ARA Contract Proposal
Capital Replacement &c.

5-57, (while I was writing Urban Expansion)

Cap. shortage pulls the plug, I

Late boom, lots of machines w/o gas, in effect. Conceal'g cap. in long term forms Δs need for work'g cap. to complement, but reduces supply. also, unexpected decline of sav., as Δ l.v. satisfy need for durable assets. (also, end of "forced sav."?)

Stringency of sht tm cap. Sell durable to get it. One man cd do it, but ~~[illegible]~~ in aggregate can get no net Δ. Is no one to whom sell it – w/o lower price.

(Durable is less productive, lack'g complement of work'g cap. (other hand, need more durable compls for exist'g durables)

(Past durables begin to soak up liq.; they get int. as well as amort & current inv., being short, also soaks it up.

(these Δl resources require current inv. to carry their current output. Even the part which is amort-n.

Expect-ns of future being basis of bi l.v., rather than current inc., holders haven't much M to buy more; nor much desire to buy from current inc. from other sources. If P of yr land doubles, you hv 2× as much provision for future as before, will think about sav'g less, even disinvest'g to dissave.

So sales start downturn, shake confidence

So we need cap: but fluid supply is small, bes much is concealed. & bes new additions to supply are slight. So we try to sell exist'g assets, their prices drop. We can't sell.

Role of the cap. shtge is make people aware that they can't sell for cash.

So it becomes evident all the antic. compl. invs won't be made. So all try sell

Cap. shortage pulls plug, 2

Road builders have antic. houses, stores, trucks — but becomes clear people will now stay put & consume

House builders have antic roads, wires, schools. Discover they won't come.

So we get the job ± done & people stop savg.

(Right now, 50-51, corps are pullg M away from mtges, & doing what w. it? "Workg cap." seems to be big thing)

Govt can overcome cap. shortage in taxing. But then it only builds p.w. — can't develop funds under them. And takes cap. from those who might.

Thus govt works cannot rescue us from depression. Just freeze more cap in useless forms.

Δ demand for steel, need more steel diverted to produce more steel

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Long gestation pd. means no need for Δ complements becomes evident until finished. Then in a rush, need shorter term cap, fluid cap.

Ec Ind p. 5. Since '52, savg as % of d.p.i has drifted down.

Cons. spendg has moved sharply toward more services & non-durables, since '50:

% of personal cons. exp.

	Durable	non-durable	Services
1950	14.1%	51.1	33.5
1956	12.8%	50.0	37.2 ✓

Savg as % of dpi

1950	5.9%
52	8.0
55	6.1
56	7.3

Cap. shortage pulls plug, 3

Check def. of "services". But even if it means services of durable cap., they still aren't buying the cap., are consuming it.

So cons. pref. is clearly moving away from handgoods.

As to "saving", that fig. is less reliable bec no acct taken of depletion. Actually real sav. may be 0, or —, & ~~things~~ wdn't show up. Still, regardless, it is a source of current cap. funds, whatever you call it.

As more spending turns to services, less cap. becomes available this way.

Are we prepar'g to produce more & more durables, while demand turns toward services? The pressure on raw materials is from ~~pr~~ demand of investors prepar'g to turn out more handgoods. When this collapses, "sav" collapses, ~~cap~~ shortage of fluid cap. emerges.

Basic paradox in this expl-n: increased inv. opp. stop inv.! Cd only work out on panic basis — which may be it. I was so near to correct explanation, but so far! I forgot about -Δ am-n.

Can always divert some of current long-tm inv. into short. Problem may be that this leaves complements stranded; & their failure triggers liq. panic.

For article, simply point out ec. ~~cannot~~ will not create cap. fast enough to swallow up much more land. Or finish the dev-mts already started.

Hi costs, incl. land cost, also contribute to tightness of M

Keynes said hi asset values reduce sav – find quote. (windfalls?)

Cap. shortage pulls plug, 4

Inv. in durables stops bec sav. stops, & it becomes more lucrative to inv. in quick-turnover soft goods.

Now ~~most~~ much long term inv. is developmental, depends on simul. compl. invs by others, is premised on attracting them.

When it becomes evident that these compl. invs won't be made, all long term inv. ceases — it is a case of all or nothing.

There is no problem of creating the nec. inventories, except temporarily.

Cons. now proceeds apace. But cap. goods not replaced as they depree.

Hi l.v. bc more gross inv. is not inc.-creating. Disinvestors spend much on cons, but prob not as much as inc. receives.

Liq. trap.

Or is it they spend more on cons, create cap shortage? The shortage doesn't need such help, being suffic. explained by hi l.v.

~~Abt tm~~ current inves, bec funds all tiedup in long; & bec no sav.; & bec hi costs. to people try sell durables for current M. Their price falls, triggering downward. Cumul. factors take over.

Cap. shtge. 5

1. Faced w. shortage of current cap. funds, holders of durables do not just wait for am-n — they sell.

2. When S falls, it kills inv. Not just ex post, but raises i, devalues durables, stops ex ante inv. in durables.

So Y falls to = C.

With durables prod-n, we can produce & have Y much higher than current cons.

W/o it, Y falls to = cons.

The Δ cons. that stops inv. is < the stopped inv. Prove it.

Incr. ret. to long tm inv. !! (in aggreg)

(cf. decr. ret, shtrun — e.g. overcrowded old bldgs)

Cap. shtge, 6

$\frac{C}{I}$

Y

Simplest statement:

produce more durables, ~~so their~~ than people want, so their ρ drops.

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early boom, invs are shoddy & short, Π comes back for reinv.

Later, invs get more durable. Creates shortage of currently available cap. funds.

Upswing. S occurs, allows for inv. in durables, these are seminal, generate more inv. — so $\Delta I > |-\Delta C|$.

Turn's pt: ~~Downturn~~ S. S declines, cuts off inv. in new durables. Reduces I by more than Δ of C. add cum. factors.

Role of l.v. — they rise, this reduces S, or ΔC. Also reduces I in durables, since land is durable, it fills that need.

Thus ~~the~~ hi l.v. stops constr. in 2 way: a, Increases cost. b, ~~the~~ Δ i.r. they must pay for long term funds. c. Previous ri's had stim. long term inv., cause of present ti-up.

(No stability possible. When rise stops, realized hi values affect oppositely from ri's & values)

~~(Dump?)~~

Cap. shtge won't appear as it is being created. Funds normally sunk for 3 yrs are sunk for 20, then not until 3 yrs pass is shortage evident

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At a given income level, changes in asset values must affect $\frac{C}{Y}$. Disprop Δ l.v. bound to affect. Also, must be certain can't people will hold. Δ l.v. mean won't hold bonds etc, claims on produced durables.

Cap. shtge, 1. Pulls the plug.

To meet the cap. shortage, start selling land. (The shortage has arisen immed. from low turnovers, not from just hi l.v.)

This starts panic.

~~Recession~~ At upper trg pt:

End of risg values destroy part of demand, cannot maintain hi values.

Dumps land to get liquid funds for now.

ΔC fails to offset all of reduced I. Bcs of Δs ret.; panic as durables start down; delay of compl. inv.

Not a shortage of cap; nor of liquidity; but of liquid cap. Result: a scramble for liquidity.

C doesn't rise hi enough to = Y, thus maintain inc. by itself. Just hi enough to stop much inv. in durables; & provoke sales of durables by those seeking liq. cap.

Orderly retreat is impossible bcs: a, Incr. ret. to aggreg. inv. (via external ecs.) When mgmt invs cease, others become unpropitious

b, regional effect – regions, sections, etc, fed by new inv. collapse utterly, despite Δ cons. demand elsewhere.

c. End of risg l.v. destroys ½ the demand, starts fall.

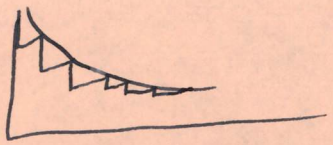
d. Etc? Probly.

Remember: this all started as effort to explain observed fact is not just a priori

Re i.q. factor proportions, etc.

Full cap. recovery means getting back ~~cap~~ C_o + int. Cap. grows when in place.

So as an input, ~~a~~ return of cap. & return on cap. are not 2 different things. Together, they are the cap. input.



Cap. recovery factor is an annualizn. of this, at an assumed i. A good approxn. for qual conceptual introdn. It shd. be =nt to getting back C_o, & int. ea. yr. on unrecovered bedance.

Value of this is in turnover or c.f. calcs. Cap. recovy is cap. input. Lower is & input.

Re idea that inv. is a factor; and that sav. is indep. determinant. Consider gross inv. On diagram, what looks like gross inv. is net inv., unless balanced by cons. Only thing that makes it net inv. is fact of saving.

But the factor of production is gross inv., anyway, not just net. It represents the use of an existing factor; whereas net inv. simultaneously creates the capital and uses it for carrying prdduct.

So spending, even if it doesn't create capital, does imply carrying products, thereby makes more production possible. But not just any spending: only gross inv.

Any factor of production, if its supply is increased, falls in price. Same with investment. But this just means lower yields. It doesn't mean fall in value of M. But paradox is: is impossible --unlikely, rather -- to supply more inv. w/o supply more MV, and this makes prices rise, except insofar as the greater supply of investment that goes with the dMV brings in more other resources and dT, to offset effect on dP.

This service, of carrying products being currently produced, is rendered by people trying to increase their assets -- or balance a decrease at the other end. Suppose a desire to increase real assets a little. More gross inv. -- & people at net inc. position consume it all. (of course they won't, since they are the people trying to increase their assets)(but they might, if desire is not to increase assets, but increase REAL assets, but they are willing or desirous to reduce c.b. -- can have various assumptions, various results). Then they have failed to increase real assets. If they assume higher demand is to continue, they must now gross invest still more to increase assets. &, thus, in trying to achieve an increase of net new inv., people increase gross investment. Process continues until dS allows creation of new assets they want -- or something else stops it, such as the higher inc. being a substitute for the new assets, their not antic. the higher demand will continue, or something. This is of course another description of Keynes cumulation. K describes the initiatinf force as dI. But if this is to mean anything, it must mean a recurrent desire to have gross inv. exceed cons. by a greater am't -- which is what makes gross I get larger and larger as C does -- and this is easiest described as a persistent desire to increase assets. Well, is more than that, is desire to increase assets by means of, or "& simultaneously desiring to", reduce c.b. For otherwise one would increase assets by dS. ~~M~~(which would incidentally cause Keynesian dI - & when one just says dI, is no way of knowing what you mean. Well, dI with C maintained is clear your intitial pulse is from dV.)

Anyway, if we just say people wish to lower c.b., that not enough. For they might do it by dC, which would not stimulate employment, not give any co mplementary resource. We must know, simul, how they feel about assets. If they wish to increase real assets, & reduce c.b., we know this means more inv., with C maintained, K. cumulation. If they want to ~~read~~ increase assets, but increase or maintain c.b., means dS. & all kinds of combinations.

The am't of inv. which is accomplished by a given dM depends on the am't of other resources that are induced into production by it. For they, by accepting it in return for work they wouldn't otherwise have done, do the investing. (or intermediaries from whom they buy simul.) But if the higher M demand lures no new resources into production, it just bids up prices of old. ??? Another element is whether people are willing to increase their

Inv. as factor 2

c.b. (Almost always, people will be willing to somewhat) If no one were, a quick whirl of dV would dT & dP until they were happy. But this might be increased inv. So this not essential. Fact is, even if it happens, mere acceptance of dM the first time is increased inv. -- that goes for dV, too, and if the first time, then each time, so dV nec. increases that kind of inv., m acceptance. So dM & dV are necessarily going to increase inv. some.

Anyway, essential pt. is this. People must accept the dM in some sense, to have new inv. Either by -dV; or dT. If employment is entirely fixed, prices will rise immediately, and dMV is not increased real inv., being cancelled by dP.

Strictly, the price of resources ~~xxxxxxxxxxxxxxxx~~ isn't the relevant price level, but prices of what they buy. Almost undoubtedly, M gets to them before it affects those prices. So dM would be increased real investment. (It still might not increase production, if resources weren't going to respond to their higher productivity. And if they didn't, production wouldn't increase much (it should increase some, if inv. is a real factor. Would it?) So then goods prices would rise, and am't of inv. would recess. The permanently lower yields to investors would mean that goods prices never rose as much as resource prices, tho, thus the increased rate of gross inv. would remain in small part.

If people have recurrent desire to invest more, this round could continue, several times. Inv. could be continua ly increased, thru continuous inflation.

Thinking it out in real terms, it is possible to increase investment there. If resource real prices rise, this would not mean that real dI was any less; it would mean, tho, that it wouldn't go so far. For, to carry a given am't of product, you must pay resources their price. This important conclusion emerges: the greater the spread for investor, the more product value(after his cut) he can carry with a given real investment. If resource prices are simply bid up by the increase in gross investing, the increase remains. But it doesn't carry any greater product.

