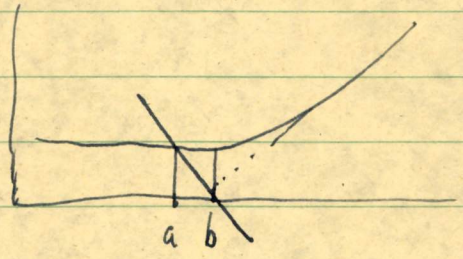
Ec. 100 B, Med Notes

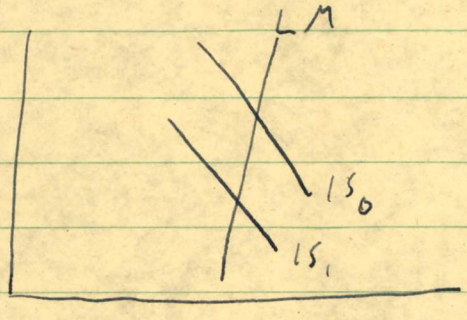
Lucido says Gordon comes around later to saying
AM also shifts IS curve to it. Check that.
Drexler thought he should

Ideas that I ~~MM~~ is indep. of S or Q, and that G indep. of T, are contrary to normal perceptions.

LM curve helps respond to this concern. It says, --- ΔM shifts curve to rt..

as to S, high s will lower i. Also, the lower Q caused by S > I reduces $ctus$ demand, moving down LM to left, (s.w.). As Q falls, investors accept lower i, thus meeting IS at higher Q than if LM were flat. (b instead of a)





Here, a drop of IS due to more saving just lowers i, not the NI (Q)

Ec. 100B 9/27/79

Gordon Ch. 1

G-1 What is Macro

1. Puzzles to explain.
   1. Why inflm.
   2. " unempl.
   3. " govt. activism (demand mgmt.)
   4. Inflm w. unempl.

~~Here, the big list~~

2. Converting ~~real~~ nominal to real values.
   Deflator (CPI) ("Implicit" deflator used, not explained.)
   Base yr. (1972 used)
   Const. $
   Current $
   Log. scale

3. Hist. of Inflm + Unempl.

1900-78, GNP deflator has ↑ 8½ times!

From:		
	1900	.158
	72	1.00
	78	1.34

(But 19th cent. more stable. 20th is cent. of inflm.)

Q: Reconcile infln. rate, p. 8, w. Δ of 8½ times.

"Natural rate of unempl." ≡ min. attainable level, compatible w. not accelerating infln. p. 9.

Think of this as a modeling concept, calc. to convey idea the writer considers central to his analysis: a way of perceiving. Beware of how it may mold & confine yr. thought. This one is narrowing, ~~reveals limits of tools~~.

"Natural" is a very strong word; applied to artificial world. p. 12, backs away already 'natural' "is neither optimal nor immutable."

Natural real output, is output at natural rate of unempl.

Is an overclaim to give nos., bcs. by def. natural rate is a judgement call.

4. What is macro?

No formal defn., but clears w. aggregs.: infln., unempl, growth, as target vbles. or goals.

Instr. vbles.: mon. pol., fiscal, + misc: (price controls; "manpower pol." (undefined.))

5. Demand mgmt. is key. or paradigm. a model of the world.
This is Gordon's mindset, He can't change.
& he is young & strong. Even those of
elders like W. Heller, J. K. Galbraith, Chas.
Schultz, Alice Rivlin, Gardner Ackley, Art Okun,
Otto Eckstein

They are in the saddle, they will be
talking this language, regardless of how facts
change; & of how their message itself changes.
Even tho it sprang from other conditions
than today, is not the best model,
becomes increasingly clumsy, & will
one day be replaced.

~~6~~ – Closed & open ecs.
Deals w. U.S. as closed, bcs. for. trade small.
A weakness. – so I will lean hard on last
chap.
Why a weakness?
– Overstates power of our demand mgrs.
a. Floor under i.r. Cap. flight.
b. Gold. Visible barometer of loss of faith. They
Keynes on obsolescence of gold
Irate that!

6. Uses of macro theory

Why thy? Gives good reasons. But omits dangers & pitfalls, being wedded to narrow paradigm; closing the circle of MCMPP: isolating wrong vbles.

Positive & Normative ecs. "Ecsts" differ on policy, not on positive ecs. True mainly of Marxpps, Gordon's minimise of establishment ecsts.

7. Modern Macro

Keynes & activism or interventionism.

Problems not due to lack of understanding, but 3 "other factors":

p. 16 ~~Overlap~~ 1. Didn't see inflm. coming. (Eg., don't buy gold.) Before ecsts. saw it, "was solidly built into expectations of firms & workers." I.e., everyone else saw it first.

Neg. cash flow
Indexed contracts
Overseas invts.

Let genie out of bottle when they became wedded to demand mgmt. Riding tiger. How get off?

2. Supply shocks – a "new" phenomenon.

I.e., prodn. responds to other forces than demand.

Not new, or special. Old as history.

What is new is overload on FMP + struggle of Mainopps to shift field w/o abandoning paradigm, in which have heavy vested interest.

1. Policy mistakes (against "our" advice)

a) Deficits re Vietnam, '65-66, cause of inflm. then + for 10 yrs after. Too strong

b) Controls, '71, lifted in '74. Suppressed inflm.

c) "restrictive" policies, response to '73-'74. Overreacted, caused '74-'75 recession. (On top of everyone's consciousness right now.)

8. Convergence w/o agreement.

Mon. v. non-monetarists. Agree positively not normatively.

There are the 2 positions to discuss in book. Mainopps. In the club.

Key words - good way to study.

Ec. 100 B, Tu., Oct. 2, '79

Chap. 2, Gordon. "Measurement of Inc. & Prices."

Why we care about real inc.

1. (a) The key to Δ unempl. is Δ real product, = real inc.

He's excluded several instruments, all changes of input mix, subst labor for land, res. + K.

Okun went even further, modestly called his "law", to keep const. empl., Δ GNP by 5% yrly.

This is why conservationists cannot swallow macro establishment. Heller v. Commoner.
Macro estabt. has made token concessions, but no real change. Must adapt or perish.
Now, instead of adapting & curing infln., are blaming it on OPEC, + "supply shocks" — transit. phenom. that don't fit our model are shocking! (hands in air)

Jealousy (+ color blind); bragging?

(b.) To G. U.S. v. others. Why? Vain comps? No one thinks there are normative measures. Many rules are arbitrary. Real purpose is as a tool, to do the best we can; to get in control of things, avoid collapses. (~~towards~~ thumbs in belt) To account for what happens — understand cause + effect.

To make a science. Science is instrmt. Micro e.g. L.L. exch; $ as numeraire; (i) Macro. harder.

Note: you are now studying Acctg.

2. Circ. flow — or "Circulation"

Households + firms.

Flows — as vs. stocks, (or funds)

Flows are per yr., etc.

Flows	Stocks - at a time.
Income	Wealth
Output	Resources
Work	assets
Service	Capital
Depreciation.	Debts.
Volume	Money

What links stocks + flows is: TURNOVER

Stock × Turnover = flow

$M \times V$ = spending

$K \times T$ = Volume

Circ. has 2 parts. Money flows; goods flows.

Flow of spending = MV

Flow of goods = $K \cdot T$ Think of e.c. as a Great Grocery Store; flow of goods ~~corresponding~~ corresponding to flow of ~~sales~~ spending. (Inner loop, Fig. 2-1, disappears from

Rule on defining final products

Part I. Currently produced, goods + services.

Main ideas.

a. Rule out capl. xfrs. Land, stocks, used housing.

b. Rule out pmts. for doing nothing currently: Welfare, pensions, gifts, bequests

c. Arbitrary exclusions. Govt. interest; cap. gains.

Interpns

a. Does not rule out current service flow of land, or old K. E.g. yr. rent. But depreen. is deducted, ~~from~~ from GNP to NNP.

b. Does not rule out consuming goods produced last yr. Rather, assumes they are currently replaced. I.e., ~~Consist~~ stock kept const.

If stock falls, ec. draws down assets. ~~Reduc~~ Disinvmt. Reduces net invt. for the pd. this cancels out the contribn. to final product.

later figures, watch the Magician!] "Remember the Vanished Income Loop." p. 23. It's the ~~supply~~ loop - the one demand mgmt. ecsts. forgot about.

