ensures that, for the corporate sector as a whole, it is absolutely certain that the funds paid out as wages will be fully recouped-either through the sale of consumer goods or through the issuance of securities. Naturally, while this certainty does not apply to the individual firm, it holds true for the group as a whole; this implies that the operating losses of firms running at a deficit automatically translate into excess profits for firms running at a surplus.

Although firms as a group are certain to fully recoup their costs, they do not know in which market-goods or securities-they will be able to do so. It may happen, for instance, that the production of consumer goods results in a loss (if the propensity to consume has fallen), which implies that it becomes possible to place securities on the financial market at rates more favorable to the firm. Similarly, the production of consumer goods might instead generate excess profits (if the propensity to consume has risen); consequently, it becomes difficult to place the same volume of securities on the financial market except at higher interest rates.

This situation, Keynes notes in the **Treatise**, is a source of serious instability for the capitalist system, as the profits and losses firms realize or incur in the goods market trigger waves of economic expansion or contraction.

Yet this instability does not obscure the central point: that entrepreneurs, as a group, have the ability to determine-entirely independently and definitively-the volume of production and employment, as well as the allocation between consumption and investment.

In the **General Theory**, Keynes reaches the same conclusion.

In the **General Theory**, there is a clear distinction between production decisions in the capital goods sector and those in the consumer goods sector.

The volume of investment is determined autonomously by entrepreneurs, taking into account profit prospects, the state of financial markets, the imponderable elements inherent in any decision committing to the future, and the very survival instinct of the entrepreneurial class-the "animal spirits"-which leads entrepreneurs to sense that in an economy where no investment takes place (a stationary economy), the capitalist entrepreneur and their profits are destined to disappear from the scene.

Conversely, regarding the production of consumer goods, decisions are made in response to market demand: entrepreneurs produce exactly the quantity of consumer goods that the market is willing to purchase at a price covering production costs.

If investments are autonomous-meaning that entrepreneurs, as a class, produce only as many capital goods as they intend to use-and if consumer goods are produced in the exact quantities determined by the market, the result is that, in the goods market, "demand is always matched, and no excess production can ever occur."

Keynes's theory clarified that, since market demand determines the volume of business output, a crisis of overproduction can never occur; this is simply because firms produce only the specific quantity of goods that the market is willing to absorb.

The phenomenon of crisis manifests not in the goods market, but in the labor market. The visible form this crisis takes is worker unemployment.

The fact that entrepreneurs base their production on market signals does not diminish their decision-making power. This is because, under the multiplier theory, it is always autonomous investment decisions that determine the level of aggregate demand and, consequently, of employment.

Workers are remunerated according to market principles (with the real wage equal to the marginal productivity of labor); thus, entrepreneurs' decisions-while determining the volume of production and employment-also indirectly determine the marginal productivity of labor and the real wage.

The entire economic framework (production and distribution) ultimately stems from the decisions made by entrepreneurs.

Therefore, if trade unions were to deem the level of employment unsatisfactory or seek an increase in real wages, what options would be available to them according to Keynes?

Few or none, Keynes answers.

Through trade union action, workers could pursue a policy of wage restraint in the hope of boosting employment.

However, a reduction in wages-which would generate higher profits-does not increase aggregate demand; consequently, entrepreneurs would continue to produce the same volume of output and employ the same number of workers. Is this what has occurred in many countries in recent years? (8) In fact, redistribution away from wages and toward profits could actually reduce consumer demand and further worsen the labor market situation. The only possibility of achieving a positive outcome would be to stimulate investment-either through increased consumption or through a drop in interest rates resulting from a rise in the real money supply. Yet, this is an indirect and uncertain outcome.

It does not appear that trade unions can achieve concrete results regarding employment.

Can they, then, fight for real wage increases?

In a monetary economy, the only variable that can be fixed with contractual certainty is the money wage.

The real wage emerges as a market outcome, determined by the interaction between the money wage and the price level.

A union may secure an increase in the money wage, but entrepreneurs will react by raising the prices of goods until the previous real wage is restored. If unions persist in demanding wage adjustments to match the new price level, the entrepreneurs' reaction will be repeated, triggering an inflationary spiral.