The significant difference between capital creation where dS is autonomous, & where it results from dI, is not just re V -- which makes it seem sterile. But dV means more gross inv., which is independent of capital creation.

The difference between the monetary & non-monetary case is not great. ~~xx~~ To get mon. case analogous, just suppose that increased m demand for goods does not cause their prices to rise. This is just nec. to keep supposition of actually more inv. offered. If they rose, is no more inv. If desire of intermediaries is to actually invest more, their spread falls, they cannot raise prices. Higher demand from others doesn't mean fall ov inventories tho, because intermed. incomes are lowered by as much as others increased, they demand less. (fact that the intermediaries do more saving anaelement in cumulation -- opposite to usual assumption) (which assumption belied b fact that m & real wages move together)

If we get, in fact, a rise of goods prices, but not a rise of resource prices, it means the intermediaries have succeeded in securing more resources, for less investment, real -- the same inv., I mean. & their spread is increased. In real terms this would be

very dubious. In m terms, thru m illusion, is quite conceivable. But its unreality in real terms makes it dubious in m terms, too.

Aside from these changes in "spread", however, is little room for changing the ratio of inv. to total product value. Aside from changes in spread, is a unique one to one correspondence of am't of inv., real, with am't of production. (Except for types of production requiring no inv.)

So if intermediaries try to increase investment, only ways it is possible to do so is to have other resources come into production; (or lower spread; or resources come in from "direct" or service production).

In m ec., if intermediaries try to increase m inv., and don't succeed in drawing in more resources, it means higher prices of resources. If intermed. desire is to increase real inv., goods prices won't rise so much as resource prices. In fact, if their desire is to increase real inv. w/o reducing c.b., goods prices won't rise at all. If their desire is to reduce c.b., but not to increase real inv., prices rise all around, is no increase of real inv. (Work out details)

So desire to change investment, and to change c.b., are distinct, and have distinct effects.

Are 3 desires, to be distinguished: desire to change assets; desire to change rate of conversion; desire to change c.b. All have different manifestations & effects (&response of resources makes different situations, too)

If intermediaries wish to increase assets, they ~~xexixhessx~~ ~~(andyzax~~ save more -- which they cannot do as intermediaries, but only as net income r eceivers.

If they wish to increase rate of conversion (which, incidentally, may net them greater returns on their capital, regarded as a flow, even tho it lowers them on it as a stock. For if they turn it over twice at 3% in a month, they get more than turning it over once at 4%)(so that which would make people wish to increase rate of conversion --and this is important, this being the most complementary and variable resource --- is increased opportunities, or antic. yields, in quick turnover capital uses, relative to other ways of disposing of assets, including long term investments. Work on this, too) they will increase gross inv.; and will also make efforts to sell goods faster, including lowering prices. (This distinguishes from simply wishing to lower c.b.) They will make no effort, i.e., to ~~inerease~~ lower c.b.

Desire to lower c.b. has some similar effects. Increased gross inv. But goods prices will rise, because intermediaries will be willing to let inventories rise; they will consume some from c.b.; & they will not tend to save from ~~in~~ net inc. position, as they will in case they wish to ~~increase~~ increase conversion.

So the paradox is pretty well settled. Desire to increase conversion does not imply rise of prices nec. If the desire is thwarted by failure of supply of other resources to increase, this will cause a rise of resource prices; and a lesser rise of goods prices. This is a very possible cause of dP. Altho, strictly, if they rigidly refused to lower c.b., the first rise of P would stop their attempted increase of conversion.

In practise, as a rule, the two go together. Higher inv. opp. cause desire to increase conversion, and also to reduce c.b. (also to increase saving). So we get all at once increased conversion, higher prices, more real capital creation.

If demand shifts to items requiring less capital, this means that a given stock of capital will turn over much quicker. Conversion is increased, real conversion. (abstracting from effect of fall of yields to investors on am't of capital; assuming, i.e., constant am't of capital, no flight to consumption or to c.b.) From pipelines view, it might seem that rate at which things come out end of pipelines -- real conversion -- doesn't depend on length of pipelines. But suppose they are halved. Only way that conversion could fail to increase would be to halve am't of capital. But, that remaining constant, must get more conversion each period -- build new, parallel, pipelines, with the lengths taken off the end.

From descriptive viewpoint: demand changes to things with shorter production processes. So as capital is liquidated, intermediaries demand different kinds of inventories, with shorter lives. These come on market sooner than they previously would have, competing with other goods; and, being liquidated, the m goes back to demanding resources quicker. In transition, you would have, besides, the holdover long-lived inventories from previous situation, depressing prices more. But have a permanent effect, quite beyond this.

Which is just another way of observing that when possible uses of capital decline, it goes into what remains, depressing yields there.

So, from this view, we should get most conversion when long term inv. opp. are least. Fact that we don't -- if it is a fact -- is a tribute to power of monetary phenomena, and others -- e.g. withdrawal of other complementary resources.

Incidentally, have encountered now various sources of elasticity & adjustment, explaining why increases in resource use can find the nec. complementary investment w/o capital creation, ~~xxxxxxxx~~ -- the increased demand rises inv. opp. in shorter term things, d raws cap. in from longer term investments --- why increased investment can find resources -- draw them from unemployed, or from service industries.

In part, process tends to ameliorate depressions. For, as long term investment drops, funds move into short term investment, and the existing capital stock is turned over more. But this is countered by other tendencies. People make long term investments when they do not expect alternative inv. yields to rise later. Comes beginning of depression, i.r. is evidently going to fall a while, so is good time for long term inv -- which includes buying existing assets.

Hypothesis: in late boom, capital gets tied up in long term investments. These investments are going to be marginal, on ass. that short term i.r. remains moderate. Due to rather inelastic demand for short term capital -- due to one to one correspondence -- the shortage of it can be met for a time from various sources of elasticity, but then it rises sharply -- aggravated by speculative financial demands -- this rise makes further long term investments look not so good. It is impossible, tho, when this is realized, for capital to rush right back into short term financin , because so much is tied up in long term projects that depreciate slowly. Furthermore, even as the long term stuff does depreciate, the proceeds from that must be used to carry the

products of the depreciation itself, so that is no source of short term capital to carry products of other resources. Furthermore, the interest income of the new resources requires short term capital to carry it. So we have tremendous rise in short term i.r., scarcity in the midst of plenty, because the plenty is all tied up in long term capital. Long term investment is an irrevocable step, for years.

Once the short term capital fails, the capital value of the investments starts to fall -- aided by very high sht. tm. i.r., even tho this represents a shortage of conversion, rather than ~~xxxxxxxx~~ high alternatives --- this causes banking crisis, cumulation, deflation, etc.

Previous to this, fact of higher capital values, including land values, due to the high anticipations caused by all the fixed capital creation, has reduced saving, further increasing spread for short term inv., reducing supply of short term capital.

A non-monetary example makes this very clear. Our intermediary is paying his men once a ~~xxxx~~ day, & holds the products a week. Now he gets ambitious, and has them produce something that will not be ready for consumption for a year. The next week, he has nothing consumable with which to pay them. -- unless they will accept claims on their produce, i.e. will save. But when capital accumulation causes saving to decline, and conversion to fall, that means both elements of gross investment fall, and is little demand for labor. This shortage of short term capital is why labor moves into service industries -- & agriculture, where it can provide its own, or friends can, from non-institutional sources.

So above is, with a bang, answer to my dilemma, why does not shift to shorter forms of production increase employment. Answer: because it takes a long time, and the process of trying also reduces long term inv.

Note Hayek similarity. Process of shortening structure of production is depression. Note also that his "forced saving" etc got capital tied up in long term forms. & was he not right?

If this theory is correct, it gives a definite practical guide to me as an investor: watch the short term i.r. When it starts to rise sharply, get out. Until then, stick around. Check past records on this. Works in '29 and '37. Not in '46, but of course we didn't have a depression then, just mkt. crash, because i.r. rose - well? Anyway, a definitely different situation, then -- beware single factor explanations, old story.

Inventories would get smaller, I suppose, until a critical stage was reached at which it was inconvenient to make them any smaller, yields rose much.

What is monetary counterpart? With banks, you just can't borrow from banks, ther is capital shortage. But with a solid m supply, how would shortage manifest itself? As long as m is still there, why cannot labor be paid? With solid m, crisis would tend to manifest itself in higher goods prices, rather than lower demand for labor in m, hence not be so bad a crisis. In the old style bank m crisis, it was that investment stopped; in coming crisis, it will be that saving stops.. i.e., S & I will both fall accompanied by higher

rather than lower MV.

In practise, many complications worth considering. But very simple model is this: no net saving, just intermed. turns his sht. tm cap. into long. Next week, he has the m again, having sold his inventory. Now he pays labor again, but they discover nothing or little to buy, higher prices. They demand higher prices, which intermed. is able to pay. As goods & resource prices rise -- goods prices more -- V falls. (Only redeeming feature: as goods P rise more, probly a net shift to c.b. of ~~xnxxxxxxxx xxxxx~~ net inc. receives, some S) This fall of V, and higher P, is the monetary embodiment of lower conversion. This is basic process, onto which others attach. (I take back that intermed. can pay higher wages. He has no more m than before. He can pay the same, they will buy much less.(unless is much saving)(If there is forced saving for a time, due to dM, this ties up capital contrary to desires, people will have more assets than they want, they will not save when dM stops, production cannot continue)

Another element in making people try to increase c.b. is higher asset values. They then need more m to deal in the assets. Thus fall of i.r. makes people try to increase c.b. for this reason also.

Try to answer question "Where did the money go", and you see how inflationary are implications of lengthening structure of production. The intermediaries who have fixed capital no longer are putting goods on mkt. M demand all hits the others. So fact that P never rose must indicate that M demand was diverted. And the fact is that the fundamental deflationary trend of times was concealed, in late 20s, by this -- I guess. Diversion to financial uses, etc., of M, shrinking of sht. tm credit base, all countered inflationary effect.

Credit base shrunk, not just because of vertical integration & self-financing, but because production of short term self-liq. cap. goods fell? Fell relatively, at least, with all that saving. So much credit was made on other things, & such credit was ephemeral.

Society had actually gotten itself into a pckel pickle where it couldn't have a very high real income ofor some time, unless it saved. ~~Xxx~~ High asset values a, kept m idle; b, stopped saving. So that real income fell, and this fall came in form of lower prices.

A key reason why it came in form of lower prices and lower m demand for resources was banks. They had loaned on long term. As they got enthusiastic, to lend long term they had to curtail their short term loans, so they raise i.r.s on them. As long as they are still lending to create new cap., ok, m demand for factors stays up. But as soon as they get into trouble on the long terms -- due to shortage of short term capital -- they liquify all their assets they can, which of course means short term loans. So we get a crisis of conversion, coming in form of lower m demand. The bank's assets, like the nation's capital, are all tied up in long terms; so they cannot lend short. Current products cannot be carried -- simply cannot, physically, the pre-existing capital doesn't exist, and there is no saving at net inc. position -- is much disinvesting at intermed. position, but that doesn't help.

It remains to explain why process goes so far without stopping itself, and then stops in a crisis. You'd think that as soon as supplies of capital for immediate conversion got shy, this would steer capital back into that. But I see several reasons, which probably must be added up for explanation.

Current saving may keep conversion ok for a while. Then when this source fades, in crisis, cannot chan e fixed capital back. Current saving is increased by capital gains, high fictitious prop. incomes, etc. Fall of lont term i.r. -- partly caused by rise of sht. tm -- stops saving.

Bank policy important. Perhaps dM & some forced saving idea keeps up conversion, then is suddenly stopped.

When sht. tm. i.r. starts its rise, cumulates, for it makes long term investments bad, & liquidating them takes sht. tm. cap, thru banks, thru amortization carrying, etc.

Are some very elastic elements of adjustment when sht. tm. capital is reduced, up to a pt., after which it is very inelastic. An "L-shaped" curve.

Long term investments take time to complete, so many will be under way when rise of sht. tm rate develops, have to be completed.

Is general unawareness of situation, so that, tho people are aware of long term investments all around, they don't consider what this will mean to them. They anticipate, if anything, lower i.r.s, not higher, for they see yields falling, want to make their long term investments now, before is too late.

Need for higher c.b. makes people invest in m, thus allow more net saving, therefore conversion. Also makes people disinvest from inventories, making more trouble later.

(incidentally, the small inventories mean that goods prices won't fall easily when m demand does. Thus it is that at that time you get the real fall of conversion, by the simple, basic process: m prices of inventories getting ahead of factor prices, while flow of m to factors falls.)

Much inertia in investing -- funds committed to expansion funds, etc
Long & sht. tm. inv. not regarded as alternatives by many for a while.
Rise of sht. rate considered temporary at first, doesn't affect long term plans.