3. What xactions compose inc. + spending ~~&~~ + final product?

~~Rather~~ Many arbitrary items.

~~+ Currently produced~~

The idea is to isolate spending on final products.

Three Part Rule of what ~~spending~~ is counted as final product.

① Currently produced
② Sold for money
③ Not resold in current pd.

(1.) Currently produced.

No used items. (Unless rebuilt.) (or replaced)

Many gray areas here, e.g.

- build up orchard + sell, is it 'used'? Loophole: when currently produced, not counted. When sold, not counted. Not resold this yr.
- Hides from old cows?
- Salvage values?
- Remodeled bldgs?

Emphasize rule first; then the gray areas.

No land purchase or sale

No gifts

No Govt. xfrs

No Govt. interest.

No cap. gains (except those included in inventory profits.)

Here, NIPA inc. falls below inc. as defined by most ecsts, which includes Δ wealth as inc., currently.

(Some object, this is double counting. But not so. Yr. wealth rises this yr. Then if you save + invest the Δ, it also yields inc. in future yrs. like any

other saving from inc.

But is real wealth created? Sometimes:

Δ ability of land to grow food

extend pow.

Δ security of ownership, less need for police + mil. spending.

Δ urban synergism.

Sometimes not, is redistrib. ~~Lower wages~~

If the loser is another landowner acctg. is OK, loser suffers decline of wealth. If loser is labor force, wages fall, then loss is not measured lack of symmetry.

Why shd. we include cap. gains?

- They are often consumed. Living hi on the old homestead.

- They are invested. Borrow on Δ to invest.

- They are base for Δ M. Maybe more important than govt. debt.

- They are taxable, (in part)

So, omission of gains is major shortcoming.

Discovery of new oil also excluded.
(Depletion, too.)

Invt., plowback, approp. + apprec. —
4 ways to build up assets. Last 2 never
counted. Plowback not counted if overseas.

Begin here

There defects have been noticed — but never
corrected. Closest ~~[illegible]~~ we ever came was
when environment movement was at peak ...
hate to tell you, ~~peak has passed~~, that was Nixon's anti
Quality of life index
Reduct prodn. of garbage + crud -- "residuals".

No large or lasting impact on MACROPS.
Closed system, closed society of soothsayers, riding toward
a cliff.

(2.) Sold on mkt.; valued at current mkt. price.

Exception: Imputed inc. o-occ. houses.

Qu. House value when new was counted: is this double counting?

Barter etc. excluded. H.wives. Do it yourself.

Pollu. not deducted directly. But indirectly, bec. lowers imputed values + directly lowers rents.

Other cons. durables not treated as such. Autos; Persian rugs. (even tho he soon has $C = f(i)$!)

(3.) Must not be resold currently

This excludes intermed. goods — except for net increases in inventories, &c. Capl.

This is the bulk of ~~transactions~~ investment. They are netted out, treated as Consumption.

Remember this when defining Investment. It is net, not gross.

There is an enormous gross turnover that occurs behind the scenes of macro models. Model says $C \to Y$, but not so. Gross inv. $\to Y$, and is offset by disinv. ~~of~~ as Great Grocery Store (GGS) sells final (or ripe) goods. Thus, the model

overstates the importance of C as an autonomous force; understates I.

This is another case where arbitrary defns. were chosen. "Gross invt.", as used by Mamoppa, does not include inventory turnover; but invt. in bldgs, machinery & equipt. gross of depreciation.

Thus, T. 2-1, p. 31, cannot tell us much. may be way off.

Summarize Rule for Nat Product:

(1) Currently produced
(2) Sold on mkt
(3) Not resold currently.

---

4. Inv. & Saving

Cap. formn.

1) Δ inventories
2) "Fixed" Inv.

all final goods not intended for resale. i.e., the corpus not so intended, even tho the service flow is. "Fallacy of misplaced concretism."

Thus, a restaurant tablecloth is 'fixed inv.', altho short-lived; while planting a timber tree is Δ inventory, altho 100 yr. life. (Bc. the corpus of tree will become part of the product.)

$$C + S = Q = E = C + I$$

$$C + S = C + I$$

$$S = I$$

a model.

"The hot pto. model."

It's major purpose is to express ~~what~~ forces that affect spending, or turnover of M. A framework, into which you can plug hundreds of ancillary forces, build elaborate models. Will use as basis of Chap. 3

5. Net exports + fin. invt.

Open ec. is considered.

Lending cap. offshore is part of our product, net fin. invt.

Again, the most plausible approps. + apprens. are not counted. Uncharted territory.

In many ways, different from domestic invt. When the o'seas K is replaced, hire fin. workers. Fin. workers man the plants.

6. Govt.

Add to both sides of basic eqn

$$E \overset{\leftarrow}{\equiv} C + I + G$$

$R \equiv$ Revs. (taxes)
$F \equiv$ Transfers
$T \equiv$ net tax rev. $= R - F$

Then

$$Q \overset{\rightarrow}{\equiv} C + S + T$$

$$S + T = I + G$$

p. 26 Beware, another input. matter being glossed over, folded into the system so it disappears.

Gordon says: "There is no reason to distinguish tax revs (R) from Transfers (F)". No reason!

Effect on incentives, a big reason. All macro however, based on ass. of no effect. Watch Laffer, setting about to correct this.

Transfers not included in GNP

7. S, I, + Govt. deficits.

p. 36, cute fig.
Shows how govt. deficit, esp. 1974— date, implies S > I. ~~to it~~

Altho definitional, this suggests displacement or "Crowding Out".

"The" govt. here means Fed. Local + state borrowing overlooked.

8. Data on kinds of spending, '76 p. 38

C = 1079.
I = 248 But after deprecn. = 180. net inv. = 68 ≠
G = 366. Product is assumed to be worth what you pay for it.

F Note how much of gross I is just replacement.

9. Circ. flow, '76

Good plumbing diagram, p. 40. Memorize - (Mock!)

Lots of detail there. Some is arbitrary. But these are the defs. used. This is the way info. is orgd, collected & published.

To understand diagram, begin w. GNP, subtract leakages ~~the~~ until get to PDI; then add injections back to GNP.

Focus on 2 inner nodes: Cap. Mkt., & Govt., know what comes in & goes out.

Wartime origin true.

To understand the world better, discard GNP. It is a bastard concept. Violates the rule against counting intermediate products. But if we violate it here, shd. do so thoroughly & count all intermed. products.

Note how much of I is replmt: $\frac{180}{248} \doteq$ ~~70%~~ 73%

Summary: Could nitpick forever, but beware these folded-in assms.

1. Delivery of goods responds to spending. Is largely the other way. Remember the Mystery of the Vanished Inner Loop. Supply Loop, clockwise, p. 23.

2. Taxes do not affect incentives

3. No crowding-out.

4. Fixed factor or input mix.

5. Many loopholes in counting final product, leave out barter, home work, appreciation, internal growth of assets like trees, appropn., discovery, salvage, remodeling, imputed inc. cons. durables

also omit many deductions: depletion, pollution, wasteful govt. spending.

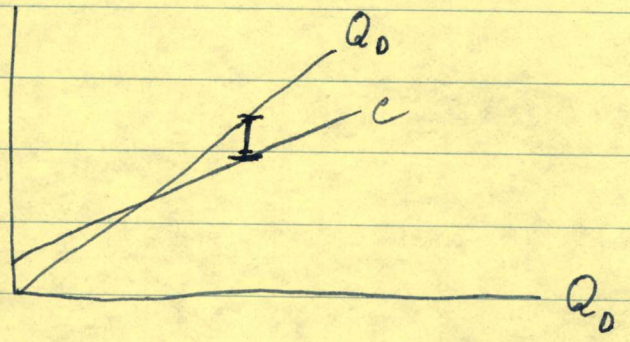
6. Automatic replmt. of consumed goods

7. Cap. export is good for us, Δ N.I.

Ec. 100 B, Thurs., Oct. 4 (10/4. Good Buddy)

Chap. 3, Gordon. Commod. Mkt Eq., & Mult.

Commod. mkt. means Goods & Services - final goods.
No cap. mkts. Thus. i.r. not a factor.



$$C = a + c\,Q_D$$

$$Q = C + I = a + c\,Q + I$$

$$Q(1-c) = a + I$$

$$Q = \frac{a + I}{1-c}$$

Mult.

$$\frac{\Delta Q}{\Delta I} = \frac{\Delta I}{1-c}$$

But anything Autonomous (A) has same mult. as ΔI, viz. $\frac{1}{1-c}$ or $\frac{1}{s}$

Leakage, if autonomous & fixed, have same neg. mult.
(This is why G. dislikes prop. taxes)

p. 75 Balanced Budget Mult.