When it comes to wages, workers have few-or rather, no-options.

The only way for workers to increase employment is to boost consumption; an increase in the share of income allocated to consumption prompts entrepreneurs to expand the production of consumer goods and increase employment.

However, this is a remedy that is virtually impossible to implement. At the individual level, it is unproductive (if a single worker increases their consumption, the resulting rise in employment will benefit others). At the collective level, it is difficult to see how a campaign to boost consumption-aimed at increasing employment-could be launched, especially if real wages are stagnating.

Keynes's view confirms the hypothesis that business decisions regarding production and employment are the driving force.

This dominance stems from the fact that a market economy is a monetary economy, as well as from the privileged position entrepreneurs enjoy: they can secure initial financing and launch production activities based on their own independent choices. It is the mechanism of money that defines the distinct roles of entrepreneurs and workers.

C- Savings, money, and interest.

Regarding the issue of savings-specifically the need for an adequate supply of savings to match the investment decisions made by entrepreneurs-Keynes held that the equality between savings and investment must be ensured at the end of the circuit; a prior supply of savings is by no means necessary for investment to take place. Indeed, when investments are realized-that is, when entrepreneurs produce a certain volume of capital goods-this production is financed through bank credit, just as the production of consumer goods is financed.

Once production is complete, consumer goods are offered for sale, whereas capital goods remain in the possession of the business sector (since worker-consumers neither purchase nor use capital goods); instead, firms issue securities (shares, equity stakes, or other instruments) that worker-consumers purchase using their saved income.

For consumer goods, the decisive moment-which determines the success or failure of the decisions made-occurs in the goods market; for capital goods, the "leap" takes place in the securities market.

The state of the securities market (specifically, security prices and the interest rate) significantly influences investment decisions, in Keynes's view (9). An entrepreneur will decide to invest if the expected marginal return at least covers the marginal cost of financing-a cost determined by the securities market.

The state of the securities market (specifically, security prices and the interest rate) significantly influences investment decisions, in Keynes's view (9). An entrepreneur will decide to invest if the expected marginal return at least covers the marginal cost of financing—a cost determined by the securities market. Even before initiating the production (or placing an order) for capital goods, the entrepreneur takes a look, so to speak, at the securities market. If conditions are favorable, the entrepreneur secures the necessary bank credit and begins the production process; subsequently, they place the securities on the financial market and use the proceeds to repay the bank loan. If conditions in the securities market are unpromising, the investment process is not initiated.

The decision to invest, therefore, rests on a comparison the entrepreneur makes between the cost of money (current interest rates in the securities market) and the expected future return.

Since it is a comparison, neither factor carries decisive weight on its own: a very high cost of money can be offset by very high expected returns, thereby not discouraging investment decisions; conversely, a very low cost of money may be insufficient to stimulate investment if profit prospects are even lower. While the "cost of money" is frequently highlighted today, this was not the case for Keynes; he viewed the two factors—the cost of money and the expected return—as a unified whole, giving equal attention to both.

The significance of the cost of money regarding investment decisions becomes apparent when one considers Keynes's view that the banking sector's function is solely to provide short-term liquidity to finance the production process. Once production is complete, a firm is considered to be in equilibrium only if it has successfully converted the entire value of its output into money—either by selling consumer goods to worker-consumers or by selling securities to savers. Keynes almost certainly rules out the possibility of banks entering the financial market to purchase securities and thereby support investment decisions. The banking system increases the money supply (assuming, as appears to be the case, that Keynes acknowledges the money supply can be managed by monetary authorities or the banking system); however, once the system's liquidity has been increased, it is the market participants who decide how to use it, and the banking system does not intervene to direct that liquidity toward any specific market, such as the securities market.

The cost of money determined in financial markets stems solely from the decisions of entrepreneurs, workers, and savers.

Let us now consider the securities market and the associated interest rate that emerges there.

The securities market appears in the final stage of the monetary circuit, when unconsumed monetary income is allocated to interest-bearing securities.

An examination of this phase highlights one of Keynes's most significant contributions to economic analysis—specifically, his explanation of depression as a chronic condition of capitalism. (10)

This discussion links directly back to the points raised in the initial framework and introduction.