Part of cumulation: when ~~tm~~ conversion falls off, labor not only loses the complement of a carrier, but also of the goods in process that would have been carried by the investors. Lacking these, are less sht. tm. inv. opp. -- so the inv. opp. don't ~~sink~~ remain same as inv. falls, but fall with it. Supply of inv. creates its own demand in part, its own opportunities, & v.v.

investors don't become aware of what returns on long term investments are going to be until long after investments are made. Their anticip. of future not going to change immediately when some element changes temporarily. -- esp. when they don't see true relations.

Projects in which cap. is supposed to Δ l.v. lend selves esp. to extravagant anticip. because land lasts forever. & these appear successful often, even tho they aren't, because fall of ~~tm~~ long term i.r.

Inv. as factor, 8

raises l.v., & this makes them pay on, just as tho they had created the l.v.

Too much com. also means taking land out of production. Residential boom, capital tied up in houses, & land too, too much of each. Chokes out other inv. Miscalculations, too much residential for rentals, plus plain demand for unimproved space for residence -- resulted in ~~the~~ lower l.v.

Foreign inv., (esp. that not repaid), is extreme in long term inv. that depletes nation's capital, thru. im.

I am satisfied that, to explain gross miscalculation of future, must integrate land in explanation. Because it has no current production cost to check it, & infinite future life. -- these are strong reasons, that can be an a big burden in argument.

Organization: What effect does -dC have on gross inv.(hence empl., production, income)

~~xxxxxxxxxxx~~ ons. not inc. creating, but gross inv. to -ΔY not automatic, as in K.

Gross investors don't invest just for immediate resale, but to make interest. They are willing to continue gross investing as before, as long as something offers yields, as before.

(Nor, short term, is there any automatic fall of inc. from -dC, but inventory increase)

They have the M wherewithal to continue investing, for M hasn't been reduced. Just matter of inv. opp.

Is just question of are there dim. ret. to cap?

No. Or at least need not be. Gen. complementarity; lower prices of other resources, if they wish to be employed.* (Get more land thru types of capital that increase land - transport; also get more labor that way, improved mobility)

(Where there is an employment problem, soluble by increased capital circ., gross inv; will get no decreasing returns until empl. problem solved, for resources will come into work as cap. inv. increased, no dim. ret. When all resources employed, then get dim. ret., process stops, as it should. Well regulated economy. Problem is just when resources unable to offer services, those who wish to, thru inst. restraints)

Does fall of pc reduce gross inv., because gross inv. is all for resale? No, for it isn't. Cap accumulation expected to be permanent. Bring in all stuff on this point here. Note that K's train of thought is pc→I, & I→S, both now shown untrue. Note poor countries, high pc, doesn't encourage inv, nor does infl, it takes sav. for cap.

There will be conditions under which dim. ret. to cap. Then undercons. may make trouble. But under these conditions, ΔM or ΔI won't help. Must either change conditions, or get no cap. formation. (Won't ΔM help? Give people M to hold as asset.)

* Here mention lower P are equilibrating, NOT downward dem. force. & even if they did reduce C, this wouldn't make inv. less profitable.

Note this means free ec. has equilibrators tending toward full empl. Speed of gross inv. det. by inv. opp, which kept up by fall of resource demands.

to inv. opp, mec, NOT det. by technology (alone), nor by antic C; but by availability of complements.

Robertson

II, P. 39, "Theories of Banking Policy"

Farm credit

(Farm credit is most shot in depression, yet on farms people find as much employment as ever. Which minimizes importance of credit h.o.)

Do they supply their own working cap?

3 general theories of banking policy: Gold Standard, Productive Credit, Price Stabilization.

technology & ΔM

In "previous half century" bank deposits in Eng increased 2½ times, due to mechanical improvements.

ΔM & cb

He concludes that an increase of M will reduce v by reducing real cash balances by raising prices. This is just the opposite of the truth: it will increase real cash balances unless prices rise proportionately to increase of M, and thus increase V. The mythical reduction of V he calls forced saving, thinks it is means of diverting resources from money holders to "nominees of banks". Of course the reduction of ir will reduce v, but probably, undoubtedly, to the expense of ~~xxxxxxxxxxx~~ investment, so no forced saving occurs that way. The only forced saving is when the public is presented with a great deal of new cash, then it either saves by accepting it or else loses by not accepting it. ---and this is stretching the phrase.

There is another alternative anyway: it can accept it and save thus, but at expense of other conscious investment.

Policy re Δcb

I have developed principle that when, for any reason, public wishes to increase its cash balances, this should be done thru increase of money rather than reduction of velocity and prices, so that the extra productive sacrifice made, and the extra obligation put upon debtors, would redound to benefit someone, the loans would actually go to producers, and debtors would not have their obligations increased for no reason. Now R. says if prices fall because T increases (presumably meaning productive T) they should be allowed to fall. However this means an increase of cash balances, and that the public wishes to increase them (otherwise it would not have allowed it) so in this, too, prices should be kept up. The only time that the general price level should ever be allowed to fall, then, is when money is taken from circulation. Why then?

-ΔP due to ΔT

— to -ΔM

Why is it ever desirable to allow debtors' obligations to rise when no new investment has occurred? Well, it just doesn't seem outstandingly harmful, and it may often be desirable to reduce the amount of money outstanding thru debt payments. If the motive is to increase cash balances, then by all means do it by increasing the amount of money; (but don't look upon this as a cure-all; that is the great error of modern theorists) but if the motive is to reduce debts, reduce cash balances, ~~why not~~ let it be done by destr oying money rather than increasing velocity and prices! If the motive is to reduce cash balances, money destruction will not make prices fall but just prevent them from rising. This evades question, suppose tendency for M to fall for other reasons.

ΔV→-ΔM -Δcb & -ΔM

Note that when v rises, m tends to fall, for the faster progress of money means a quicker ability to pay off debts. A desire to reduce cash balances would ordinarily take both forms, then, and perhaps have no effect on prices.

R. concludes that if T rises, prices should be allowed to fall. I say that the fall is due to an increase of cash balances, voluntary, which is better met from an increase of money. It seems to me, further, that an unregulated banking system would tend to supply the increase, for debts would be paid off slower and new money would find an easier reception when people wanted to increase their cash balances. --meaning that the ir would rise as conscious investment declined, and banks would step in with new money. Hence unregulated banking would tend to keep a neutral or stable price level.

ΔT & 'natural' banking

The publics investment habits closely control bank expansion, I'd say. If banks start to expand, and the public does not wish to increase its investment in money, it will continue to invest almost as much as ever in securities, and the bank expansion will be stopped by a fall of ir. Even this isattributing more initiative to banking than unregulated banking would have. Actually banks would wait until (the public started hoarding cash, and) ir rose, to expand credit. (all this is with no hps)

ΔM, Δir, cb, & bank control

Burgling thru banking

The government can rob the public thru banks, but competitive unregulated banks could not do it by themselves. They are sensitive to the public in their actions. Cash reserve requirements probably make them even more sensitive --- if they violate the customary ratio, they must be stopped, by cash drain.

But public might make them behave exploitatively.

Cash reserve requirements

Failure to expand

The banks can make an opposite error, R points out: fail to expand when cash balances are wanted more, and thus prevent the potential investment from going to borrowers. Unregulated banks would probably not commit this error.

He does not so far touch on what to me is the greatest gremlin in banking: unproductive and/or speculative investment, based on the non-productive and speculative features of our economy, which make ir appear different from what it will turn out to be.

Of course even a productive ir might change rapidly --- tho this is extremely uncommon, in general historically. --tho cyclically perhaps. And a sharp rise of ir would both increase v and cause the banks to create m. The rise of v would offset the pressure to create m, but not stop it. It might stop it before long tho: it certainly is a limiting factor, preventing banks from increasing their loans indefinitely. For when people didn't want to hold as much cash as they were they would invest it, competing with banks, at lower and lower rates. But does this mean the only way banks can be stopped from continuously increasing money is to lower ir? No, because unregulated banks would have to pay interest to their depositors and/or perform

Δir→ΔMV

ΔV→-Δir?

limits to bank exp.

other services for them, such that, with utterly unregulated banking, an increase of ir would not encourage banks to lend more at all, but to pay their depositors more. ~~Only~~ if it encouraged people to hold more deposits would it increase bank loans. ~~And there is no reason why it should, since~~ other irs would be rising proportionately, but even so some Δinr thru liq. would occur. Thus increasing liq. & allowing ΔM & Δinr, not ΔP.

R. erroneously concludes that increased cash balances thru lower v mean more consumption by those getting cash increment; and handles it sloppily in general.

Thought: people with a given "real" income are better off when others have a lower real income, because then they can buy more land.

Hence the more unequal the distribution, the less land commanded by those with less, even tho their real income in other terms may be very high. Hence a real basis for the "jealousy" of inequality despite high real standards that is supposed to motivate communism. land & inc. distr.

Inequality will not necessarily cause much land to be taken from productive use. A high ratio of consumption to investment expenditures will do that, and inequality may encourage the opposite.

That property income is largely used for consumption purposes is well illustrated by the Neale family, certainly.

p. 47, a very queer arrangement: some dubious equations about banking and capital, which he claims prove that progress can occur if banks add to money at the same rate as T expands. But I don't see any connection between the equations and the conclusion. R.

Too rapid bank expansion he insists extracts forced saving --- but I recall his description of forced saving was very bad.

The gold standard does not seem to me to interfere with working of banking system in accord with principle of stable prices, but R. thinks it does. Seems to me if prices fall, the g.s. prevents it, by causing inflow of gold. Thus it prevents any local disturbance from having great effects. It is merely a system for linking the money systems of the world. R.'s error is in looking on one nation as the thing to be stabilized, and world influences as extraneous. — & regarding nation as more stable than world. — tho it is, to a stabilizing govt. "accidental circumstances" he calls them. Also, I should say, if a country wanted credit, under g.s. it would raise its ir and that would attract gold from abroad, allowing credit to expand even more than it would without the g.s. (or some other system of world money) The "accidental circumstances" were gold discoveries I guess, and that is a weakness I suppose --- true of banking in general as well as gold. g.s. defended by me

Land, cont. good stuff. About this land distribution business: when incomes are very unequal then, according to modern credo, there will be a high proportion of investment to consumption. But in semi-feudal economies it seems true that less land is used for production and more for consumption than in equalitarian ones. The fact is, where morcellement has proceeded greatly, more land per capita is certainly used for production than where great estates are held for pleasure. This is not to say that individual rich may not spend more for investment than individual poor, and a higher % of their incomes too, but it does seem that where distribution is more equal a higher % of investment by the poor more than compensates for the less % by the rich. So that, the less equal the distribution, the higher the % of consumption expenditures. But does the land use really indicate the ratio of consumption to investment expenditures? The ratio of residential to productive experditures is roughly shown, but even that not precisely. Competing for land will be those who wish to use it to produce things for

sale, and those who wish to use it for its own sake. If consumption expenditures rise, more land will go to those wanting it for its own sake than those wanting it to produce for the market, assuming expenditures for land to have varied the same. But this assumption may not always be met. In a poor equalitarian society people might spend almost everything for consumption, but they would never spend it for more land for consumption, but rather for food, and whoever bought land would do so only for production, no one having the surpluses needed to use land for consumption extravagantly. Thus the growth of capital would make it more likely that some consumption expenditures be of this nature. The richer the society becomes, cet par, the more land will be used for direct enjoyment. This of course will reduce employment, ultimately. But it differs from other consumption expenditures in that the thing bought has not been produced and so the interest rate is not raised, except by the fact that the money was not spent on investment, but it was a consumption expenditure anyway. It is like other consumption expenditures in that the recipient will probably reinvest it, it not being net income.

So we have at least two significant proximate variables: the degree of consumption expenditures, and the context. The ultimate significant proximate variable is of course the context of all expenditures. --they determine how resources are to be used and hence the marginal productivities of various factors, since these vary according to what is being produced from the given resources. The richer the spenders, the more goes for residential land. The less equal the distribution, the greater % of expenditures is controlled by the richer, hence the greater % goes for residential land. So the greater our riches, and the less equal their distribution, the less land is available for production. Semi-feudal societies show that inequality is an important component of the story. They lack great wealth but those who do have it can keep land for themselves. If the poorer got richer, (assuming pure economic control of land use) they would bid more for food, it would be moreprofitable to use the land for food production, investors would buy it for that purpose. So, after this refining, my originalstatement is ok, with this new understanding of it.