If Δ taxes, get a net Δ spending by reducing S.

$\Delta G = 100\%$

$-\Delta C = s \times 100\%$

Fructify the misc's board.

Wd. make a good algebraic study.

Once you set up the basic eqns. can add all kinds of ancillary fns.

Ec. 105B, Tues., Oct. 9, '79
Gordon, Ch. 4, "Spending, the i.r., + money."

1. What was Autonomous ~~in~~ spending in Ch. 3 ~~became~~ (Inv. + a) ~~are~~, and which had so much leverage, are here treated as fns. of i.

Double leverage. This is what has beguiled policy makers, the idea that there is a cockpit, a center of control, where you can turn a few screws + have multiple influence over the whole machine. Like Tolstoy on Generals + wars, is easy to get carried away.

Note, Gordon has plunged right into govt. controls over spending. Bypassed, for now, important early issues: - supply side, the clockwise circ.
- is the circ. self-regulating?

i here is det. by M which "the govt. provides".

Forces key gns — but as titans, for this chap. doesn't deal w. them, just lays groundwork.

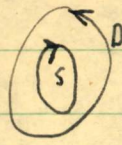
a) what dets. i, + why does short rate jump around so?

- early '58, .5%
July '74, 12.9%
Feb. '76, 4.8%

b) crowding out?
c) ΔG or $-\Delta T$ better to stimulate?
or ΔM?

(We may have further qns: How dismount tiger? How

Δ empl. w/o Δ spending, + w/o overdrafts on ness, + inv.
Where is the Heart in this Circulation?)



which also self-regulates

Here, assumes away one big limit on cockpit control: Δ P. (Doesn't even mention slower cap. turnover, supply side, caused by lower i.)

But does focus on another one i.e. the LM curve, which says at lower i, +N +higher Q people board, V is bottleneck. (Thus leading to desired conclusion, need more Δ G)

Where is the Δ flow of lent capl. going to come from for desired Δ inv?

2. Dim. rets. to inv., so $I_p \propto \frac{1}{i}$

E.g. of planes, using leaner routes.

Note echo of Malthus here. Running out of land. But where Malthus had this reduce wages directly, now we have it happening indirectly by choking off I_p.

Marx began this – dim. ~~rate~~ rate of profit. Only he linked it to underconsn. imperialism.

Keynes. MEC. Euthanasia; socialize inv.

Fallacy is one of composition — overlooks social synergy. So we needn't be gloomy, + can still believe that lower i → higher I_p.

Actually, dvlg. world. land affords stupendous outlets for inv. Overpowering K needs — in fact, too many.

So we see a ~~subtle~~ shift of emphasis to "bus. optimism" as what determines I_p. a potential fudge factor. aka "confidence"; (more recently, flight from the $.)

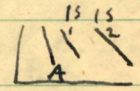
Note elements of trickle-down theory evolving. Began w. concern for empl., but the route lies thru Δ inv. opps. "The machine that takes up. jobs is good for you." We'll return to this qu.

The IS curve is more complex than showing I_p as $F(i)$. It shows Q as $F(i)$, assuming $Q = 4A_p$, where A_p is Aut. spending. $= I_p + a$.

3, IS curve, rpt.

4. Shifting & tilting IS curve.

Shifting

- change mult. (also tilts: 

- Δ optimism

Tilting

- ~~depen~~ slope depends on how fast we get dim. rets. to K. If curve is steep, it means pvt. sector is choked off, calls for Govt. E.g.: if zoning closed down all bldg.

Plug for use of G. (It is to offset waves of pessimism, by investors. They are seen as responding more to mass psychology than to objective facts.

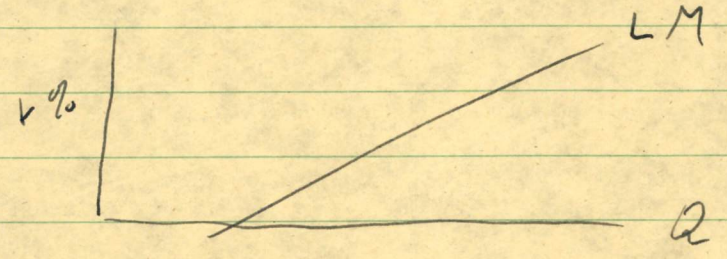
Actually, cap.-int. sectors bear brunt of instability when $\pm \Delta i$ are great.

5. LM curve.

What chokes off boom? Sticky fringes, slow $\underline{V}$.

Low i also a problem. It encourages borrowing, but stifles lending.

LM curve puts this all together



As Q rises, people need to hold more M. This wd. stop ΔQ. Higher r, on other hand, causes them to hold less, i.e. to ΔV.
Curve shows what r is required to offset hoarding + let Q rise.

Has to more than offset hoarding — has to cause ΔV.

Other factors affect desired balances, besides i.

1. Elastic Δi.
   Opposite effect from actual higher i.
   But instead of holding cash, you go into short term loans, damping the effect.

2. More $M_1 \rightarrow \Delta V$

3. a. Low $P \rightarrow \Delta V$
   b. Elastic $-\Delta P \rightarrow -\Delta V$

4. Better timing — bills come right after paycheck. Credit cards help w. this.

5. Regularity + predictability of pmts.

6. No. of transactions. Q_1 on LM curve.
$MV = PQ$
   But cf. 8.

7. Vertical integ. of firms.

8. Intermediate xactions. Can suck MV from final goods xctns — + be quite ± unstable.

9. Liquidity of assets as M substitutes.

Many factors. Hard to model. Call for combo. of modeling ability plus Judgment. These seldom go together.

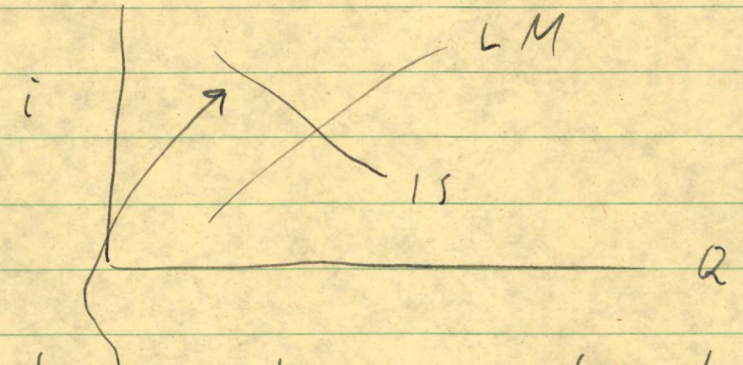
6. a) Why LM curve shifts?

ΔM shifts to rt.
(−ΔP, same effect)

b) Why tilt?

Responsiveness of demand for M to i, can change.

7. Eqm. when curves cross



Start here. Lower r, but boosting, then rises to choke off ΔQ, put cap on Q.

Key words, concepts

Autonomous
Leverage
Multiplier
Double leverage
Equilibrium
~~Eq~~ Determination of NI
Velocity
~~Ave~~ Rim returns
Synergy
Hot pts effect
How demand for a stock accumulates to a ~~change~~ flow

Ec. 100 B, Thurs., Oct. 11, '79

Gordon. Ch. 5: Effects of Monetary + Fiscal Policy.

Excellent Chap. study hard. Wish I had had this 30 yrs. ago. I was constantly irritated by the glib, didactic, sententious, tendentious pontificating way — dogmatic, too — ecsts. wrote. Leaping to extreme + forgone conclusions by looking at oversimplified ideas (like the Mkt.) w/o considering other factors — like Tolstoy's Generals.

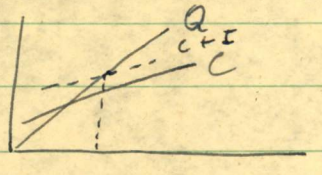
But Gordon reps. a mellowing + maturing. Model which is simple enough to understand, yet accommodating enough to can show + absorb counter arguments.

There already was such a model ~~the~~ before — $MV = PQ$. Another paradigm, ~~Was discarded~~
Still used by many. Fiscalists wanted new paradigm that was more tendentious, to express their preferred policy choices. But $MV = PQ$ still useful.

