

DON ISRAEL PATINKIN

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Don Israel Patinkin was undoubtedly one of the important world economists, mainly as an important representative of post-war monetary theory. His life's work certainly made a significant contribution to the development of economic theory. In particular, it is necessary to emphasize his contribution to discussion of the classic dichotomy and solution of the controversy between Keynes and the classics (Patinkin's controversy), tracing the historical



development of monetary theory from 1870 to 1940 and its further development, integration of the theory of value and the monetary theory by means of the real balances effect, analyses of the role of financial instruments and the conditions of neutrality of money in static or dynamic conditions, the development of price theory and the theory of unemployment, as well as to working out the first explicitly unbalanced macro-economic model.

D. Patinkin was born on 8.1.1922 at Chicago in the state of Illinois into the family of Russian Jewish immigrants Albert and Sadi Brezinsky Patinkin. He married Deborah Trossman in 1945 and they had 4 children.

He considered whether to become a rabbi or an economist and decided for economics. He studied at Chicago University, gaining the degree of bachelor in 1943 and master in 1945. He completed his doctorate and gained his PhD in 1947. He gained the titles of honorary doctor of Hebrew literature from Chicago University in 1976 and honorary doctor of law from the University of Western Ontario in 1983.

After completing his studies, he worked as a university teacher at various universities and in various teaching positions. However, his educational activity was centred in two universities: Chicago University and the Hebrew University in Jerusalem. After the creation of the independent state of Israel, Don Patinkin applied for an academic position at the Hebrew University in Jerusalem, and in 1949, he emigrated to Israel.

Apart from his educational activity as an ordinary professor up to 1989 and then as an emeritus professor, he also devoted himself to fulfilling academic duties, acting as rector of the Hebrew University from 1982 to 1985, and to rich scientific research activities. He held leading positions in various scientific research institutions – as director of the M. Falk Institute for Economic Research in Israel (1956-1972), president of the Israeli Economic Association (1976) or as a member of the National Council for Research and Development in Israel (1960-1964), the British Academy, Israeli Academy of Natural and Social Sciences and an honorary member of the American Economic Association.

However, the above mentioned activities did not entirely exhaust the potential of D. Patinkin. His activities also extended into the practical field. He worked in various institutions such as the Council for Higher Education in Israel, as chairman of the Sub-committee on the Government Budget of the Israel's Emergency Economic Advisory Council or as president of the Econometric Society. With his knowledge and rich experience, he contributed to the education and development of many young students, some of whom achieved important positions in the Israeli government or in business.

To gain a comprehensive view of Don Patinkin, it is also necessary to point to his need to publicly present his view on political events in the region which became his home. He thought that the future of the Middle East must have the form of peaceful coexistence. It was necessary to solve disputes not by military means, but by intensive diplomatic effort.

Don Patinkin received many awards for his work, including the Rothschild Prize from 1959 and the Israel Prize from 1970, both for his contribution in the area of the social sciences. Don Patinkin was a significant personality, gifted, versatile in his learning and extremely consistent. Throughout his life he intensively studied, collected materials, maintained rich contacts with economists, organizers of conferences and publishers. He was in contact with many important economists of the 20th century, the most prominent of whom included F.H. Knight, K. Arrow, M. Friedman, R. Harrod, J.R. Hicks, S. Kuznets, F. Modigliani, J. Tobin, P.A. Samuelson, J. Viner and R. Weintraub.

His credo was to live fully and happily in two worlds at the same time. Don Patinkin died on 6.8.1995 in Jerusalem at the age of 73 years.



Brief historical review of the works of Don Patinkin with an emphasis on their contribution

His first published article, *Mercantilism and the Readmission of the Jews in England* was published in 1946 in the periodical *Jewish Social Studies*. In the following years (1948-54) he produced a series of articles, which led to the writing of Don Patinkin's remarkable work: *Money, Interest and Prices: An Integration of Monetary and Value Theory*, in 1956. This work is considered to be an exceptional and culminating work, which covers existing knowledge and so enables an understanding of the depth of economics, while also presenting many stimulating questions from various areas, as is proved by the fact that they later attracted the interest of many economists. The central idea, as shown by the sub-title of the work, was integration of the monetary and value theory. The integration is based on rejection of Sayov's law of markets and places money in the function of a utility, that is the understanding of money as goods, based on breaking the principle of the homogeneity of demand. D. Patinkin integrated the monetary theory and the theory of value with the help of the model of the micro-economic theory of general economic equilibrium of L. Walras and introducing real balance effect into the function of demand of all markets. It involved a central idea not only of the neo-classical synthesis, but also played an important role in the formulation of post-Walras theory. The part of D. Patinkin's work, which included a detailed analysis of Walras' works, was described as one of the most imposing parts of the work in the review by J.R. Hicks.