A boom in residential housing must necessarily be followed by a period of lower returns to paid factors, for the capital created affords no further opportunities to labor. Before its creation this desired housing afforded a genuine avenue of increased labor productivity. It is, indeed, not wholely misleading to describe this by saying it increased the demand for labor. One must carefully understand just what is meant however. Real investment is real demand. --and it does not have to be pre-existing either, or even supplied by a different individual from the laborer himself. In the sense that the amount of investment may change, the demand for all paid factors may change. And this need not mean a narrower gap for the investor---it would, if cet par----but a higher productivity of capital, which originally widened his gap and then brought in more investors. Investment is the proximate demand for factors of production, and it pays in goods. (tho if the individual factor is the individual investor, this cannot be), for him as an individual) If investors decide that housing is the thing, and offer their claims on goods to factors to put up housing, an avenue ofproduction is opened in which labor and raw materials are more productive than before, at least in the investor's opinion. And so are sites. He will pay more for them, and he does not expect to lose, rather he considers them more productive for

various reasons. In his enthusiasm he oversubdivides and also misjudges the real productivity of his capital and overbuilds in the sense that he cannot sell them for what they cost, the latter bringing the boom to a violent halt, the former meaning that as the boom progressed there was no provision of complementary factors for the constructing factors, but the opposite, a continuous removal of sites and raw materials and "capital" from uses potentially or actually complementary to labor. A housing boom is doomed to end in depression, with our present system and psychology. An industrial construction boom is less likely to, but the sudden stoppage of new investment may would occur anyway and may be the controlling factor, the failure to provide complements being secondary. But I hardly think so. Over-residentialization is a genuine threat to marginal productivity.

end of land

In view of ~~this~~ new attitude to 'demand', as gross investment substitutive effects among hired factors may be reviewed --- but are still net complementary of course --- the partial substitutive effect simply being more strikingly displayed in some cases, where factors compete for complementary investment.

gross inv. & partial subst.

In organizing the thing, chap 1 might be relegated to an appendix to the chap on reflection, or hp and unemployment. Chap 2 might then be expanded into a section, bridging the gap from current analytical ideas to mine, regarding investment, money, etc. For some readers this would be a necessary preliminary; for others, unnecessary, and I might so state. It is too bad to start with such complicated and unproductive disputing. Yet these ideas, which are nearly universal, stand directly in the way of correct analysis, and must be met. There must simply be some way of separating the sheep from the goats, telling readers of the kind who "immediately accept a new terminology and think in terms of it" to proceed to part 2, while those who "criticize the groundwork in detail" should labor thru part 1. I might advise all to skip it, returning to it after seeing the simple and sweeping analysis it makes possible by reading the later parts first. Or I might just take the cream of it as a first chapter, putting the sweat in an appendix or a later chapter. Or I might start right out with Holdout price, putting Say's Law with Chap 2 also, making sure the gist of that was part of the cream of the new chap 1.

thesis org.

It depends, of course, on what one is writing. If a very formal textbook or last word, by all means start with the groundwork and build up the case, developing the science at length as you go. In that case the science itself is the excuse for writing, the conclusions just sort of inevitable results. That is the ideal scientific way of writing. But one cannot get away with that for some time, until he is recognized as an authority. One must make it exciting by suggesting conclusions. Or must one? George didn't, Keynes didn't, I don't think Marx did, Kinsey didn't,. Dewey never organized at all I guess. Einstein? Darwin, Newton, Smith, Freud, etc --- certainly plenty of people who wrote important books without worrying about popular tastes, and without putting the groundwork last. That doesn't mean one can't improve on them. One can show the significance of everything he says in the groundwork, show the nature of the problem as Einstein does, what gives rise to it, show real examples, as Darwin, ---these thoughts make my master outline of summer 1947 seem better than the analytical part on which I have specialized since. Plenty of problems about writing technique to handle.

Back to Robertson: p. 47, his equations say that the proportion of money which the banks have backed by circulating capital(as opposed

to loans made for other purposes) must equal the proportion of circulating capital which is obligated for bank loans. He concludes from this that as long as banks create money as fast as T rises, progress can continue without trouble. But I see no connection betwe n equations and conclusion.

Three principles of banking policy judged: gold standard, productive credit, price stability. The first he thinks just accidental. g.s. Higher prices due to gold discoveries (or reduced production abroad and consequent gold import) he thinks will increase saving by force, (2d aspect of forced saving) in two ways, but he is wrong. Only one way, and that is less sure than he makes it.--higher prices temporarily alterdistribution in favor of property by lowering real wages primarily, increase saving. This however is not a monetary but a holdout price phenomenon caused by money. As to money, no new lending is done if the rise of prices is due to gold inflow or production, but only when it is by paper money creation. But gold inflow causes paper creation.

His criticism of gold standard that it did not change with fluctuations of production is probably good, but not necessarily, for did not the FR system combine the two? One can stick to g.s. as means of keeping international stability and still not be prevented from expanding the currency to keep price level stable--- indeed, it would be wiser to do so under g.s., in fact one would be compelled to, for increased production would lower prices and bring in gold, thus expanding currency even faster than "natural banking processes" would. Yet he concludes that g.s. is universally condemned because of its rigidity. I think the real basis of condemnation is not rigidity but unmanipulability. G.s. will vary, but producers, not govt, must take initiative. And, of course, for world as a whole it may not vary with production, but then neither may banking technology. It does involve a waste of gold, a real criticism. But it probably fell because it couldn't be manipulated.

Limits to bank exp. Which reminds me, what limits a free banking system from issuing money? Cash or gold reserves always have. Were there none-such, what would be the limit? They would, in their expansion, drive down ir so as to set a limit to the rate at which they would expand, but still they might expand every year? Uncontrolled banking would have to pay interest on deposits, and that is what would stop them. And if that were made illegal? Services to customers. And if that werecontrolled? (of course if it were, so would the general amount, but justsuppose) I don't see that anything would stop them, ntil they had driven down ir so low that further loans were unprofitable. However Cash is with us to stay, and as long as a given ratio to it must be maintained, by prudence or law, such expansion is impossible.

2d feature of g.s. banking is need for liquidity of assets in sense they can be turned into gold or cash. This, as just seen, is an importantstabilizing influence. R. seems to think it more important whether they may be turned into final consumer goods but that seems irrelevant to me --- to the creditor what counts is with how little trouble they may be disposed of for universal credit, not how consumable they are.

Lloyd's Bank in 1927 revealed that 25% of its loans were "personal and professional", i.e. for uses little looked into and accepted due to borrower's credit standing. System doesn't guarantee that loans will be to finance "circulating capital".

'Productive credit' - Principle of Productive credit, proclaimed by FRB in 1923 report, Many centralbanks subsequently founded on American model. Assets be-

If banks are limited by gold reserves, thru law or custom, & gold is imported, this is like Δ technology, allows bank exp. But is it found? If all m. more gold, no, we would just be taking gold. But 2d any expansion increases lending. This is more inherent in g.s. than in internationalism, tho later may augment it. But we could stop it any time by revaluing. etc — ?

note and deposit liabilities of Central Bank must be productive or "self-liquidating" I guess. "Investment and speculation" not supposed to be helped. But trader and producer are entitled to depend on banks for the whole of their circulating capital. He thinks this is too much, will inflate from present level. But is so? Who else makes short term loans? Well, many business finance much from their own capital for one thing, and will doubtless continue to do so. He seems to think the fact that the money does more than just come back to the borrower disrupts the theory, but it doesn't at all.

Correspondence of M to goods

He observes that 90% of money cranks ignore velocity, assuming money to be borne with goods and then to die with them. I skirted the same error in my thesis, in that most imperfect part on money. The fact that so much production is financed by banks gives greater verisimilitude to the crude Larson idea that money is borne with products. Indeed, it is the es ence of the "natural" extensibility of bank credit. Where there is genuine production, banks should be able to extend further loans, and these will be proportional to the increase of production.

proportionality of ΔM to Δ prod.

Prod. credit policy criticized

Principle insufficient?-- e.g., doesn't cover increased hoarding, when, as I've decided, more money is appropriate toprevent price level fall, and when a free banking system will provide more money due to higher ir. - i.e., will provide the productive credit that private lenders fail to give.

Other reasons for insufficiency

In 20s, Ame icans reduced velocity, he conjectures from fact that they increased investments. But it hardly seems fair to so conclude -- a higher ir would increase investment and increase v.

Get facts: how large a % of financing is done with bank money.

20s, Am. banks made more long termers.

Stable price policy

Stable price principle. He criticizes because when prices should fall due to dT they don't, but I think thisis ok, since desire to hold m has risen. If not, prices would not be allowed to fall despite dT. So I like this one best? So? How about these banking & intl. as deterrent to spending, etc.

Wholesale prices fall faster than retail when productivity increases in 20s he says. So? Why?

p. 57

FR system undertook to stabilize price level presently, but no one knows what price level. Wholesale fell, 1925-7, and wheat too I guess.

Trend to -ΔM (& weakness of stable price test?)

Business became, in Am. 20s, more able to finance itself, had less recourse to banks, and FR trying to keep prices up loaned in such a way that stocks were driven up, he thinks.--which is possibile if the money were put out by buying securities rather than lowering rediscount rate, or indeed even in the latter case if members allowed to lend to brokers etc. Allowed great consumer borrowing too, something new then.

They might really finance growth

Robertson, 17

IV Saving and Hoarding

His "day" is something during which you spend the money you made the day before. This I regard as poor, for it forces the introductio of cash balance later as something extra. We should regard income as coming in at the same time that expenditures go out, cash balance being the resilient cushion between, or, better, the reservoir. What, then, shall a period be in my terminology, for I certainly talk about periods enough. It is one "turnover" of money. But the period of turnover can be arbitrarily altered, such that we might say "in this turnover, some money was held idle", which is a simplified way of saying that in general v fell in this arbitrary time period. And the period could not be defined as one turnover of m, for then it would lengthen as v fell. It must just be some period approximating one turnover.

def. of period

He distinguishes "Lacking" and saving, lacking being failing to receive as much as your income was worth when you got it, whether because you save or because your money depreciates. But this seems a fairly useless category.---why combine those two separate ideas? He evidently does so on the idea that what is lacked thru depreciation is saved elsewhere, but that is not true. Saving is voluntary Lacking, depreciation is "automatic". Further, he says you don't lack if m appreciates and you save a little -- which again seems pointless.

He has a poor definition of hoarding: raising the proportion of cash balance to income. So if one's income rises and he increases cash balance, that doesn't count. And the previous cash balance is not counted as hoarding, just increases after the base period, tho they may be immense -- the pre-base balance, i.e.

He everywhere assumes that entrepreneurs have variableincomes in short periods, others fixed. True, I suppose.

Keynes and Kahn had an odd definition of saving about thistime, (1933) which was designed to prevent saving and investment from being necessarily equal, which they would be, according to those worthies, with sensible definitions.(not that R's is perfect). R. analyses their arguments and it is the story which Stewart, and, I suppose, they too, were still sticking to, that income is composed of c plus I, and it is spent into c plus s. But, R points out, M may change due to banks, and he might have pointed out that v may change too, so what is spent need not equal what is received. Further, I might say, there is no reason that everything received from sale of consumption goods shall be spent on them -- indeed, K. has at times argued that none of it will be!

sav.-bank. def.

R. thinks it better to define saving and investment so they are not necessarily equal, the difference being the cause of changes in price level. This seems ok, tho his analysis is limited.

2 kinds forced saving

K.

R.

Accuses K. of fusing two distinct types of forced saving: the reduced p.p. of past producers when new money is created; and the increased share of income going to property in inflation. The latter I say is not a monetary but a hp phenomenon, is not forced in any monetary sense. Still K. is doubtless wrong and confuses them, but R. is not right.

Hayek.

The former type is generally meant by "forced frugality", the latter is perhaps K's innovation, or R's. But Hayek used both kinds, oddly intertwined, for the former was the originator of extra saving, and the fact that wages rose to stop the second kind was the stopper of saving. But generally the term is not generally defined.

Robertson, 18

I see a smattering of truth in Hayek. We have "too much" investment followed by "too little". But the causes of the shift completely elude him I think.

V Industrial fluctuation and the natural rate of interest.

But how define the "natural rate". It is one that is to "preserve equilibrium". Which may mean what one's ideology wants it to. I'd say let it mean free banking, when rate of expansion is what dT, dV, and banking technology make it.

But they throw in ideas of normal degree of employment, and cannot decide if full employment of normal employment is equilibrium that should be striven for, and if capital should be growing, how fast, etc., and they really must decide what the role of money in capital formation is before they try to define equilibrium --- everywhere in economics we see the same error, that people try to build the superstructure before the foundation, i.e. that they fail to equip themselves with necessary capital before undertaking tasks that need it --- but then, we have the opposite error, many who develop elaborate systems for no purpose.

R's own opinion!

His cycle: investment opportunities rise, new investment occurs, with various minor adjustments described in detail, wages rise, so supply of investment falls, just as investment opportunities also fall due to saturation --- Continentals emphasize former, he latter---. In trough, he thinks investment opportunities, tho they fell rapidly, will rise slowly -- in truth, people's ideas of them may behave that way, tho even that is dubious, but the realities won't of course -- and he thinks hps, wages esp., won't fall as fast as they rise.