Reform needed. Dismal quotes.
What the mellowing has accomplished is, the ~~Keynesians~~ Keynesians have figured out for themselves what their critics tried to say from the start: they will provoke infln. + it will ruin them.

Review stages of model.

1. Vulgar, naive underconsumptionism.
   Oversavg chokes off circ.
   Misers hoard up S, & size of their S hoard has no effect on inv.



   Some of this still in model, not entirely purged.
   Bus. emphasis is on Fed. control of i --- nothing on flow of pvt. funds, either from net S or from replmt.

2. Big Mult. to the rescue. (Wm. Tell Ov.)
   $\Delta(I + G + a) = \Delta A$, get multiple ΔQ.
   There are no other bottlenecks. Idle fixed cap., idle labor, stagnant or torpid stocks, thus Δ real capl. flows, real ec. responds to ~~demand~~ monetary. Supply responds to demand. No ΔP; no encouragement to cartels, no OPEC; no shortage of real cap. flows.
   Other Those weaknesses are still outstanding.

Other weaknesses have been seen & accommodated by LM curve. Crowding out. Another choke on Mult.

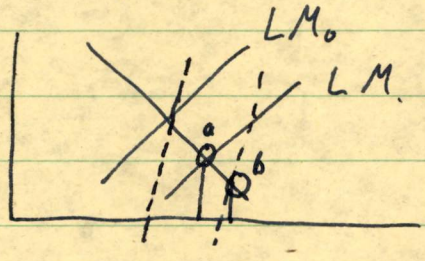
3. A new impetus for broadning: $-\Delta i$, $+\Delta Q$.
LM curve.
Limits effects of Mult.

(In $MV = PQ$, can show same effect.)

Gordon, Ch. 5

1. Reviews policy tools for IS curve
$-\Delta i$
But also can shift curve
Δ confidence
Δ mult.
Δ G

2. $\Delta \frac{M}{P}$. When are effects strong.
IS unaffected (? shd. think this wd. ΔA)
LM shifts rt. Hot pto. effect.
($\Delta M \rightarrow \Delta V$) Makes people eager to lend, not eager to borrow. So i falls.



i can drop a long way.

Dash lines show that if LM is nearer vertical, ΔM has stronger effect, a bigger ΔQ. This means that a lower i does not reduce V much. Higher M increases V, + that is the overriding effect. It takes ΔQ to increase

demand for M, soaks up the surplus; hes. - Δi is not operating.

(This kind of theorizing presumes that the $\frac{\Delta M}{\Delta P}$ can command real K flows. A point of entry for criticism. How are real flows suddenly produced?)

A vertical LM curve — shifted to r.t. — means ΔM must all be soaked up by ΔQ, none by -Δi. (Note bogey of horiz. LM curve, liq. trap.)

~~The vertical case seems fairly likely, (esply. when you add ΔP.)~~

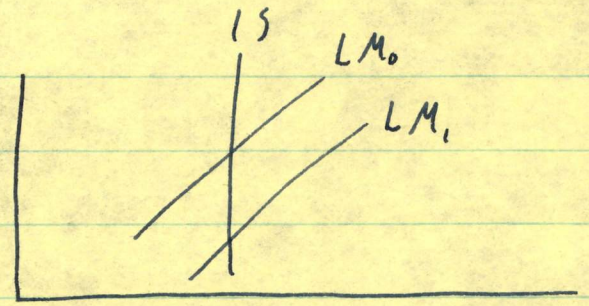
Weakness: this analysis has ΔM not affect IS curve, + A, at all.

M.

3. Weak mon. pol. Flat LM; liq. trap.

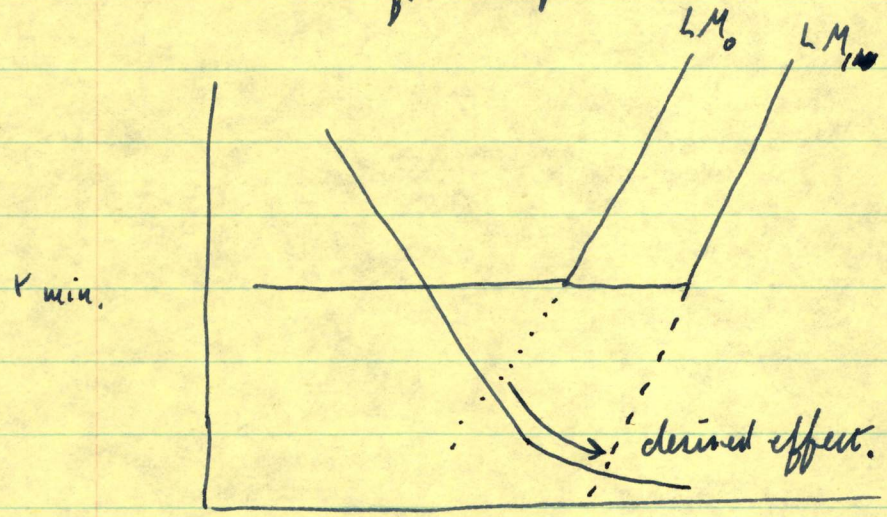
a. Vert. IS curve. ΔM has no effect.

Note, he's having C unaffected by ΔM. Too much emph. on i as the needle's eye, the center of ~~the~~ model.



l. r. drops, Q the same.
Nonesuch. Hsg. the balance wheel.

b. Liq. Trap.



But there is no actual effect.

ΔM does not lower i, bcs. no one will lend below r min.

Has no other effects either -- no Δ IS curve. They are screened out by the operating assm. here, (never made explicit) that all effects occur thru needle's eye.

Liq. trap is close to heart of Keynes.
It says $\Delta \frac{M}{P}$ cannot help.

Thus rules out all measures but ΔG. (Wm. Tell Ov.)
p. 118, "fiscal policy to the rescue." " " "

Rule for Monetary Impotence. (Dirty words!
Cf. fructify.)
pp. 117 .. Gordon backs away from liq. trap,
but then drives in again. Our ambiguous
manoeuver.

Monetary policy impotence: belief peaked in '50s; since,
comeback of mon. policy.

4. Gt. Depression.
Leads to K-u. hawk model.
One cd. also operate on IS, not LM.

5. Weak monetary effects: qualifications.
I.e., how effects can be strong

ΔM can ΔC. About time he got to this.
Elsewhere, has made custom. cons. depend on i
primarily, as tho all C were durables, based
on debt.

Real Balance Effect (Pigou)

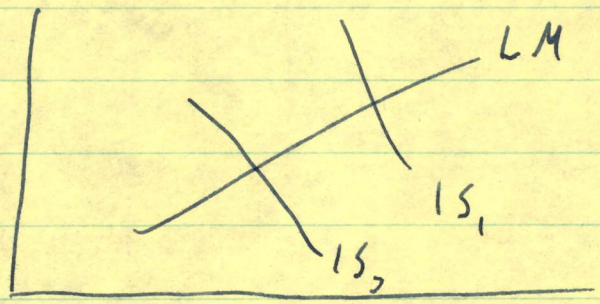
$\Delta \frac{M}{P}$ can affect IS curve.

(also shifts LM sched; Δ mult.; etc. Keynesians vastly understate this. which is pre-Keynesian.)

Gordon overstates case vs. real balance effect by choice of base year trick, p. 124 $\Delta \frac{M}{P}$ by 68%, 1933-40. But much lesser Δ, if any, from 1929 max.

6. Crowding-out effect.

This is what LM curve shows, when ~~it~~ shift IS curve to rt. by ΔG.



LM
Vert. ~~LM~~ means 100% crowding out.
Flat LM " " effectiveness of ΔG,
zero crowding out.

7. Case study, Vietnam.
'64, deficit, + ΔM, good results. ΔM offset crowding-out.
'68,

Gordon, Chap. 6

I still need to read this.

Ideas Ch. 7

1. Key instruments of demand determination
   1. Autonomous
      a. I w.
         Confidence -- demand side
      b. G
   2. M supply

2. Ch. 6 lets price change, output fixed

3. Diff. mec overlooks
   a. synergy

NB b. Basic macro idea of circular flow, w. demand as only limit on mec.
Implicitly they are slipping in res. limits here.

Summary Ch. 7, Prices + output both change
Notes #2. Use this, Oct. 25

In time, optimistic early macro, all ress. were underemployed. Problem was circ. Get that going, employ more of all, w. no cut in share of anyone.

London started out this way.