Interest in this work is shown by its repeated publication with a second edition in 1965 and a third in 1989, and its translation into various languages: Spanish in 1959, Japanese in 1971, French in 1972 and Italian in 1978.

In the earlier period he devoted his attention to the monetary theory of classical economics, specifically in the work: *The Invalidity of Classical Monetary Theory*. The classical monetary theory is based on the quantity theory of money and is concerned with the determination of absolute prices. Economic entities are not subject to the monetary illusion, and so a growth of several times in the quantity of money does not lead to a change of relative prices.

In this period and throughout his life, he was concerned with intensive study of the works of J.M. Keynes, especially the works containing his understanding of the importance of monetary theory. He later presented his own interpretation of Keynes' theory. This presentation broke the post-Keynesian monopoly on interpretation of J.M. Keynes, and it can be said that discussion of the approach and analysis of monetary theory of J.M. Keynes relies precisely on the work of Don Patinkin concerning the given problem. Don Patinkin states that a *Tract on Monetary Reform* (1923), *Treatise on Money* (1930) and the

General Theory of Employment, Interest and Money (1936) differ not only in substance, which is decisive, but also in form and aims. Patinkin considered that the main contribution of J.M. Keynes was the development of a portfolio approach to demand for money, as well as an attempt to dynamize and incorporate the monetary theory into macro-economic theory.

D. Patinkin was a great supporter of J.M. Keynes, but it is interesting that he did not understand Keynes' monetary theory as definite break with the previous theory, but saw a continual process in it. He attempted to find continuity and compatibility between the classical theory of the old Chicago School and the preference liquidity theory of J.M. Keynes, which can be described as a contribution to economic theory. He regarded undermining of the equilibrium theory of unemployment by undermining the argument of the liquidity trap as his contribution.

His effort to ascertain whether the theory of J.M. Keynes influenced the theory of the Stockholm School is also interesting. In this context, he attempted to test the theory of R. Merton on the multiplication of discoveries in science and confirm or refute the widely accepted view that the Stockholm School was formed under the influence of the theory of J.M. Keynes. He refuted this widely accepted view, just as he also cast doubt on the thesis expressed by B. Ohlin on the similarity of the analysis of J.M. Keynes and the Stockholm School. He stated that more detailed analysis leads to the rejection of similar claims. The Stockholm School started from the teaching of K. Wicksell, who identified a direct relationship between the movement of interest rates and prices, but only an indirect relationship to output.

He also made a parallel study of the history of the Chicago School and published it in the *Essays On and In the Chicago Tradition*, *The Chicago Tradition*, *the Quantity Theory and Friedman*. This is understandable, since apart from J.M. Keynes, the works of the representatives of the Chicago School, especially F.H. Knight, J. Viner, L. Mints and H.C. Simons, had a very significant influence on the formation of his views.

From Don Patinkin's other areas of interest, his concern with the Israeli economy should be mentioned. In particular, he dealt with the history of its first decade in: *The Israel Economy: The First Decade*, published in 1959. His attention concentrated especially on the problem of agriculture and the social problem. He continued to take an interest in the Israeli economy, but published no general works on its further development.

Don Patinkin posed questions of the type: How should a society be constructed? What role should the government play? Should it be oriented to the liberal economic system or to the socialist system? Don Patinkin strongly defended the classical liberal positions. He did not understand liberalism as a natural order or tendency, but more



as a conscious choice. He emphasized that the question is not the choice between social control or laissez faire, but rather how to use social control to implement and maintain liberalism. He attempted to put these ideas into practice and adapt them to the conditions of Israel.

Don Patinkin published works in the English and Hebrew languages. In some cases, he also translated his works from Hebrew to English.

Macro-economics versus micro-economics, the verbal approach versus the mathematical approach

Don Patinkin inclined to macro-economics, which fascinated him. In relation to micro-economics, he presented his idea of micro-economics, which should research the formation of decisions from the point of view of various periods, in conditions of uncertainty, or market imperfections, when respecting transaction costs and the active effect of money, but he did not devote attention to it in the longer term. He took an interest in micro-economics at the end of the 1940s, when he wrote several articles dealing with the problem of imperfect competition, analysis of the theory of general economic equilibrium and especially the price problem, especially the questions of price flexibility and the questions of determination of absolute and relative prices. This is not surprising, since the old Chicago School was generally known and recognized, precisely from the point of view of its contribution to price theory.