Continentals emphasize projects that have been started that will be stopped when ir rises. This is an odd one -- such should be a minority. Indeed, wouldn't most of long term financing be already arranged for when a big project started? And wouldn't there be a strong vested interest in finishingit? etc.

Air→anticav

By the same reasoning as in my chap 1, there can be no divergence between mr and mp of cap., i.e. anticipated mp of cap. But to talk of a divergence gives the general idea, that credit will expand, dM. Perhaps this is much more inflationary than dV, when ir rises. (in this shorthand I have usually used ir to mean anticipated mp of cap, in the classical way, rather than as supply, which I denoted by mr)

antic. infl. (dP?)

Another doctrine is the real vs. money rate of interest.(the above being natural vs. actual) This is Fishers. When price rises are anticipated, people will pay more for money.(and this will help bring price rises, no?) He evidently proposed it as a guide to policy, to prevent fluctuations. R. doesn't seem to think of it just as an intellectual contribution, and rejects it as impractical.

VI A note on the theory of money, 1933

R. defends expressing cash balances as a % of income, which K has attacked. But K wants to express a portion of cash balances as % of income, not to do away with the % of income expression. K. is trying to make it seem that the other % of cash balances has no hope of ever being spent, but R points out that it will be. In the "Cambridge approach", "K" means the % of "R" (real income) over which people wish to hold command in money.

Skipped some.

VII The future of trade cycle theory

Hayek & Keynes, both draw from Wicksell. Both regard boom as time when investment exceeds spontaneous voluntary investment -- I doubt this. H. says slump comes because saving is inadequate; K because, while adequate, it goes to waste in hoarding.(R mentions not this, but extra consumption by non-entrepreneurs, stoppageof production, and borrowing to produce at a loss$/ -- odd) K. believes (or believed in 1933 when this was written, for he seems to have different ideas now, vaguely) that continuous inflation was the answer. And this makes him at one with the money theoriests, who propose the same thing, tho analytically he is like the Austrians.

(ineluctable; logomachy)

K. evidently had an odd definition of saving about thistime, to establish some norm as normal.

Both K and H wanted to restore the high level of production of "instrumental goods", as a remedy. This means they look to continuous sacrifices by investors to keep things running. For investment raises wages, but at the expense of reduced consumption by savers-investors, to overcome hps of land and labor. K. would do it with inflation, H with economy by consumers and reduced taxes on entrepreneurs. R. suggests that cap. formation should slow down.

Hawtrey thinks of public works as "ritual", inflation being the vital thing.

VIII The snake and the worm

1936. Those who would inflate to insure full employment are enriching entrepreneurs to keep labor employed he thinks --- i.e. he is thinking of the second kind of induced investment, as well as fall of debts value, etc. Those who opposed inflation used to claim the results of forced saving did not last, now admit they do, but think the price is too high to pay -- . Also, they are not assuming that full employment has been attained, but rather that it isn't worth the price. --their opponents evidently accusing them of "assuming full employment", etc.

The theory of the rate of interest he calls the central mystery of economics, and the basis of disputes the most intricate between the inflationists and the "defeatists".

The root of the conflict is that the inflationists think the cycle is the worst evil, the others think the chronic tendency to stifle enterprise and make thrift "leak" is the worst. -- this doesn't seem to me exactly the array of forces, but maybe in part.

p. 112 -- before 1929 restriction schemes were applied to "ease the problem of excess capacity" (how euphonious!)(eupphemous?) in leading RAW MATERIALS.

In the 1936-7 boom many governments unbalanced budgets meticulously balanced in 1931-2 --- who were they? Relation to bust of that year? Did inflation fail?

We must not a very bad feature of inflation: both by lowering ir and by increasing m it raises land value anticipations.

The growth of large firms means reduced demand for short term bank loans, which would be deflationary in itself. -- but is overcompensated of course. (by what?)

IX Effective demand and the multiplier

p. 114, he voices the key confusion. Why doesn't production increase? Because part of the increased income would not be spent--- i.e., he visualizes a constant decline of v -- but why the decline should be greater when production increases he does not say, and it seems to me an increase of productionwould reduce it -- reduce the

decline, i.e. --- but he declines to take responsibility for this statement.

Demand price, D, and supply price, Z, are introduced, D being expected revenues, Z being known costs, of increased output. When Z exceeds D, as it will when money is to be hoarded, production will not increase, he thinks. And he has a further quirk of not counting payments to entrepreneurs as even partly income.

Accuses K of using demand price to sometimes mean what entrep s expect to get, sometimes what they do get.

R thinks of the increased income as due, not to the first extra payment due to new investment, but as the subsequent expenditure -- just the opposite of a sensible system of definitions. R. dreams up a little fantasy on this by which entrepreneurs will beunaware that money will be hoarded and that demand price is below supply price, and will expand anyway,(and their own profits at an arbitrary high level have been counted part of supply price) and they actually make money, tho less than originally considered part of Z, and continue to expand profitably --- but really it is not that they expanded that made it profitable for them to expand, but that they werecontent with less.

The supply curve visualized by Keynes is most peculiar. Additional units are called forth with no increase of price up to a certain point, i.e. curve is perfectly horizontal, and then duddenly it becomes perfectly vertical and increased money demand just raises prices. Of course it might be more nearly reasonable to say it is almost horizontal, then we know just who will be called into production by increased money. A lot of money raises prices a very little and increases supply a great deal.

X The Trade Cycle - An academic view. 1937

Power of Central Banks, and govt control of them, has grown greatly in 30 years. But some elements of old power have been lost. In 19th century, fear of boom was due to fear of gold outflow. Today, 4 kinds of "boom-shyness": speculation, vicious circle, loanable fund deficiency, investment saturation.

Prof. Robbins seems to go for the third, or Austrian type. Boom-time investments don't pay out, because ir rises too high because labor gets too much and doesn't saveenough. That must have been a pretty dominant theme before Keynes --- esp, as I recall, in central Europe. Robbins says let rates rise early, to avoid a boom with its disappointing bust after; K says keep them down for recovery, and always. R. thinks importance of investment is overstress d by both, but offers nothing in place.

Wicksell himself, pioneer in studying relation of ir to prices, thought this was little connected with c cles, which he attributed to changing real investment opportunities due to technology etc.

Govt control of money supply will end up in forever keeping ir down so the govt can borrow cheaply, he fears, and current events seem to bear him out.

XI A survey of modern monetary controversey 1937

Optimists, Pessimists A & B, and Blondinians. Optimists will go upward and onward at all costs; Pessimist A think of under-investment; Pessimists B think of lost opportunities to invest; Blondinians think of excesses, vicious spirals I suppose, and natural vs actual ir. Wicksell thought authority's power to affect ir with mr was unlimited, Marshall stressed limitations. Until recently, money policy as affector was over-stressed, liq-

idity preference understressed. Now the optimists and the B pessimists have joined to throw out the natural rate of interest as something that should be striven for, believing the authority can permanently, with repeated doses, defeat the tendency to return to the natural rate. --at least the Optimist thinks that, the B Pessimist thinks that income will be altered to the rich, they will invest more, but he fears they will hold their money as such, he wants to print plenty to fill them up and make them invest.

The Bessimist B thinks of liquidity preference as something long term, that can keep ir up forever, the Blondinian sees it as only short term matter. (Stewart, I recall, could not understand this point once when I broached it) The Blondinian is less sanguine than the optimist that the money authority can keep ir down forever, but he is also unlike the Pessimist B for he doesn't think hoarding can keep it up forever. The Blondinian, i.e. is one who thinks of money as having short term effects, not permanent ones, and who takes into account possibility of price changes.

XII: British Monetary Policy.

acc. princ. & cumul. inv.

(even the "principle" of acceleration might make a little sense in view of the new attitude toward investment as demand I have developed). Investment in some goods may stimulate even more investment in goods that produce them, etc) & the normal increase of trans. is a -Ahp.

Why not take m&b this spring instead of land ec. Works in with theory better.

Klein, the Keynesian Rev., tidbits there here. - not major outline of what he says, which is left wing bs

neo-Wicksellian depression theory, popular in early 30s. Myrdal. But Hayek included.

Myrdal: natch i.r. given by any one of 3 conditions: 1) Sav. = inv., both 'in schedule sense'. 2, ~~M~~ Causes stable p 3, Yields antic./cost of prod. — not clear, says Klein, if means new inv. or all inv. Does nat. rate # 3 equate S & I? Depends on def., & K's def. made answer no.

Swedes had i.r. & p. level theory, not gen. empl. theory. Their theory implies i.r. manipulation will give full empl. (Ohlin stressed expectations, not i.r.)

Hayek: when mkt rate pushed below natural, cum. exp., ΔM, but people will not save that much voluntarily, structure of production has gotten longer than people want it (are still plenty of inv. opp., but inadequate credit), people will not save enough, inv. will have to decline.

Neo-Wicksellians thought cumulation up would occur whenever natch rate got ~~below~~ above mkt rate again. K. disagreed. H. stressed alternativeness of C & I, K their compl. 'no, K. said something

Hawtrey: i.r. & flow of m. - Δi.r. would cause entrep. to Δinventory, make m flow. Sensitivity to Δi.r. the crux, & intentions stressed. K. also stressed i.r., but for fixed cap. & K. pessimistic, H. opt., of what could be done with i.r.

(Note again how Central Europeans stress alternative aspect of C & I, not just Hayek but MacHlup, Mises, Ropke, Strigl (& Robbins), Fellner. Some connection with Central Eur. inst? Banking?)

Non-monetary over-inv. theories: Spiethoff, Tougan-Baranovski; Cassel, maybe Schumpeter, like K., stressed Δ inv. as objectable. But like Hayek, they stress lack of cap., not of opp. for it, as cause of bust. (not so different, for reduced expectations can be interp. either way as well)

Under consumptionists did not stress deflation, sav > inv., but over inv., too much to buy. K. differed, Klein with K. (K. said he differed in thinking inv. as good an expenditure as any, ok.) Under cons. ists thought there plenty of inv. outlets, just you couldn't sell goods (?)

Walrasian system of gen. eq., d & s relation for every commodity in system, millions of eqns & unknowns.

Klein agrees with conclusion from family budget studies that marg. prop. cons. same at all levels, redist. doesn't affect cons, only i.r. & general inc level affects (~~If why test, if no change?~~ cons. ∴ p. 60 (He later reverses, says Dorfman) (& says redist. is answer)

Klein, 2

But i.r. has ~~a~~ no influence on cons., (only on inv.) so only ΔY affects C. i.e. on dist. of Y between C & S

I. r. not important in determining inv., only antic., since risk plays major role, not int. Thinks bus. inv. very bearish as investors always, cap. must pay out in 5 yrs – bs

Liq. pref. depends on i.r. & N.I. (This makes circular element in K, since liq pref. is one thing determining i.r. & N.I. So he has not shown ultimate causes)

→ Essential circularity of K. also seen in use of $\frac{dC}{dY}$

Klein thinks Keynes didn't understand what he had written, for he admitted his system depended on rigidities, & said an illusion caused unempl. Klein Humified. Says That ~~but~~ [as ~~and~~ wages fall, Y falls,] ~~but~~ if sav. & inv. schedules are such, sav. (presumably ex ante) exceeds inv., ~~so~~ as i.r. falls, both being inelastic to i.r. $\frac{3}{5}$, & is no stopping fall, a continuous deflation. Until $-\Delta Y$ reduces sav.

The ~~non~~ under-empl. eq. w/o rigidities interp. of Keynes

Gets an eq, in perf. comp., where wages are above intersection of s & d curves for labor, due to superior bargaining power of employer. Hence unempl. Utterly WACKY.

Mentions that as $-\Delta W$, real c.b. rise, but says expected future fall causes postponed empl., defl. to int., revolution.

A CONCEPT OF GENERAL OVERPRODUCTION

Certain lines of production are controlled tightly, prices artificially maintained. E.g. urban land.

Result is often competition, as high prices bring otherwise submarginal resources into industry. These are then included in cartel, the resources in effect retired from use. So more come in, and more and more.

When collapse comes, why doesn't this thing become cheap, and the resources revert to other uses? Because the resources are tied up in the originally restricted use, either by physical half-development like subdivision streets, or/and cherishedcconvictions that resource will go back into higher use.

Now old idea was that if everything became cheap, nothing was any cheaper relative to goods, so was no overproduction. But pattern is that originally restricted goods become overabundant but not cheap, as prices artificially maintained; and resources cannot go into other uses because they are tied to the restricted uses.

Some resources can move -- e.g. uncommitted labor. But union labor moves slowly if at all; likewise highly specialized labor. Sunk andspecialized capital moves slowly. And of course land.

So pattern is one of overdevelopment of industries where restriction is tried and fails; with resulting locking up of resources from industries where resources can be more productive, socially.

There is also probably tendency in restricted industries for unduly high % resources to go into very durable equipment, rather than current output. And into land development. For one thing, because in order to start out, that is what you have to build first. Thus we get overcapacity.