But here, suddenly, problem is implicitly redefined. Only labor is unemployed. Becomes a micro + distn. problem. Get more empl. by lower wages.

We don't need macro to tell us that. Early macro denied it, in fact — on undercons. grounds. Now we have come full circle, macro used as a club to beat down w.r.

Only now we do it by fooling people, by money illusion.

Early macro had its problems, but by cfsm. was pretty healthy. You had ΔG or ΔI causing ΔY until full empl.; no dim. rets. -- then you get inflm. ~~at end of~~ when all ress. employed. 

No cost-push inflm., only demand-pull.

Then ~~you~~ it became obvious we were getting inflm + unempl. Had to change model. OK — but

— they didn't have to make labor the fall guy, blame it all on w.r.

— they are inconsistent later, anyway, come back + say that most inflns. are demand-pull; i.e., past Q^*

They used to try to get capl. off strike by getting it loaned at lower i.

Now, they emphasize need to Δ inv. opps. Accept w/o qm. a floor under i.r. Is the reverse w. labor — no emphasis on Δ job opps, but on removing floors under w.r.

As to rent + l.v, fastest rising cost-push of all, not even mentioned. Just accepted, silently. (+ used as collateral.)

So, big changes. Tool of most vital, virulent ideologues. When formed there were unions. This was their tool. Now, unions lost their intellectuals — drove them out, — + conservative ideologues are taking over.

Which is right? Neither. Old vads. had wrong ideas — under cons.; const. prices.

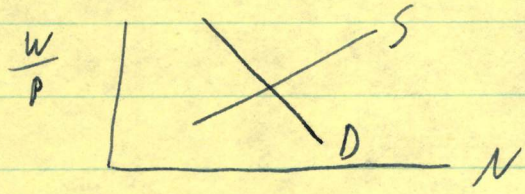
New cons.s have wrong ideas: labor to blame for all problems: lower w.r. solves all.

R+. ideas: Δ job opps. by Δ valence of land + cap. for labor.

Formal structure of Gordon's chap.

1. The labor mkt.

F. 7-3, top, p. 180



S rises bcs. of mgnl. disutility of work.

Issues; arguments, re backward bend

a. Is s.r. curve, no time for wealth effect

b. Are unempl. seeking work; also students, h.s wives.

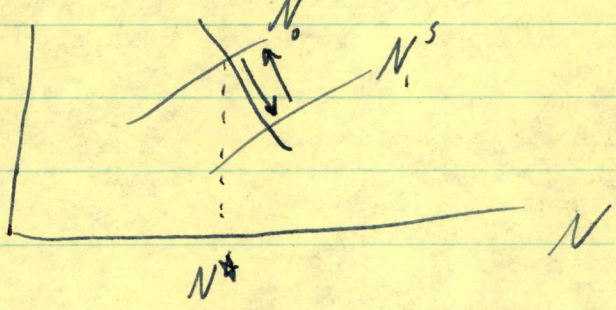
c. Leisure becomes costlier (decline of small town baseball after depression.)(leisure was cheap, then.)

D, ~~curve~~ has mg. ↓ bcs. of diminishing rets, as more labor uses fixed prop. (if there were no diminishing rets, curve wd. be flat)

Curve is less steep than vertical bcs. of Pigou effect.

2. To ↓ empl: shift S curve by an illusion.

Labor mkt.



p. 180
F. 7-3

Let ΔG raise demand for labor, but also P.
Effect is to shift N curve to rt. People will now work the same N (vert. line) for lower W/P.

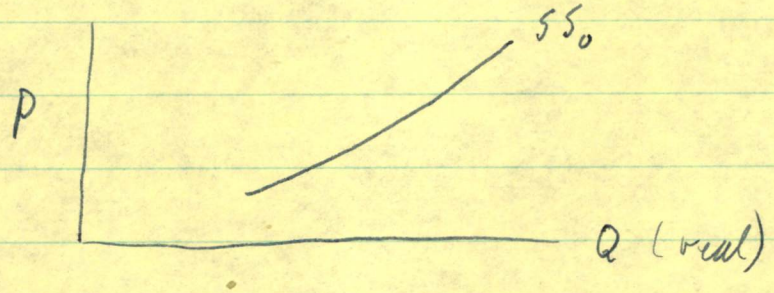
Technically, N_0 shifts to N_1 when P/P^e changes.
If P/P^e rises, curve shifts to rt.

$$\frac{P_1}{P_0^e} > 1 \quad \text{shifts curve to rt.}$$

Prices have risen, but workers don't know it.

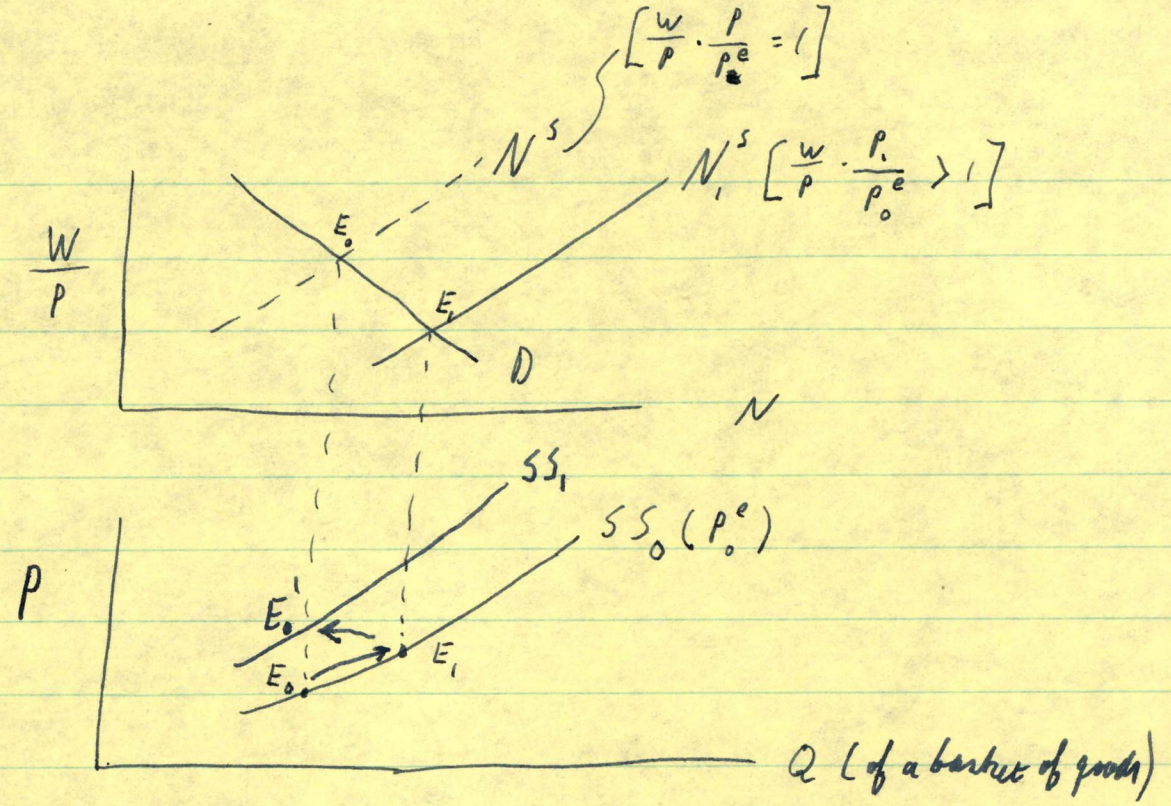
(But why doesn't demand curve move rt., since employers do know prices rose. Blunder by Gordon? No, $\frac{W}{P}$ is on the axis, so higher P just means Δ demand along fixed curve.)

Bottom frame of 7-3, aggreg. supply SS rises w. P, not bcs. labor supply curve is +ly; but bcs. labor curve shifts to the right. (axes are different)



SS_0 says you get + supply response to infln. by fooling workers into working more.
SS_0 is supply as f of Price. In long run, will be vert.