The first works of D. Patinkin were clearly mathematically inclined, but later he turned away from a strongly mathematical form of expression. Precisely D. Patinkin's approach led to M. Friedman claiming that he is a representative of the Chicago School in its "oral tradition". The reason for the change of approach was an effort to address the widest range of economists, not only the relatively narrow group of mathematical economists, as well as the rejection of his article on the problem of unemployment by the periodical *Political Economy*. He came to the conclusion that he had placed too much emphasis on the purely formal deduction of curves and development of theories, but had not given enough attention to their relevance in relation to the real world. Don Patinkin made no further attempt to return to the circle of mathematical economists, although he was very well qualified to do so. In the 1940s, J. Marschak wrote of him, that he had the ability to become a leading economic theorist, that he would be a theorist, a theorist rather than a historian, a theorist rather than a practical advisor.

The classical dichotomy, integration theory of value and monetary theory

D. Patinkin used the term classical dichotomy for the

first time in his work: *The Indeterminacy of Absolute Prices in Classical Economic Theory*, published in 1949. Although various economists had criticized the separation of the theory of value and monetary theory, it was D. Patinkin who integrated these theories, in a way which could explain the determination of both absolute and relative prices. He achieved this thanks to the real balance effect, which he incorporated into Walras' theory of general economic equilibrium. The real balance effect represented a new element from which economic subjects derive utility. It is a specific case of the effect of wealth, which reflects influences on real variables caused by a change of wealth.

Real money balances are the amounts of money, which individual economic entities leave in their possession. Their size is relatively stable. Economic entities use them to secure current transactions and to cover possible unforeseeable events. If real money balances are higher than desired and relatively stable in the long-term, economic entities will increase consumption. On the other hand, if they are lower than desired, consumption is reduced. It is necessary to realize that in this case, he did not consider the nominal sum of money possessed by the economic entity to be decisive, but whether this sum was sufficient to secure stable purchasing power. If the balance is disturbed, economic entities will make an effort to regain a balanced situation. Thus, the real balance effect becomes an important transmission mechanism, which joins individual markets. If the influence of real money balances on consumption is recognized, then they can be understood as an important factor influencing the development of aggregate expenditures, and as a factor, which works automatically. This statement is very important, since it enables us to draw the conclusion that the market mechanism has self-regulating strengths capable of automatically renewing balance.

Don Patinkin's model is a model of full employment, a model in which the classical and Keynesian approaches are combined. It takes four markets and describes the market mechanisms, which secure the automatic achievement of balance in all markets.

Keynes versus the classics

The disputes between the two dominant orientations – neo-classical and Keynesian economics, arose because of the absence of an integrated macro-economic view among the neo-classicists and the absence of satisfactory micro-economic foundations in Keynesian economics. Patinkin came to the conclusion that Keynesian economics represents a specific case of neo-classical economics for certain types of market imperfection. After their removal, the Keynesian models work fully in accordance with neo-classical theory. He also stated that Keynesian



economics does not violate the basic theses of neo-classical economics and does not mean a new alternative paradigm. This presentation of the dispute resulted in increased activity by representatives of neo-classical economics, in the direction of defining macro-economic categories, which would enable them to find neo-classical answers to topical questions.

Money – an exogenous or endogenous asset?

The history of monetary theory can be presented through the discussion on the endogenous or exogenous character of money. Don Patinkin understood money as an exogenous asset, as net money. The exogenous character of money is a key pre-condition for the real balance effect, which can influence expenditure through money. When the issuing of money is limited, the empirical importance of the real balance effect is conditioned by the understanding of government bonds. Patinkin understood bonds as a component of wealth, as an exogenous asset. If bonds are an exogenous asset, that is, they are issued by the government in the interest of refinancing government expenditure, it is possible to explain money supply and explain the meaning of the theory of choice of portfolio, that is to understand the determinants of demand for money. Knowledge of the supply and demand for money, under *ceteris paribus* assumptions about other markets, enables the securing of balance in all the markets. To eliminate the instability, which could be caused by endogenous private loans, he proposed the creation of 100% reserves.