An individual who decides not to spend their entire income in the goods market—and who operates within a monetary economy—can direct their savings in one of two ways:

- they can purchase interest-bearing securities issued by firms, or
- they can increase their holdings of liquid assets.

This is a crucial decision for the equilibrium of firms, illustrating how the monetary, financial, and real sectors are intertwined. It shows that they cannot exist in isolation; that pitting them against one another makes no sense; and that there is no validity to positions that disparage the first—the monetary/financial sector—in favor of the second. They are two sides of the same coin.

That is why I have devoted so much attention to Keynes in this discussion: he was someone who fully grasped this state of affairs. Indeed, if an individual decides to use their savings to increase their holdings of liquid assets, a corresponding amount of liquidity is withdrawn from the securities market; security prices fall, the cost of money rises, and firms cut back on investment. Consequently, firms that have already initiated the production of capital goods fail to place their securities successfully and are forced to cancel their investment plans (11).

The challenge regarding investment is not finding a corresponding amount of savings; Keynes demonstrated that, through the multiplier effect, savings equal to any given level of investment are always generated.

The real issue is ensuring a cost of money that encourages entrepreneurs to invest at a level high enough to avoid unemployment. For this to happen, savers must channel their savings into the securities market rather than hoarding them as liquid assets.

Thus, the enemy of investment is not consumption-which reduces the volume of savings, as is often claimed-but rather the preference for liquidity, which reduces the flow of money into the securities market.

This is because, under capitalism-recalling the issue raised in the introduction-there is a real possibility that the securities market may appear unattractive while liquid assets seem highly appealing. This triggers a drop in investment as market participants hoard liquidity instead of purchasing securities, resulting in unemployment.

I have already described this mechanism and the functioning of the relevant markets-processes that operate independently of supply and demand and corporate fundamentals, relying instead on opinions, conventions, or emerging beliefs.

Here, Keynes presents his most profound analysis of the monetary economy, while simultaneously offering one of his most radical critiques of the capitalist system as a money-based system.

For this reason, too, fiscal and monetary policies cannot be separated; the measures taken in one sphere influence the other, and vice versa.

In theory, the creation of a securities market could be a major source of dynamism for the capitalist system: the ability to make liquidity yield a return without necessarily purchasing real capital goods; the decoupling of the management of productive assets from the financial ownership of the firm; and the possibility of circulating wealth between parties in arbitrarily divisible shares-thereby overcoming the inherent indivisibility of capital goods-all represent forms of flexibility and, consequently, sources of progress for the capitalist system.

Indeed, the securities market has been hailed by distinguished economists as the beating heart of modern capitalism. Keynes does not deny its utility, yet he ruthlessly highlights its flaws.

In his view, stock markets are destined to fail in the functions they are theoretically supposed to perform; instead of serving as that mythical meeting place where savers entrust the management of their liquidity to entrepreneurs, they become arenas for the squandering of resources, dominated by two figures:

the **rentier** and the speculator. These terms are used without negative connotations, as each figure engages in activity driven by normal, legitimate, and not immoral logic. Speculators, for instance-to use the term without any derogatory intent-are individuals who hold money in liquid form rather than in securities, seeking to profit from expected future changes in interest rates. A **rentier** is an individual who-having accumulated savings in the past or inherited wealth amassed by previous generations-lives off the returns on their securities; consequently, they manage their liquidity scrupulously, converting it into securities only when convinced that doing so is the most profitable course of action. According to Keynes, a **rentier** may well conclude that the best way to allocate their liquidity is to hold it in a non-interest-bearing form. As Keynes explains in detail, returns must be considered not only in the immediate term but also from a forward-looking perspective; since money entails no carrying costs, it may ultimately prove advantageous to maintain a liquid reserve whenever there is reason to believe that security yields will rise-making it prudent to delay a purchase (for instance, regarding bonds issued by a state or entity in distress that is likely to issue new securities with higher interest rates, despite the associated risks).