F. 7-3

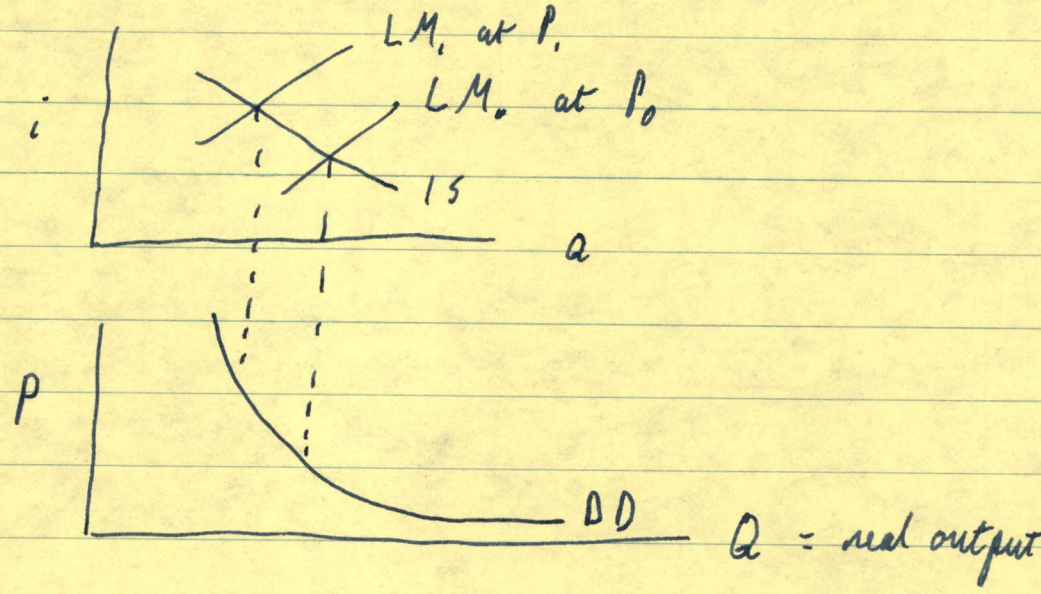


On SS_0, expected P^e_0 is const,
But then, workers catch on,
N^s_1 goes back to N^s
SS_0 " to SS_1
E_0' is same Q_1 higher P

Counter clock wise motion.

→ Note what Gordon leaves out: forced saving by workers during the interval of adjustment.

Next. DD curve, aggreg. demand. Brought fwd. from Ch. 6. Locus of Xs of IS-LM curves. p. 146
LM moves around, shifts, w. Δ P. Rpt.

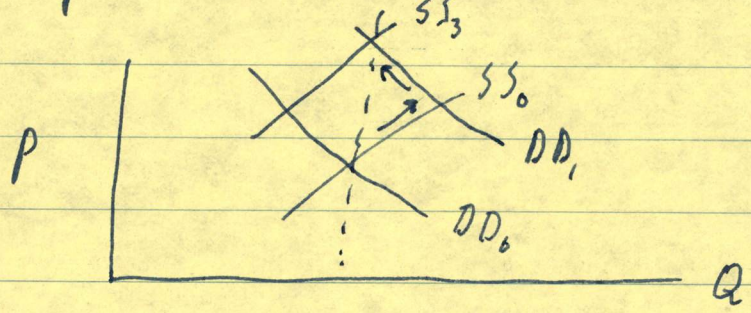


a ~~fiscal~~ lower P creates demand for more real output
1. Given spending buys more
2. There is more spending
Pigou – cons.
Keynes – Δ inv. via lower i

at given P_0, can also shift DD curve by factors that move IS curve to rt., e.g. Δ G, Δ k, etc.

Now join DD + SS curves

Fig. 7-5



(Each carries much baggage. Vulnerable to criticism ea. step of the way. Here we get overall framework, big view of what saying & the techniques used to say it, the pvt. language of ecsts.)

Let a demand pull inflm. by, e.g., ΔG.
In 7.3 we got counter clockwise rotn. by shifting SS to rt., by forcing workers.
Here, by shifting DD to rt, by ΔG.

7-6 What moved us out SS. was business. But workers are unhappy, that moves us back again.

7-1 Conditions for continuing demand-pull infln.

ΔP will also stop. if cause is just ΔG. Bus. ΔG crowds out other spending. p. 188. his explm. is muddled. ~~but~~ + understates it.

But ΔM can go on forever.

Cost push can also cause infln — esp. if ratified by ΔM. (Minsky, validating capl. values.)

Fed. can inflate by policy of fixed i (e.g. by supporting price of govt. bonds. Or, price of mortgages in resale mkt.)

Suddenly a new element in model — Fed ΔM by $-\Delta i$. ΔM is not introduced outside of mechanism of IS/LM curves.

(Value of p control — prevents cost push.)

Cost push can't cause infln. unless ratified by ΔM. So, he concludes, p. 193, distinction is spurious. (But if there are price controls, + infln. due to ΔM + govt. debt,

that is purely demand pull.)

Why does Fed. ratify? Key qu. A matter of taste, group preference formation, etc.

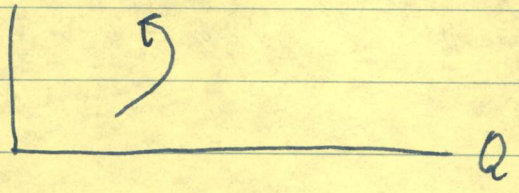
'73, 'supply shocks.'

a. ↓ farm prices, ↑ dem. demand. But this is from $ devaluation, a result of infln.

b. ↓ oil prices -- much the same.

7-8 Case studies, infln. in hist.

Mostly due to demand pull. Shown by hist. of P + Q, over time.



They travel counter-clockwise. I.e., orig. shift in demand does ↓ Q; then tapers back.

Only one is clockwise, '72-'76. And that is ambiguous. Depends entirely on what you take to be the base year. So do they all.

Chicken-+-egg.

Policy lesson:

Res. of chicken + egg, we need a coord'd. set of policies, to stop infln. + generate empl.

1. Const. M
2. Hold down cost push, sustain supply

Why so hard to follow? Attempted synthesis. Giving up large parts of orthodox Keynes; ~~but~~ ~~egg~~ granting that infln. is bad. Incorp. new ideas of rational expns; monetarism. But is uncomfortable with them. Trying to cover tail, same time.

Gordon. Ch. 7. Notes #1, Cannibalized

Letting price & output both change.

Key words

Natural output, Q^*

Comparative statics

Aggreg. supply curve

"Adaptive expectations". – base expectations on past experience

Value of home time

Money illusion

~~Ratifying cost~~

Demand-pull

Cost-push

Ratifying of cost-push

Supporting the bond market

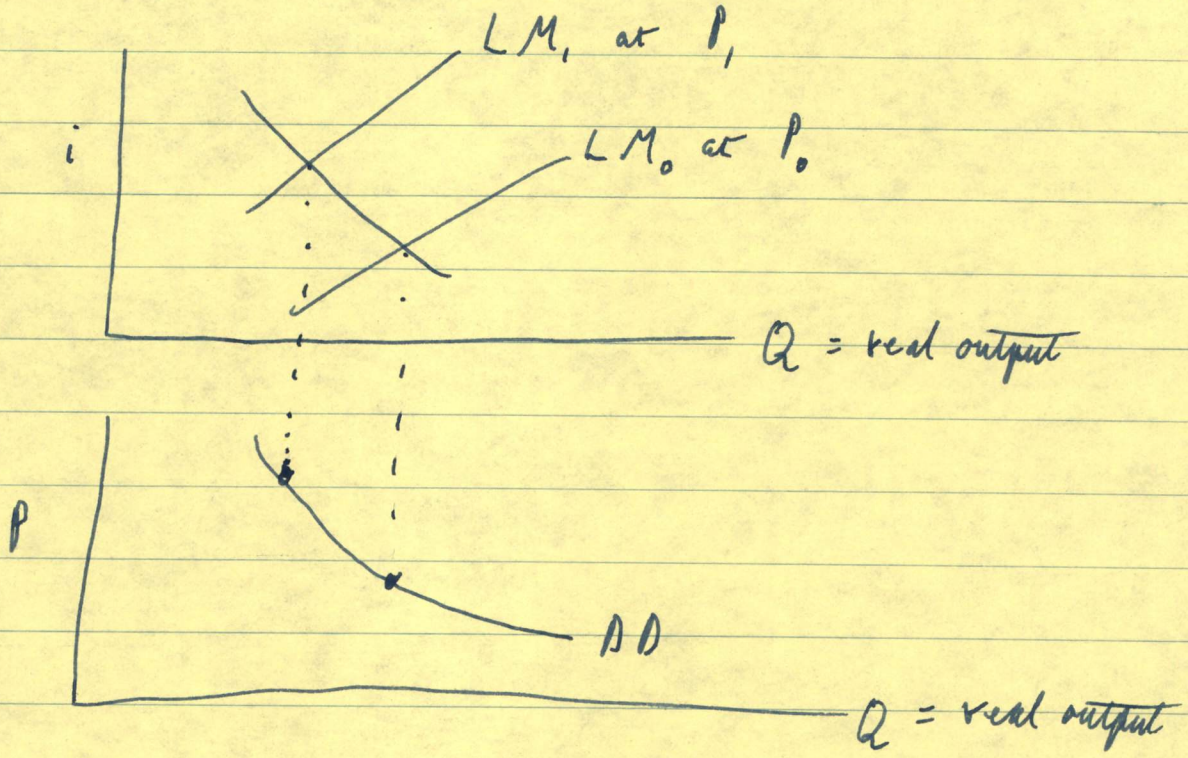
Price controls

Supply shocks

Gordon going thru a crisis

p. 145 The DD curve

As P rises, LM curve moves left.
Each x'ing w. IS gives a Q. Join them, for DD curve.