The big, the new idea here, that gives substance to previously unacceptable idea of absolute overproduction, is that resources get locked up in the wrong industries.

Mill, Principles, Bk. I, Ch. VI, ¶2 anticipates Wicksell in seeing dangers of freezing too much capital.

Jikes w. his wages-fund theory of course.

- Some current works on replacement policy.

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Kyklos XV – '62 – Fasc. 2

Program of ARA res. under Sec. 27

1. Empl. multipliers from area, & aggreg. national, diff. kinds of facilities.
   How to use given funds to complement labor most. Cap. may sub. for or compl. labor. How identify & encourage types most comply. in areas that need
2. Stability or permanence of gains: empl'mt. compl. by a. turning over; b. using labor during life.
3. Identification of bottlenecks, limitations on empl'mt, growth.
   (Answer will be capital. as $ output/man, /acre, /machine (of given sort), need more liq. cap. to carry products. Cap. fmtn fails to keep pace; & extant supply gets frozen, "indisposed", or undisposable
   (I should say we have land, cap., lack "inkt."; & "indy." Meaning?)
   Local land prices & availability? Ownership, as Klein & Saks advise.
4. GPT – bias vs. durable pvt. invmt. [Isn't that good?]
   [No, bec response is just less invmt., let plants grow older -- less frequent renewal]

4. Regional dg & decr. rets.
   Encourage recrn. bec decr. rets elsewhere
   Discourage decentralizn of many urban fms needing focus – become them for urban redevmt.

5. Balanced $ output, aggreg.
   If one area $s output, lowers relative prices. Competitors squawk. Solution: $ all kinds of output.

6. A national optimal pop. distrn. -- for guidance, what areas to abandon, what ones to spark redevmt in — to max. eff. of xptn system, e.g.

7. Coordination w. other Fed. fms that affect location: hiway bldg., e.g.; airline subsidies; defense installations; etc.



Willard Hotel

PENNSYLVANIA AVENUE AND FOURTEENTH STREET - NATIONAL 6-4420

The Residence of Presidents

WASHINGTON, D. C.

Leg. Stanback, Thomas M. J., "Postwar Cycles in Mfrs Invies.", Studies in Bus. Cycles No. 11, NBER, '62.

Finds durable invies lg re less durable ones. May discuss.

Inv. in. Rapid obsolescence causes faster turnover of existing cap., given amt of cap. causes more empl.

When future looks better, or mr falls, shift to durables. At first this is good. But presently cap. is converted into more durable forms, & turn turnover slower.

Anything encouraging changing form of cap. encourages employment.

When mr falls or yields rise, it becomes desirable to turn short term assets into long term ones. Conversion & new inv. both increase. When r.r., you want to dump existing assets on mkt, shifting use to present. In former

case value of factors rises vs. consumables. Consumables come on mkt from converters, but people want less of them, taking claims. (This may appear asymmetrical, & it is, but I think rightly. When shifting rates to future, must change purchables usually, to other forms. When v.v., cannot change durables so fast, can only neglect maintenance etc But, no, symmetry still dominates, for when yields fall flow of cons. goods to be converted diminishes. We have an effect from consumables, & from durables, in both shifts)

RBCT, Hayek, "Price expectations, monetary disturbances, & malinvestments". 1933, roughly, ideas originated he says.

355-6 When people invest, they assume present yields will continue for a while, and that other people will continue to invest for a while in the complements of what they are investing in. Good point -- i.e. when people stop investing in houses, further subdivisions are waste of time. Hayek also stresses that mahy investments, once started, must continue a long time, if the first m is not to be wasted. He also stresses that many investments are built on assumption that customers will invest -- i.e. they are to produce investment goods.

(When saving stops, inv. does too, & as gross inv. is what employs people, that reduces employment. So? Maybe....

356 Large, unforeseen decline of saving would explain crisis, he says, roughly because lack of it means previous expectations not realized because they require further investment -- which is roughly true, but he doesn't put it clearly. But is no reason for having savings fall suddenly, except in result of crises, so must explain crisis some other way, this is his cumulative explanation.

He explains it that division of m demand between cons. & inv. is what entrepreneurs think is consumers desire between saving & consumption, so they invest accordingly. Is esp. bad when banks create m, giving impression people want longer structure of production, i.e. want to postpone consumption more, than they really do. (so he uses the ass. that final consumption expenditures, or expenditures from net inc. position, are major determinant -- which paves way for underconsumptionism, perhaps, breaking him down. Anyway, his theory is not coherently worked out, tho he definitely has a good idea)

359 dM causes increased incomes, but not increa sed saving, for it is just m incomes that rise, prices rise right along with. So more is spent on consumption, to offset which must be more dM, this cannot be maintained, so time comes when cons. demand rises relative to inv. demand.

360 So expected complementary capital not created, as i.r. rises. "..a scarcity of capital making it impossible to use the existing ca ital equipment appears to me the central point of the true explanation of crises;" But least acceptable to lay mind.

Many 19th c. observers explained crises as due to excessive conversion of circulating into fixed capital. James Wilson, 1st ed. of the Economist, did so, re r.r. crises. A group of Manchester economists took it up. Bonnamy Price in Eng., Courcelle-Seneuil & V. Bonnet in France. Yves Guyot. v. Prices & Production, app. to Ch. 3, for fuller account.

Note difference of K & Hayek: H. explaining cause of crisis, K. telling why we can't get out of it.

361 Guyot: "Crises are produced, not by overproduction, but by overconsumption".

Attributes failure of these early theorists to make a dent, & be overwhelmed by "a century of underconsumptionist propaganda" to vagueness in their concepts of capital. (which might spring from their identifyin land with it?)(no, hardly classics) But his own concepts are also vague. He lapses into most unaccountable muddles, after the clearest statements.

362 What he means by scarcity of free or circulating capital is there is more demand for consumer goods than supply. (that's not clear enough, tho on right track. & his expression of it is much less clear than this)

Finis

See graph, p. 4.
See p. 16, war & liquidation

Misc. ideas, draft. Structural causes of unempl.

1. If 7% labor force is unempld, & want to employ them, requires 7% Δ of circ'g cap. (& perhaps less bec they go off relief, but likely more bec of more specializ, accelern., etc.)

Is excess capacity in fixed cap., don't need that.

2. Creat'g money w/o creating correspond'g pvt. debt, as constraint to produce, & more, to return goods to buyers for money, has odd effects. Trace them . . .

3. You get land only by paying rent in advance, or buying - pay in advance. Thus consumes much circ'g cap. If sellers continue to treat as cap., ok. But a, Renters treat as inc. b, Sellers treat cap. gain part as inc. Thus, now, buying land involves considerable social disinvestment. Ceases to be a x/fr, becomes a leak.

4. Shortage of circ'g cap. shows up, not in consumers' being unable to find goods to buy, but in mfrs, wholesalers, & retailers' having trouble finding money to finc restock'g of inventories. I.e. they seek to reduce inventories -- & equilibrate downwards, as hired factors can buy less. But is only a little room for reduc'g inventories. It is invmt. in durables primarily they seek to reduce.

5. "On disposal" — wide selection, & in quality, & in rates of use, cap. makes possible. W. less cap., wd. use more labor, by shoppers & sellers both, as in r.e. mkt., to match customer & product.

5 (cont.)

Thus dearer labor creates new needs for cap. as subst., not complement. More durable.

6. Need to show:

a. A trap is possible, conceivable, where shortage of s.r. cap. blocks employment of hired factors, & ligu. of extent cap. (which is like a hired factor in requiring circg. cap. to employ it.)

b. We actually are in the trap

c. L.v. play role

d. Monetary manip. alone cannot untrap us

e. More heavy invmt., public & pvt., worsens trap (even pvt. bldg?)

f. Need to stimulate:

1. Cap. turnover
2. Cap. fmtn.

7. Bldg. taxes – my ambivalence must be resolved.

They discourage durability in bldgs, thus keep cap. more active. Allocation-wise, clearly bad, get too little bldg cf. autos &c. undertaxed items. As to cap., & scatter, & need for public bldgs & works, probly overcompensates, get more durable cap. structure overall — & more cyclical.

8. ~~Cap. fmtn. problem~~ Cap. turnover problem

If munic. sells bonds, builds roads, etc. .... money never repaid? Yes, after long lag. (& assuming no bankruptcy). But if permanent debt set up, maintained by refinancing, even as cap. wears out, then is like borrowing to consume, consumes capl. Thus munic. is living on & l.v., like pvt. owner

As long as debt is unpaid, also, reps. drain on cap. [& it is Δ b.v. + heat permits it.] True of all long debts, (& long real investm). Structure of future liqn can build up so a shortage is inevitable. Just as (alleged) in timber. Requires aggreg. anal. to foresee.

Leakage from circ'g cap. is offset by inflows: from new savg; from liqn. Need to set up flow diagrams, sources & leaks, w. time lags.

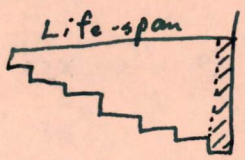
In any pd., there is cap. that turns over once, thus no leakage; cap. sunk, a leak; cap. turning over more than once -- whether leak or not depends on whether integral no. or $1\frac{1}{2}$, $2\frac{1}{2}$. $\frac{1}{2}$, etc. Is also some coming in from previous pd.

Simul. flow anal. might work better? Like canal capac., $= A \times v$ (cross section x velocity) Note that use of velocity, which implies a pd., does not keep us from using instantaneous vel.

Let C ≡ quantum of cap., mared in current $ (note how C declines when Δi !) a central ambiguity in "quantity" of capl. — how resolve & measure?

Let L ≡ rate of turnover by liquidation & reinvestment, in $\frac{\text{units of C}}{\text{year}}$

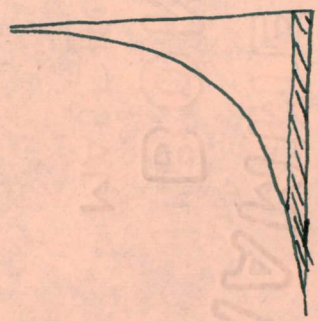
Then CL is key determinant. But leakages must be expressed in lower L. No, not all, some are in lower C: cap. consumption, cap. devaluation.



Shaded area is fringe of cap. currently melting. Note, by taking top strip & turning it vertical, & adding to shaded area, could double current supply.

"Circ'g cap." is misleading (as well as sounding obsolete.) It sets apart artificially the bottom row. But right column is the liquidat'g cap.

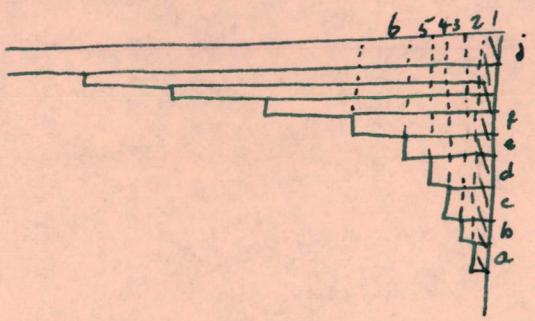
Note need to distinguish gross & net lign. — liq. ore stocks, e.g., is not consumption, they become steel. & liq. strip mine shovel, same story.



Probly structure of cap. looks like at left, w. concave effect, thus giving slight warrant to circ'g vs. fixed dichotomy instead of continuum. But continuum still better

Shaded area is 2 things:
a, Goods available for cons.
b, Source of money for investors to reinvest, employ inputs

Number columns rt. to left, & letter rows ~~top~~ btm. to top.



Holders liq. col. 1, thus get m to pay inputs to buy col. 2 + a. They pay them to reconstitute cap. structure, probly much as it was.

Let length of rows rep. curve. life of cap., so can rep. each yr's opn. as moving column 1 to left, or rear, of each row.

W/o great detail, can get to year when liq. yields too little m to employ hired inputs next year. Not bec. cons. demand lacking, but

invmt. or reinvmt. demand lacking. That then reduces cons. demand, but always a pace behind.

Needs work.

9. ARA can't very well emphasize quick payout in own invmts. Not inventories, anyway. But are other levers, angles. "Quick impact". "Revolving funds". "sustained impact"

Aid contingent on more than local planning — local policies to encourage comply invmt., renewal of site, "matching". Local assumption of some fixed charges is most convinc way.

10. When have infl. w/o full empl., as now, have reached limit of inflationary technique. That is clearly no longer the bottleneck, time has come to look elsewhere.

11. Monetary counterpart of long term cap. is long term loans. ✓ Banks remain loaned up w/o having to make new loans. Length of loans may not fully reflect durability of cap., make refinancing necy., but again, no fncg of current output involved.

Capacity of bank'g system, assumg we want to avoid deval'n & infln., is limited. ✓ So when durables absorb lendg capac., less remains for current. Also when land absorbs it.

✓✓ analyze portfolios, declining short term loans.