In such situations, money serves as a store of value; since no other asset can substitute for it in this role, speculators' entire desire to hoard wealth translates into a demand for liquid balances. If money were a commodity like any other-produced through the use of labor-an increase in the demand for liquid balances would spur production, thereby shifting workers from other sectors to the money-producing sector. However, since modern paper money (legal tender or bank deposits) is not produced through standard industrial channels-and indeed requires no labor input-an increase in the demand for liquid balances causes employment to fall in other sectors without any offsetting increase elsewhere.

The presence of the "rentier" in the bond market means that when bond yields drop to a level so low that further declines seem unrealistic-suggesting that future movements can only be upward-the demand for bonds evaporates. No one is willing to buy bonds; instead, everyone prefers to hold their assets in liquid form, awaiting a rise in yields. With the bond market stagnant, bond prices cannot recover, and consequently, the cost of money cannot fall any further. It takes only for speculators to perceive a given interest rate as the lowest possible for that rate to effectively become the floor.

If investment remains depressed at that rate, it becomes impossible to stimulate it through a further reduction in the cost of money. Keynes held the view that the banking system could not intervene directly in the bond market. While the existence of "mixed banks" (universal banks) could have resolved this issue, Keynes did not envision such a model, despite the fact that examples of it had existed even in England. The banking system envisaged by Keynes could-if supported by monetary authorities-increase the quantity of money in circulation; yet the only result of such a move would be to swell the cash holdings of market participants, who would hoard the new money just as they did the old. The new liquidity would not flow into the securities market but would remain trapped within the speculators' cash holdings (12).

Precisely because the capitalist system is based on money and securities, it enjoys the undeniable advantages of goods circulating via monetary intermediation and capital goods being traded through the securities representing them; yet, on the other hand, it pays the price of being exposed to prolonged waves of crisis from which no spontaneous mechanism-neither a fall in money wages nor an increase in the money supply-can extricate it.

Hence Keynes's conclusion that depressions can only be overcome through public intervention directly in the goods market: an increase in public spending on goods and services is the only measure capable of reviving depressed aggregate demand (13).

However, Keynes also levels other criticisms at the stock market.

Beyond the issue of the *rentier*-with his demand for high returns and his capacity to trigger irreversible depressions in the process-Keynes identifies flaws in stock markets regarding the long term and the productive use of resources.

This is where the "pure speculator" comes into play-the second figure dominating the stock market according to Keynes (14).

Unlike the *rentier*, the speculator buys securities not to enjoy their yield, but to resell them as quickly as possible once the price has risen. Furthermore, unlike the *rentier*, the speculator purchases securities not with previously earned (or inherited) capital, but with funds borrowed specifically for stock market trading. On one hand, the speculator has no long-term interest in the companies whose shares he buys; he simply needs the price to rise rapidly (if betting on a rise) or fall (if betting on a decline). There is no limit to the volume of the speculator's operations; he faces no income constraints-unlike the *rentier*-but only credit limits set by the banks financing him.

The speculator can pour vast amounts of liquidity into purchasing shares of companies with no serious prospects-and will do so if convinced that, perhaps for fleeting reasons, the share price is likely to rise soon. ...just as it is prepared to sell off substantial blocks of shares in commercially solid, established companies-and will unfailingly do so if it believes that the stock price is set to fall, even if only for a short time.

Under these conditions, stock prices do not reflect companies' earnings prospects, but rather the very short-term views of speculators. At this point, the stock market no longer serves to channel savers' funds toward the best companies, resulting in a poor allocation of resources.

D-What about Keynes's views?

Keynes was undoubtedly prescient-especially considering the era in which he wrote-in describing a system that operates independently of any qualitative assessment of firms or rational corporate criteria; instead, it is driven by the discretionary, expedient, or internally logical decisions of stock market operators-decisions that transcend the firms themselves. It is, in any case, a system that does not tend toward equilibrium-as noted in my introduction-and operates outside the standard supply-and-demand frameworks found in distinguished economic theory (15). Keynes's analysis of monetary theory reveals a vision of the capitalist process that is even more heterodox and dissident than the one usually attributed to him.

His contribution centers on the demand for money-specifically the speculative motive-whereby liquid holdings act as alternatives or rivals to interest-bearing securities, making liquidity preference a dominant factor in determining interest rates. Furthermore, speculative demand gives rise to the liquidity preference that eliminates demand for securities and creates a downward rigidity in interest rates; these factors hinder monetary authorities from effectively stimulating a recovery in productive activity and lead to prolonged unemployment crises.