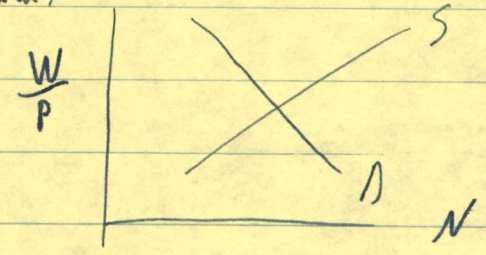


DD shows Q as fn. of real M supply.
It says in effect, if h.o.p. fall, all produce more.

It serves as aggreg. demand curve.
Embodies Pigou real balance effect. Δ cons.
∴ Keynes effect: Δ aggreg. demand due to -Δi, which in turn is caused by Δ real M

We are coming to end of framing difficult tools of orth. macro; can get down to cases; + applying to real world; criticizing orthodoxy; rebuilding.

Demand curve for labor, det. by diim. rets. Complement of labor assumed fixed.[F]



Supply curve, due to rising psychic cost of effort. ("value of home time") (he shd. mention value of welfare.)

So here is a macro where only labor is unemployed, all else is fixed. Higher empl. means higher labor-int., in s.r. (in l.r. he lets them change, but here we have s.r. only.) (nicely hedged.)

So he lets input mix change. Δ empl. by Δ labor-intensity. This departs from orig. approach — at least as I perceived it — where only way to Δ empl. was Δ Q. Here, AP of labor can fall.

"Aggreg. demand for labor" as f. of $ wage. Why affected by w.r. at all? If all w.r. rise, no one is really getting more. 3 reasons:

1.— distribn., labor takes from propty.

2: Real balance effect

[F] If cap. flows are established as a complement, then they vary a lot in s.r.

3. Illusions. Gordon pursues this, but poorly.

All 3 are involved, but he melds them, in his own way.

7-3 Aggreg. S curve (of labor?) $N^S(W/P^e)$

+ Δ of labor supply says unempl. is semi-voluntary. But he drops old idea of involuntary unempl.

To Δ empl., real wage must rise to workers, + fall to employers. (p. 178). (Or, demand cd. Δ due to more land, different, more comply. capl., etc.) (Something lost here - Hansen's frontier. Real Δ inv., Δ demand for labor, w/o inflm. I must bring it back.) Δ job opps.

He has this happen by illusion. Firms sell immediately, workers are paid later, spend slowly, so they see another, later price level. p. 178. Or, they are simply unaware of ΔP, p. 179. [That is backwards. It makes the workers out to be the capitalists. In fact, workers produce inventory, or fixed capl.; capl. holds it, (on ave. 3 yrs?) sells later. Workers are pd. fast.]

Crux of Δg empl. is to fool workers into accepting lower real wage by money illusion. p. 178
His treatment of money illusion is, bad, but it is

Fri. 1 PM, Bragan

Mike
I'll
try
it defs

clear that this is main point he is making.

Money illusion means lower real wages, by raising prices. ~~while workers hold money (i.e. are capists. Then, is~~

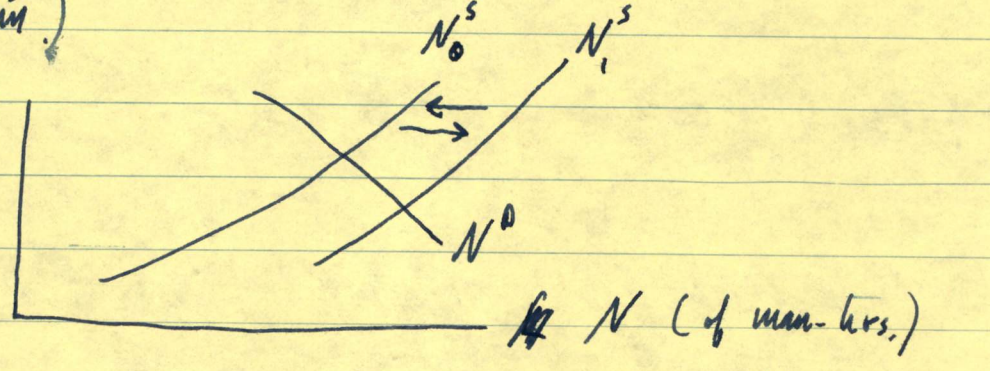
(Lower real returns to bonds etc. may be more important. Is a way of crystallizing or scaling wage contracts by arrogating rewards from one group to others)

This cd. happen w. long union contracts if not indexed. (But most are; + most workers are not union.)

It cd. happen by exploiting workers as holders of M — i.e. not as workers. This does happen re pension funds & small savings. OK. But on the whole is forced.

Ship. (Gordon's formulation has employers be exploited more, the sells invested., at P_0. Then price rises — no invg. gain.)

Labor mkt.



Counter-clockwise

Labor supply shifts rt., due to illusion: then back, when they catch on. First, in labor mkt: then in Q.

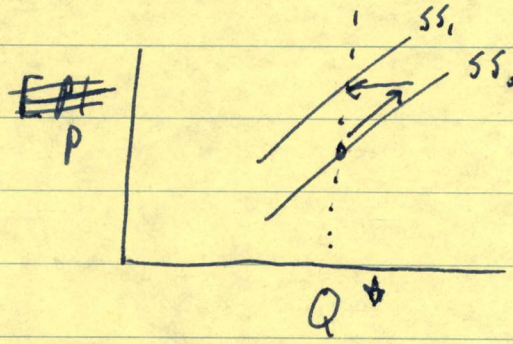
(Gordon has double world of illusion! "Bus. confidence" shifts IS curve: money illusion shifts labor supply.

How, we may ask, can bus. confidence affect inv., when employers sell all before they pay workers.?)

p. 180, derives output, Q, from empl., N.

$Q = kN$. (To simplify, suddenly drops diminishing rets., p. 181; but only to simplify, doesn't show slight drop in AP of labor. Watch this, too.)

Fig. 1-3
p. 180



SS_0 is cost of producing Q_1 a basket of goods.
P is price of the basket or unit.
Price rises -- i.e. demand rises, -- so you go up arrow to u.c. Then workers catch on.

Δ ~~deficit~~ spending jogs you up SS_0, but changed expectations jog you back to Q^*

This is formalizing a very iffy set of ideas!

Gordon has had chances to throw more fundamental & less fundamental punches. Chose the less. Flashy footwork, no knockouts. Macro ed. be handled better.

7-4 Forming Expectations

The faster they catch on, the less the ΔQ, the more the ΔP

7-5 S.r. effects on Q & P of ΔG & ΔM

ΔG shifts DD curve to rt. (DD is aggreg. demand, a locus of pts. that satisfy both LM & IS at different price levels. It carries a lot of baggage! v. p. 146 re DD curve.)

But it ΔQ only temporarily. SS shifts back & up.