Long loans are attractive to banks, so long as liquid. Less work.

✓ Banks end up monetizing l.v., cease to supply production credit.

Short borrowers cd. pay higher i.r., but anti-usury laws prevent their competing that way. So even if we turned banks loose of reserve constraint, they wd. stick to 6% 30-yr. mortgages over 6% prodn loans.

12. "Structural" unempl. Meaning?

a. In space, location

b. In time

1. Obsolete training

2. Structure of cap.

12. Try again. The structure of a nation's capl.

a. In space – location

b. In time – durability

c. In other qualities

d. Time & space: cap. flows, or relocation over time

13. Can begin w. some incontrovertibles:

Site renewal, higher freq. means more empl. – & less cap.

Then apply to automated machinery: the less durable the machine, the higher labor input, & lower cap. input, in final product.

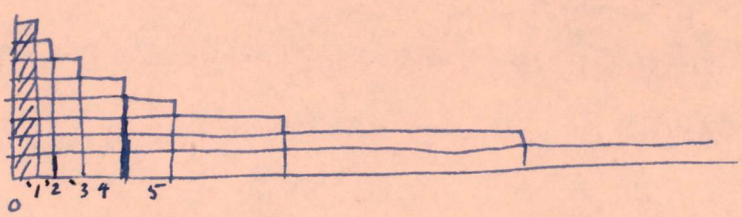
Need more land over which to spread cap.? & that may be limiting factor, at some stages. But here comes puzzler. If land limited. l-v. rise, so we get faster turnover to ease on land. No puzzler: w. cheap land, hi int. causes fast turnover; w. dear land, land does. Either case, equilibrates toward full labor empl. But hi int. won't hasten demolition of old bldgs, just cause flimsy initial constr. W. hi l.v., get heavy constr., renew often (not needy. Can build taller w/o sig demob.) are diffs. tho. W. cheap land, get thin-spread cap., but not faster turnover. Use $\frac{1}{2}$ as much per acre, but no such to turn over.

Turnover a $\frac{\text{output}}{\text{cap.}}$ but not a $\frac{\text{land}}{\text{cap.}}$ Thereby a paradox, the more valuable land becomes, i.e. the farther we get from a "resource-oriented" economy, the higher the % land input. At mgn, all input is cap-lab. bec land worthless.

You can apply more cap/acre w/o sig demability, but not likely. When go into larger scale, surely need to spread over longer time to make pay out

14. Returning to my time-structure diagram, p. 4. some inputs will yield nothing for yrs; some are unfinished business, will require later complements. So don't think of individ. inputs as bands of uniform width.

also, invest it:



15. Now what happens if you come to col. 5 & is a deficit. Too little to sell that year. Trouble comes in t 6, middlemen hv. received too little to employ hired inputs — includ'g liqn. of col. 6? — well, those parts of it that are for prodn. The parts that are for cons. will go fast.

There are 2 or more cap. structures — one culminat'g in cons, e.g. residence, another in conversion to other goods, e.g. factories.

16. Theory of equating internat. resource endowments by migration of cap. instead of labor. Some intl. theorists go so far as to claim it can solve problem completely. Probly wrong, but also shows how much can be done by relocating cap. instead of people.

Odd that some people, e.g. Schultz - Hathaway - C&D, think only in terms of people migration domestically, simul. some ecats, & probly they at times, wd. solve intl. problems by cap. mign.

Society, as well as individuals, has interest in using up existing pvt & munic. capl. in depressed areas. When a few pull out, they can liq. homes, finc new ones in Calif. When all pull out, no resale, they go w/o cap.

17. Cap. import into growing areas accompanies people, bec they take it with them. In form of claims. Easily cumulates.

18. 'Structural' refers to tech. change as well as migration of indy.
Tech. change includes subb's cap. for labor. That means factor propns
— which is a good word ∴, opens door to everything I want to do.

19. "Tech. change" alone is not enough. Sub. of cap. for labor very.
Given that, my research asks:
a, What is ideal adjustment
b, What mechanisms work for (a)
c, What obstructs (a)
d, What policy needed to achieve (a)
e. Where ARA fit in?

20. Human & training, analogous (partly) to land & improvement.
Is opt. lifet. pd. for acquired skill, then is shame to waste valuable human intel on old skill. True only of s.r. skills, but some people can run thru several skills in a lifetime, & must, change is so fast.
Increasingly so.
Regular retraining at age 45 a good idea.

21. Problem of outmigration, effect on residual popn.

22. Key expert invmt go where localities recognize 2dry benefits & subsidize them.
But there are deferred benefits, subject to all the evils thereof. also differed, subject to exaggeration. Rationed thru l.v., usual problems.

~~13~~. 22. Today, an expnt indy. means to a town what a r.r. used to mean, & they use same means to attract.

23. Immobility due to poverty, their blasted long time by C. Goodrich, return to poor hills in depression. (also C. Hamman). And higher migration rate of negroes.

Petty vested, hard to liquidate, are more likely cause. Middle-class immobility — hi & lo move.

24. Need something like a successful modifn. of Say's Law — show can Δ output & simul Δ demand. Explg. if do so in a pocket of unemplmt.

Fact is, interregional cap. flows mean in growg areas, produn not only creates own demand, but new long term invmt creates demand w/o output. Compensating, older regions liq. cap. When older regions cease liqg. growth of new stops, which hurts bec they have so much unfinished business.

Anyway, new plants by ARA aren't siphoning off limd. aggr. demand. More likely problem, add to aggr. demand for many yrs w/o liqg any output.

25. Continual drain on nation's cap. producg mil. stuff cd be diverted to other needs, if just jell idea that make-work not necy. & liquefiable cap. is necy. Seems like a complete reversal, complete denial of standard underconsumptim philosophy. Is it possible to soften the blow? Desirable? Or try for shock effect? Better avoid head on at first, begin w. most plausible aspects, go on from there.

Factor propns is good entrée. Cap. turnover. Etc.

26. $GNP = NI + Depreciation$.

Here is "fixed" v. "circ" cap. concept, very much alive! Find out basis of drawing line, thus get annual est. of lifn. of one kind, at least, of cap.

27. In hypothetical crisis pd., "business" anties less lifn., hence sees less need, & has less power, to replace. So, cuts back spending, in antic. Thus reduces cons. demand. It is not that consumers come & find less to buy. Here is missing link. Involves no cumulating. May trigger off cumuln., if whs now try to liquidate lns of less volume.

28. Concn. of assets is involved. Owners of cap. tire of mgg so much, so put it into slower-turnover durables, reduce load, & grow sales. Thus firm goes out of poultry, into cattle breeding, lengthens out his cap, slows turnover. Less leaks per $. Goes into land. In aggreg. this bids up l.v., inc. to sellers, dissipates nation's cap.

27, resumed.

"Business" is not adequate word. Lengthening invmt. comes by govt. taking funds. May not repay at all – e.g. a pay as go highway bldg plan. Return to that. Suppose muni's. borrows, repays over 25 yrs. Here it is lender whose return of funds is slowed. But avoid the complication of a lender. Lump those w. assets as "asset-holders."

[Positively charged. Endowed. Surplused. Loaded. "Asseted." provisioned, funded, stocked, warehoulders, storeholders, owners, laden, monied, financed, solvent, investor, holder, store-carrier, capitalist]

27 (cont.)

"Asset holders" is the best word. Objection, even tho polysyllabic. Abbr. a-h

A-h plan in advance to replace assets as liquidate. (assets too broad.

"Warehholders" better -- wares excludes money & land) Abbr. w.h.

w.h. plan in advance to ~~liquidate~~ replace what they liquidate. Come into pd. when will liquidate little, bec isn't ready, so they invest little. Initiative is w. them, consumers are passive, $C = F(Y)$. Thus they adjust inc. payments to what they have to liquidate, & so proceeds smoothly.

Thus storekeeper has pipes & tobacco. Pipes turn over once a yr, tobacco once a month. Tires of fooling w. tobacco, puts all cap. into pipes. Cuts volume to 1/12. Knows this ahead, cuts buying to 1/12. Not at first. Liqs tobacco, & puts all in pipes. Now he knows sales will be 1/12, so orders 1/12 as much as before.

So simple.

Now, inc-erectg spending is detd by amt of real cap. ready to liquidate – plus some adjustment for direct services

28. Regional flows, help clarify aspects of (27). If warehholders liq. in one region, invest in another, cap. flows out, & leaves depressed area behind. Full liqn. difficult? One aid is l.v. fall, so less amtn is inc.

29. Hi l.v. destroy old cap., & Δ demand for new, thus doubly aggravate cap. shortage.

They might seem to speed replacement, but demolition isn't liquidation Creates new invmt. opp., but not any funds to exploit it.

~~30~~ 28 (resumed) "~~Structural~~" could mean shift'g betw. regions, thus come at my aggreg. thy. this way.

30. Tendency of wareholders to create invs = lig.g fringe of capl. is ec's way of prevent'g infl. Is no way to Δ real payments. If try by spend'g more M raise P, but coax out no more real wares, or little more! but you do get inputs produc'g, perhaps creat'g their own cap. Does have benefit of ΔP_o re P_{ro} ..., i.e. raising current prices vs. future, thus discourag'g durable invs, encourag'g disentangling. Unless, ΔM used to support durables prices, worsens.

Thus there's something to underconsumption. But not to be i. And it's only a long run aid.

31. How do we get into the trap so deep? Many ways.

a. Majors escape w. their assets into future

b. Concen. of assets, mgrs push into future to min. burdens.

c. Tend start more than com finish, many reasons.

Scattered settlement,

Logrolling

d. Land

32. Say's Law probly sounded like Panglossi' Law. It might also show, tho, something else at fault besides inadequate aggr. demand.

Keynes etc. say trouble is prop. save.

Replacement bottleneck thy. says trouble is inadeq. real liq. cap. (both to force output, & to liquidate other fixed cap. Takes cap. to liq. cap.!) Takes real liq. or melting fringe of cap. to employ current inputs, & in money means spending to replace liqg cap. Supply, here, creates own demand in sense of replacement spending in antic -- supply, here, is from a cap.

Problems are a, supply too small; b, Wareholders outright reduce wares, liq. w/o replaig, then supply comes, absorbs demand, ends cycle.

Replacement thesis is just Keynes rewritten on ass. initiative is w. assetholders not consumers, bec former hold most money.

33. You can liq. stage n capl. by sale to cons., requires no liq. cap. to liq. But stage 1 cap. needs conversion to intermed. stages. Shortage of liq. cap. will encourage vanishing interm. stages, thus hurt st. 1 harder than st. n.

34. (next)

34. As cap. circulates faster, we ↓ y up to some point where more man-hours, thus more acre-hours, are offset by lower output per man & per acre.

There is chronically such a surplus of underemployed labor that we rarely reach that state. It must be made part of the model, tho, as a limit on the engine.

---

35. Water makes better analogy than electricity, bec. water flow ∝ A, λ while amps ∝ A alone. (so? How about ℰ?) $I = \frac{\mathcal{E}}{R}$, so elect. analogy ok. Still, wtr. easier understood.

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36. Taxes may reduce pvt. cons., create social cap., thus not nec'ly rep. drain of cap. from pvt. sector.

37. Public drain on pvt. capl., raises pvt. $\dot{i}$, but that not reflected in plans for public projects, so cap. keeps draining into pyramids etc. while in pvt. sector $\dot{i}$ rises. So a little pvt. cap. employs many, but at low ave. prody. [Low empl. from public project shd. include l.v. as reflecting cap. value, so hi $\frac{\text{l.v.}}{\text{empl.}}$ on underused lands reps sterility of public capl.]

Why can't residual pvt. cap. maintain empl. by very fast circn? What is limit?

38

Liquidation is healthy, like a good purgative. Hence stimulating after-effects of war. In war, emphasis on liquidating what we have, converting to what we need, fast. Shown by use of GNP, ignore depreciation.

In stuffier times, emphasis is all on diverting ligin. to remote future to minimize comptn. War, build for rapid impact, short life. Break mnpies, & necessitate postwar replacement.

If can do it in war, is overlong structure really irreversible?

39. As lever, use stability & sustention of growth. Requires hi turnover, replacement begins as 1st placement ends.

40. New orthodoxy views idle capacity, concludes need more demand. What is answer?

41. As much cap. drained off into long term, i rises, so remainder turns over faster. What keeps it from employing all labor? And other inputs? Low productivity – but they cd. lower wps.

42. Surplus of idle factors that cd. create cap. is not same as surplus of cap.

Modern 'cash-flow' dispute coming up. Cash flow is before deprecn, and it 'is a rough measure of indy's ability to invest.' –

Donald C. McGraw, Pres. M-H P.C., BW, 3-2-63, p. ~~77~~ 96

By Misunderstanding and Mishandling the "Cash-Flow" . . .