However, Keynes's contribution extends beyond the theory of money demand and speculative hoarding. He revived the concept of the economic process as a monetary circuit (16) -a concept present in classical economics but overlooked by neoclassical economists.

The fundamental features of his concept are:

- the capitalist system no longer appears as a collection of undifferentiated agents, but rather as specifically identified groups driven by conflicting interests: the banking or financial sector, the business sector, and worker-consumers;
- banks (or the financial sector in general) generate the liquidity used by businesses; this is the source of banking power, as banks-"by controlling the money supply, occupy a key position";
- the next position in the power hierarchy is held by businesses; subject to the approval of banks, they determine employment levels, production volumes, and-indirectly-income distribution;
- finally, there are the workers, who-according to Keynes-have no means of influencing employment levels or negotiating real wages; in a monetary economy (such as modern market economies), bargaining can only address nominal wages rather than the price level of goods, even though the real wage depends on the combination of the two;
- we are dealing with a system that is unstable, anarchic, and dominated by speculation, as well as hierarchical and therefore prone to conflict.

Is his monetary theory more important than his fiscal theory-despite having been overshadowed by the success of the **General Theory** (17)?

There is no definitive answer.

What is certain, however, is that a whole school of economic thought (18) has recently rediscovered it.

NOTES

- 1.S. Lombardini. "Equilibrio, squilibrio e sviluppo dell'analisi keynesiana" [Equilibrium, Disequilibrium, and the Development of Keynesian Analysis], in **Keynes** (various authors), published by Cassa di Risparmio di Torino, special issue of the journal **Piemonte vivo**, 1983, p. 161 et seq.
- 2.A. Graziani. "Aspetti della dottrina monetaria di Keynes" [Aspects of Keynes's Monetary Doctrine], in **Keynes** (various authors), op. cit., p. 49 et seq.
- 3.J. H. de Soto. **Money, Bank Credit, and Economic Cycles**. Rubbettino, 2012; J. H. de Soto. **The Theory of Dynamic Efficiency**. Rubbettino, 2014.
- 4.H. P. Minsky. **Keynes e l'instabilità del capitalismo** [Keynes and the Instability of Capitalism]. Turin, Bollati Boringhieri, 1981, Chap. IV, Sec. I: "Cash flows and the demand for money."
- 5.J. M. Keynes. "The Ex Ante Theory of the Rate of Interest," **Economic Journal**, 1937, p. 666.
- 6.J. M. Keynes. "The Ex Ante Theory of the Rate of Interest," **Economic Journal**, 1937, p. 669.
- 7.J. M. Keynes. "The Ex Ante Theory of the Rate of Interest," **Economic Journal**, 1937.
- 8.J. M. Keynes. **The General Theory of Employment, Interest and Money**. Turin, UTET, Chap. 19.
- 9.J. M. Keynes. **The General Theory**, op. cit., Chaps. 11 and 12.
- 10.J. M. Keynes. **The General Theory**, op. cit., Chaps. 13, 15, and 17.
- 11.P. Davidson. **Money and the Real World**. New York, 1978, Chap. 11. (12) J. M. 12.
- 12.Keynes. **General Theory**, op. cit., Ch. 15, Sec. III, and Ch. 17, Sec. III.
- 13.J. M. Keynes. **General Theory**, op. cit., conclusion of Ch. 12; and A. Graziani, "Aspetti della dottrina monetaria di Keynes" [Aspects of Keynes's Monetary Doctrine], in **Keynes**, op. cit., p. 64.
- 14.J. M. Keynes. **General Theory**, op. cit., Ch. 12, Sec. III, V, VI.
- 15.Samuelson. **Economics: An Introductory Analysis**, 4th Edition, p. 39.
- 16.A. Graziani. "Aspetti della dottrina monetaria di Keynes," in **Keynes**, op. cit., p. 65.
- 17.A. Graziani. "Aspetti della dottrina monetaria di Keynes," in **Keynes**, op. cit., p. 66.
- 18.S. Nerosi and G. Ricchiuti. **Pensare la macroeconomia: Storia, dibattiti, prospettive** [Thinking About Macroeconomics: History, Debates, Perspectives], Pearson 2020, p. 192 et seq. (on Post-Keynesian theory).