Patinkin's conception of money as a fundamentally exogenous asset is entirely understandable in the historical context, and contrasts with the endogenous understanding of money, for example, in the conception of J. Gurley and E. Shaw. Their work – *Money in a Theory of Finance* of 1960 contained reasoned exchange of the exogenous view for the endogenous view of money. The work was assessed by D. Patinkin, who used his review to spread his own analysis. Their agreement lay in understanding economy as essentially monetary, unstable and to some extent positively influenceable with the help of the correct monetary policy. They also understood monetary policy as a macro-economic discipline. A further important agreement lay in the fact that they accepted the approach of the theory of general economic equilibrium as a framework for the presentation of ideas. On the other hand, they disagreed on the role of private credit and the role of commercial banks, which are the main private mediators of loans. Patinkin understood the private loan as a key source of economic instability, while Garley and Shaw understood it as a positive element of economic growth and they regarded commercial banks as entities, which could encourage economic growth. They could be

considered compatible, if Patinkin's view applies to the short-term, while Garley and Shaw's view is long-term.

The exogenous character of money was also important for reconstituting the quantity theory of money. D. Patinkin's quantity theory of money is based on the automatic action of market forces, which work, by means of the real balance effect, in the direction of the renewal of market equilibrium. D. Patinkin rejects the conception of money as some sort of insubstantial monetary veil over probably important real phenomena. He claimed that an economy is more a monetary economy, in which we cannot divide the real sector from the monetary sector. He attempted to integrate the real and monetary sectors by means of the real balance effect. He claimed that quantity theory of money is macro-economic in character, and by means of an equation of exchange, it expresses the conditioning of absolute prices by the quantity of money. The quantity theory of money is directly connected with unbalanced situations around a probably unstable point of reference. In the view of D. Patinkin there is no justification for the assumption that the system has a tendency to constantly move from an unbalanced to a balanced situation, because stability is not guaranteed in any way. He stated that although the claim that money influences only the price level can be accepted in the case of equilibrium, the significance of this claim is minimal if the economy is always unbalanced. He also admits that it is possible to postulate questions of stability and discuss them, just as it is possible to discuss questions of a stabilization policy.

Patinkin did not suppose that causality deriving from the quantitative equation of exchange always leads from exogenous money to prices. He was aware that money supply also rises endogenously within the credit system. The Israeli state financed its expenditure both by direct issuing of money and indirectly by means of credit financing. It confronted the danger of uncontrolled inflation by controlling prices, which led to distortion of relative prices. Patinkin saw the solution in freeing prices, which would lead to a rise in prices and a decline in real money balances, resulting in reduced demand. However, pressure for the maintenance of real incomes together with continuing government spending led to further re-financing of rising expenditure. In this situation, money supply underwent endogenous variable and the economy lost its nominal anchor.

Don Patinkin was critical of Friedman's conception of the quantity theory of money, which was published in the article: *The Quantity Theory of Money: A Restatement*, of 1956 and in further works. He held the view that Friedman's theory had nothing in common with the quantity theory of money in the formal sense, but was actually a more elegant and sophisticated version of the modern Keynesian monetary theory. M. Friedman opposed this view with the claim that the quantity theory cannot be



interpreted as a synonym of the long-term neutrality of money.

The neutrality of money

The neutrality of money reflects the assumption of the quantity theory of money, that the quantity of money influences only the price level. In the framework of the general theory of economic equilibrium, the neutrality of money can be explained by the fact that the growth of demand for money is accompanied by a symmetrical decline of demand for all other goods, so that a new equilibrium is achieved with a decline of nominal prices in equal proportion, if interest rates and output remain unchanged.

Short-term non-neutrality of money is a specific feature of the monetary theory of J.M. Keynes. If there is unemployment, prices do not rise in proportion to the growth in the quantity of money, but the increased quantity of money leads to decline in the level of interest rates and so to increased investment, employment and production. M. Friedman also states that in the short term, monetary changes lead primarily to changes of output, but in the long-term an increased quantity of money is pri-

marily manifested in changes in the price level.

D. Patinkin claimed that the thesis of the neutrality of money relates to the equilibrium situation, but in the course of solution of situations of lack of equilibrium, money influences the real variables. This also relates to a situation, in which bonds are not understood as net wealth, since in this case individual subjects fully anticipate future tax increases and so do not increase their consumer expenditure.

Don Patinkin analysed the development of economic thinking and formulated his own evaluations, which sometimes differed from the generally held views. As a result, he engaged in controversies with many economists. However, he suffered from extraordinary sensitivity in relation to criticism, which explains his relative isolation after his emigration to Israel. At an international conference in Lausanne in 2001, under the title Don Patinkin and the Origins of Postwar Monetary Orthodoxy, somebody stated that an effort to integrate all parts into one consistent whole is a very demanding task, but the understanding and identification of inconsistencies and introduction of possible solutions is a very worthwhile activity, which is unforgettably associated with Don Patinkin.

Selection from Don Patinkin's works

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