Let's Not Eat The Goose That Lays The Golden Eggs

Because of a basic misunderstanding, labor and management may be heading toward a battle that need not be fought. The issue is whether cash-flow or profit is the best measure of business earnings, and therefore the best measure of business' ability to raise wages, improve fringe benefits and shorten hours of work.

When business and union negotiators sit down around the bargaining table they frequently clash. This is probably inevitable. But it is pure waste — for both sides and for the public as well — when the clashes are caused by a misunderstanding rather than by realities.

The "cash-flow vs. profits" issue, should it develop as suggested by reports from Washington and the public pronouncements of labor leaders, will be a prime example of such waste.

This editorial, one of a series on business profits, is designed to point this up. It discusses the difference between cash-flow and profits. And it shows how confusion between the two might have disastrous results.

The Meaning Of Cash-Flow

Cash-flow can be calculated in various ways. One way — and the most common one among businessmen — is to add (1) after-tax profits minus dividend payments to stockholders, and (2) depreciation allowances. Another way — the one used by the AFL-CIO — is to add (1) total after-tax profits, and (2) depreciation allowances.

This adding of depreciation allowances (roughly the cost of buildings and machines either worn out in production or rendered obsolete by time) to profits (what is left over after all costs and taxes are met) may seem a clear case of adding apples and pears and coming up with a mixed fruit compote. But the practice does have its uses — as, for instance, in predicting business outlays on plant and equipment. Since cash-flow represents the total funds corporations generate internally for replacing used-up facilities and acquiring new ones, it is a rough measure of industry's ability to invest.

But organized labor apparently sees cash-flow in an entirely different light, as being virtually the same as corporate earnings.

Here, from the June 1962 issue of **The American Federationist,** the official monthly magazine of the AFL-CIO, is an example: "The cash-flow, which is reported profits plus depreciation allowances, is the accurate measure of a company's returns since it is the amount of money left over after payment of all costs and taxes."

The key phrases in the above are (1) "profits plus depreciation" and (2) "after payment of all costs," which are linked in a way that makes the statement an out-and-out denial that depreciation is a cost. (Nor is this a mere slip of the pen. Virtually the same thing is said, in only slightly different words, four times in the same article.)

Quite clearly, however, depreciation allowances are designed to cover costs, which now and forevermore are the opposite of profits. There are no real profits or net returns to a business enterprise until all costs are recovered, including the cost of buildings and machines either used up in production or made obsolete by time. To argue otherwise is to strip logic from the language of economics, to quash intelligible conversation on the subject of profits. If business spends its depreciation allowances on higher wages or dividends, it is failing to replace its worn out and antiquated productive facilities.

The Measurement Of Profit

Aside from the dispute over the meanin "cash-flow," "depreciation," and "profit," is also the question of profit measure

many bought over 80,000 bbl. a day from the Soviet bloc at a delivered price of about $1.70 per bbl. This contrasts with the $2.50 per bbl. that West Germany paid for its oil from free world sources, such as the Persian Gulf.

When the Comecon pipeline—including its network of spurlines—is completed, the Russians should be able to step up their worldwide exports to over 1-million bbl. a day by 1965.

Price havoc. Testifying before a Congressional committee, George T. Piercy, executive assistant to the president of Jersey Standard, recently estimated that completion of the pipeline will cut present Soviet oil transportation costs by one-third. Last year, it cost the Russians about $1.05 to move a barrel of crude oil from the Ufa oilfields to Klaipeda on the Baltic. "When this line is installed, it will reduce their cost to about 29¢ a barrel," said Piercy.

Since Persian Gulf delivered oil prices are about $2.20 a barrel for Southern Europe and $2.50 a barrel for Northern Europe, this marked reduction in Soviet transportation costs could enable the U. S. S. R. to put even more pressure on free world oil prices.

Strategic importance. Although technically the Comecon pipeline system involves only the "mainline" mileage between Kuybyshev and the East European satellites, it nonetheless has many strategically important spurlines that are within Russia itself.

One of these, tying into the Comecon line at Unecha, will run north to the two seagoing-tanker terminals of Ventspils and Klaipeda on the Baltic. This spur has an export capacity of some 340,000 bbl. a day. Still farther north, an almost-completed pipeline runs direct from the Ufa oilfields to Leningrad. And to the south (but too far east to register on the map) the Soviets are building a pipeline from Stalingrad to two ports on the Black Sea, each capable of exporting as much as 200,000 bbl. a day.

In its efforts to step up its oil exports, Russia is also contracting for large tonnage of seagoing tankers. Recently it placed an order for a ...en 35,000-ton tankers with Japan, ... an order for another 15 tankers ...aling 320,000 deadweight tons ...h Yugoslavia. Russia is also try... interest Britain in an agree... to build at least $50-million ... ships in return for cheap ...il.

... angle. The rationale be... export drive is complex. ...al to Western Europe,



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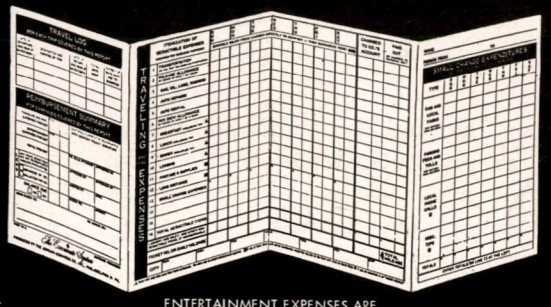
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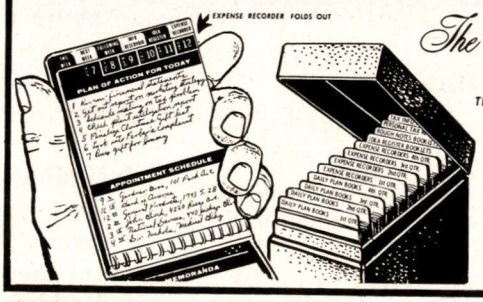
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Labor points out, and correctly so, that profits as reported by the U.S. Commerce Department's Office of Business Economics have been distorted over the years by revisions in the federal tax laws. Among these are several new ways of calculating depreciation allowances inaugurated in 1954, and the new Internal Revenue Procedure 62-21 introduced in mid-1962. (A recent Department of Commerce study attempts to measure the effect of some of these revisions.)

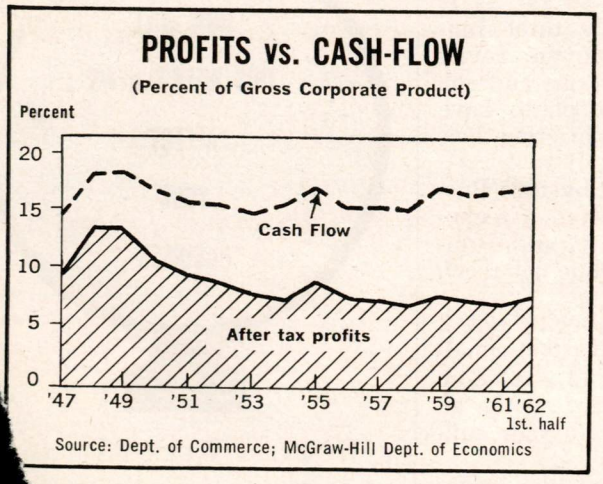
These changes were designed to enable businesses to charge off their depreciation costs at a rate more closely in line with the rate at which their facilities actually wear out and become out of date. But these more realistic techniques of figuring depreciation allowances in no way disturb this basic fact: depreciation is a cost and not a profit.

Moreover, tax changes have not permitted firms to charge off more than the original cost of their facilities, but only to speed the timing of the charges. As a result, any profit understatement owing to stepped-up depreciation during the years immediately following tax changes is necessarily followed by a profit overstatement in subsequent years.

So it is important to remember that changes in the timing of depreciation allowances work both ways. Some tend to understate current profits relative to those of earlier years. Others do the reverse.

The Correct Measure

As the chart in the box below shows, the corporate cash-flow has not been squeezed during the past several years nearly so much as profits. This alone offers a temptation to suggest that cash-flow — rather than profit — is the best measure of corporate returns or earnings.



But the temptation must be sternly resisted, profit—not profit plus depreciation—is the correct measure of a firm's returns. Those who argue otherwise are treating the language of economics in a cruel and unusual way. They should cease and desist before killing effective conversation altogether.

Eating The Goose

There is not the slightest inclination here to suggest that the profit figures released by the U.S. Office of Business Economics are perfect. Like many statistics, they may not always reveal everything they seem to. But we should remember that they are the most comprehensive and useful measure of over-all corporate profitability we have.

It is even more important for us to remember that depreciation is a cost and not a profit. The funds attributed to depreciation allowances, like any other funds business has, can be paid out in dividends to stockholders or in higher wages to workers — but only if the economy is liquidating; only if it is failing to replace its antiquated and worn out facilities.

The depreciation reform, announced in July by the Treasury, was designed to make depreciation allowances for tax purposes more truly representative of the rate at which machinery actually wears out and becomes obsolete. This, in turn, was intended to speed up machinery and equipment replacement, which will increase productivity, cut costs and give U.S. business a better crack at world markets. It would be ironical, indeed, if this long-needed reform were used to justify wage increases so large that they would actually cut into the funds needed for our program of modernization.

This would be a pure and simple case of eating the goose that lays the golden eggs — a point both labor and management should certainly keep firmly in mind.

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Donald C. McGraw

PRESIDENT

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with its highly developed industry and lack of domestic crude sources. By fulfilling this need, the Soviets can obtain much-needed free world currency. "In 1961, Soviet bloc oil exports to the free world totaled some $509-million," says Piercy.

Ramifications. But currency exchange is the least of the worries connected with Soviet oil export. "Khrushchev has threatened to bury us on more than one occasion," Sen. Kenneth B. Keating (R-N. Y.) said not long ago at a Senate hearing. "It is now becoming increasingly evident that he would also like to drown us in a sea of oil. The Soviets are dumping oil at bargain prices throughout the world . . . for political and military reasons."

It is this same fear that prompted NATO nations last November to embargo the export to Russia of large-bore line pipe. The Soviet Union's purchases had been heavy in the preceding three years.

From 1959 to 1962, Russia purchased or arranged to purchase 680,000 metric tons of 40-in. pipe from West Germany, 240,000 metric tons from Italy, and 135,000 metric tons from Sweden.

Large-bore problems. The NATO embargo has slowed construction, so that completion has been postponed from the end of 1963 to at least mid-1964. The key to the completion date is the priority that Soviet economic planners decide to give the Comecon crude pipeline system over several large natural gas pipeline projects that are also under way. And on a longer-term basis, it depends upon their ability to get their own large-bore pipe plants into efficient production.

The Russians themselves have long had trouble manufacturing large-bore line pipe. So far as is known, there are only three big-diameter pipe plants in the Soviet Union—two in the Ukraine and one in the Urals. All three plants have been having difficulties meeting their production quotas.

The Soviets say that by 1965 Russian oil exports to Poland, Czechoslovakia, East Germany, and Hungary by use of the pipeline will reach 300,000 bbl. a day.

If such a quantity went by rail, it would require about 600,000 standard tank cars a year, and impose an almost unbearable strain on the already overburdened Russian railroads.

The Comecon pipeline also makes economic sense from the viewpoint of the four satellites; it is unlikely their planned petrochemical complexes could be put into operation without it. **End**

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BACKSTAGE AT BUSINESS WEEK



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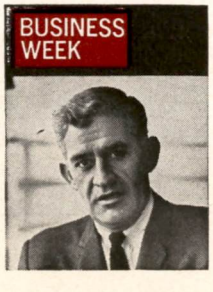
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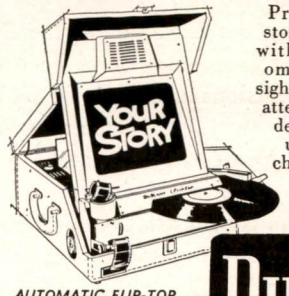
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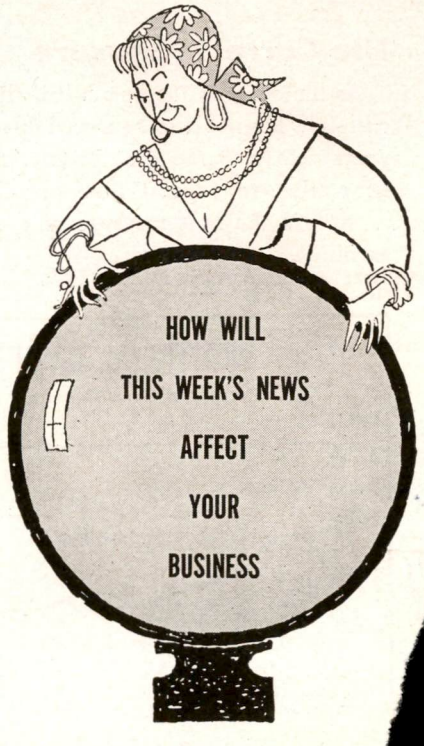
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