Conclusions

Can certain consequences of economic theories even give rise to what has been termed “weary democracy” (1) -with obvious repercussions for the implementation of those very theories?

In the US, between 1950 and 1978, the rich and the poor shared in the gains of economic growth; real household income doubled for low-, middle-, and high-income Americans alike, confirming the economic adage that a rising tide lifts all boats.

However, from 1979 to 1993, this adage no longer held true: income growth was concentrated in the wealthiest quintile of the population. Current data dramatically confirm this trend.

Since the late 1970s, the vast majority of the nation’s income gains have gone to the top 10% of earners.

In real terms, the median income of working-age men in 2016 was lower than it had been four decades earlier.

Since 1980, the wealthiest 1% of Americans have doubled their share of national income and today earn more than the combined income of the bottom half of the population (2).

The new, financialized economy not only drains resources from productive activity but also exposes the economy to devastating risks and exacerbates the tension between capitalism and democracy. In the post-war capitalist model, companies generated earnings by producing goods, selling them at a profit, and reinvesting those profits into new productive capacity. This drove employment and economic growth that was widely shared across income groups.

In finance-dominated capitalism, companies have made money not by investing, but by speculating on the value of existing assets. Levy, an economic historian-as Sandel notes-calls it “asset-price-appreciation capitalism” (3). Yet, one of the duties of a democratic government-as stated in the 1979 *Economic Report of the President*-is to maintain conditions that allow citizens to feel they are in control of their own destinies. Otherwise, the erosion of trust in government and social institutions-and the resulting frustration, including over wage levels-leads to real-world political consequences (such as those outlined earlier) that render economic measures impossible to implement. Ultimately, it paves the way for populism.

In America, four companies control 80% of beef production, 70% of pork production, and 60% of poultry production.

Moving beyond agriculture to other sectors, a handful of multinational corporations today determine what is produced and the prices we pay. They control the economy and the companies that employ millions of American workers.

Three major Wall Street firms-Vanguard, BlackRock, and State Street-are the principal shareholders in 95% of the companies listed on the S&P 500 index; they own General Motors as well as Ford (nominally a competitor), and are the largest shareholders in ExxonMobil and Chevron, as well as in pharmaceutical giants like Pfizer, Merck, and Johnson & Johnson.

Given this situation, a number of questions arise:

1-Do the influences and consequences of the financial sector spilling over into the real sector not imply that the real sector-and not just the financial one-fails to conform to the model predicted by the dominant neoclassical theory of Lucas, Sargent, Modigliani, and Friedman?

2-In fact, this model does not exist; for if it does not exist in the financial sector, it cannot exist in the real sector either-unless one assumes the existence of separate worlds.

3-Let us acknowledge the existence of information gaps, information asymmetry, and information inaccessible to other agents-concepts developed by Akerlof, Stiglitz, and Shiller (who challenge Fama’s views in the financial sector) and which, in the non-financial sector, provide a counter-argument to New Classical macroeconomics (by successfully establishing micro-foundations for the two main conclusions of Keynesian theory: the existence of persistent involuntary unemployment and the real effectiveness of public intervention in the economy-meaning an impact not just on prices but also on GDP-based on the premise of incomplete and asymmetrically distributed market information). Yet, despite all this-despite the presence of so-called market failures (externalities, market power, information asymmetries, etc.) in both real and financial markets-if the financial market operates in the manner described (functioning independently of, say, company valuations or asset fundamentals) and follows its own internal logic (divorced even from information asymmetries or data regarding companies), can the neoclassical construct truly be considered a model? Is it a benchmark, or a standard point of reference?

Keynes-an expert in both economics and philosophy-demonstrated that the solution to an economic crisis did not lie solely in the monetary and financial realms. As both an economist and a philosopher, he applied a broader principle to economics: the solution to a problem arising in a specific sphere is not found by remaining within that sphere, but by looking outside it. In the midst of a systemic crisis, the true crisis lies in people's negative expectations-and thus in a lack of confidence, a refusal to extend credit, and a loss of faith in the system and its institutions. When trust and confidence are absent, monetary and financial interventions prove ineffective: as Keynes famously put it, "You can lead a horse to water, but you cannot make it drink."The point is not so much whether Keynes's monetary theory foresaw the specific distortions or recurring phenomena witnessed in 2008; rather, as Minsky (4) noted, the issue arises when expectations-inherent to the system's functioning-become self-fulfilling over time, fueling bubbles and exacerbating financial fragility without anyone being directly at fault. Yet, this outcome is not inevitable-despite the financial system's inherent characteristics-because financial regulation can help curb excessive risk-taking by banks and firms.

Vittoria Chick (5) has highlighted the evolutionary process by which banks manage credit through financial innovation, becoming increasingly independent of reserve requirements, with securitization representing the latest stage of this evolution. Financial regulation-the work of legal experts, economists, and lawmakers-is therefore crucial, particularly given the post-2008 realization that a new and different regulatory framework was needed following the ill-advised dismantling of the system established after 1929. The Dodd-Frank Act was introduced in 2010 (6) -a measure eliciting mixed reactions-aimed at protecting consumers, regulating derivatives and shadow banking, and establishing a supervisory authority for non-bank financial institutions at risk of failure. Yet, following decades of stability after 1930, these rules likely represent only a timid response. Despite this, under the Trump administration, Congress passed a law in 2018 providing for partial deregulation (the Economic Growth, Regulatory Relief, and Consumer Protection Act). Strict Federal Reserve oversight no longer applies to banks with assets under \$250 billion (the previous threshold was \$50 billion), and many regional and community banks are exempted from complex capital requirements and stress tests.

NOTES

(1) M. J. Sandel, **La democrazia stanca. Nuovi pericoli e possibili soluzioni per tempi difficili**, Feltrinelli, 2024, p. 228 et seq.; for a general overview, see J. E. Stiglitz, **Economia e informazione. Autobiografia, scritti e interviste**, Datanews, 2006; J. E. Stiglitz, **La strada per la libertà. L'economia e la società giusta**, Einaudi, 2024; J. E. Stiglitz, **Il prezzo della disuguaglianza. Come la società divisa di oggi minaccia il nostro futuro**, Einaudi, 2017; Eugene F. Fama, **The Theory of Finance**, Holt Rinehart & Winston, 1972; Eugene F. Fama, **Foundations of Finance**, Basic Books, 1976; Robert J. Shiller, **Irrational Exuberance: Revised and Expanded**, Princeton Univ. Press, 2016; Robert J. Shiller, **Finanza e società giusta**, Il Mulino, 2012; George A. Akerlof and Robert J. Shiller, **Phishing. L'economia della manipolazione e dell'inganno**, Mondadori, 2024.

(2) M. J. Sandel, **La democrazia stanca**, op. cit., p. 276. 18 As evidenced by certain phenomena frequently cited by Sandel as examples: in the early 2000s, Ford Motor Company made more money selling car loans than selling cars, while General Electric made more money selling credit cards and financing corporate takeovers than selling refrigerators. In 1978, US manufacturing companies derived 18% of their profits from financial activities; by 1990, this figure had reached 60%. In the 1980s, as U.S. Steel was closing plants in the Northeast and Midwest, its CEO declared that the company was "no longer in the business of making steel," but rather "in the business of making profits." Mere soundbites? Or signs of a trend?

(3) M.J. Sandel, **La democrazia stanca** [Democracy's Discontent], op. cit., p. 256, and notes 27, 28, and 29 for citation references.

(4) H.P. Minsky, **The Financial Instability Hypothesis**, Levy Economics Institute of Bard College Working Paper No. 74;

(5) V. Chick, "The evolution of the banking system and the theory of saving, investment and interest," in **Économies et Sociétés**, Cahiers ISMEA, No. 3, pp. 111–126; V. Chick, "The evolution of the banking system and the theory of monetary policy," in S.F. Frowen (ed.), **Monetary Theory and Monetary Policy: New Trends for the 1990s**, Macmillan, London, pp. 79–92;

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