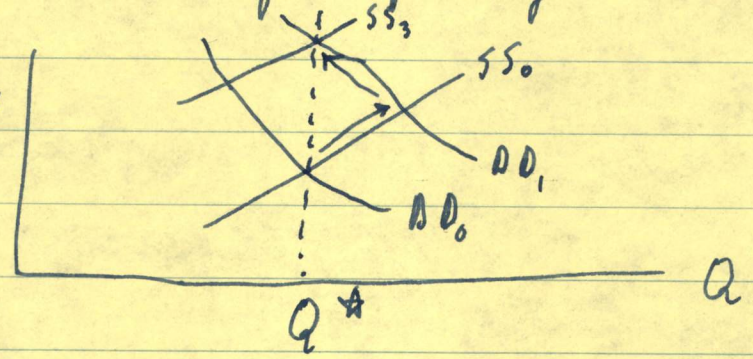


Fig. 7-5

At SS_3, are back to Q^*

Factors that can move DD:

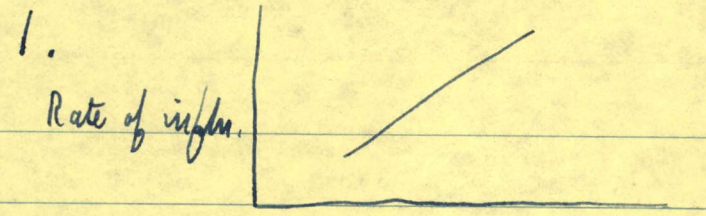
1. $\Delta \bar{A}$ from xfr. pmts, or reduced taxes. (i.e., ΔG)
2. ΔI, Δa, from confidence
3. Δ mult.
4. ΔM

Ch. 8. Major ideas.

Defs. of Inflm. & Unempl.

2 Phillips Curves. The last curve, so spend extra day.

1.

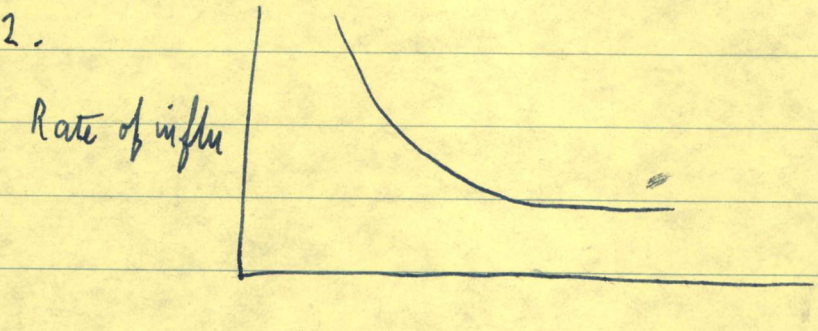


-- but $Q^* = k$, so

down + offset curve.

~~But by treating it~~

2.



Misstate Okun's Law, p. 210. Oversimplifies, just says

Unempl. $= \frac{1}{k} Q$ or $\frac{Q}{Q^*}$

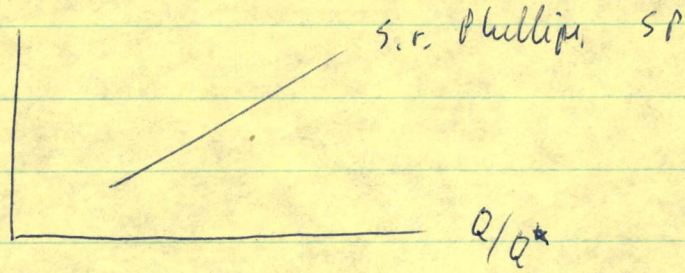
Ave. Windfall supply shock.

Ch. 8. Inflm. + Unemppl.

I. Basic Models. — This is a rate per year, model becomes dynamic

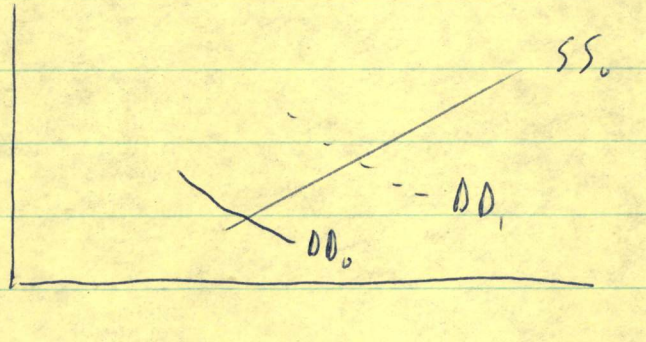
p = inflm. rate. Lwr. case means %

8-1 bttm.

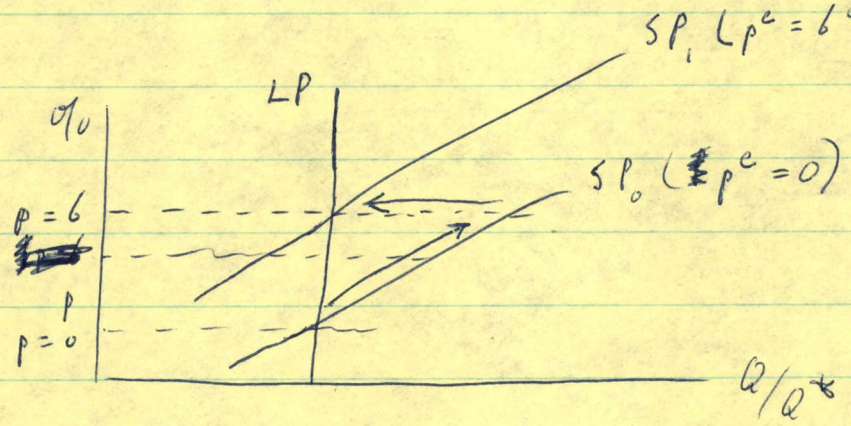


(This is assuming the inflm, p, is demand-pull. Cost-push wd. work the other way)

8-1 Top



8-3

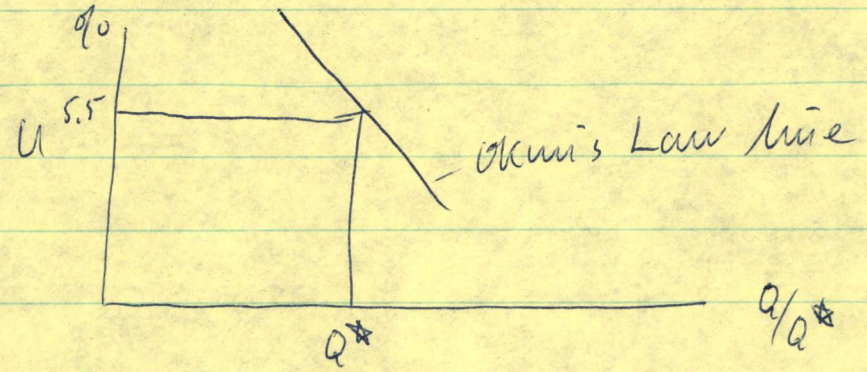


SP is + ↗, but LP is vertical

(So why food w. it? No permanent solution. LR is pretty -↗, actually, bcs. SS curve shifts left.)

u = unempl. rate in %

8-4



This reduces the law to trivia.

The interesting part is (1) that the line keeps moving to the right, as productivity rises.

(2). Δ of line.

$$\Delta\left(\frac{Q}{Q^*}\right) = 3\,\Delta u$$

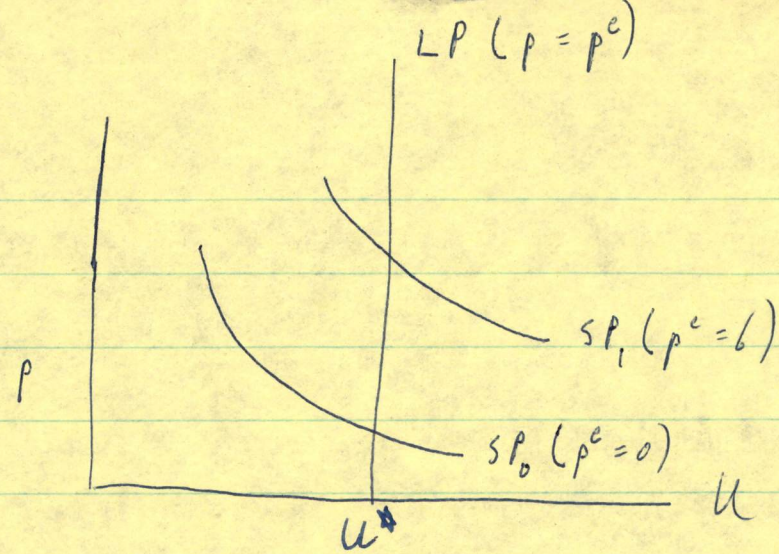
1973-75. E.g. $\frac{Q}{Q^*}$ drop from 1.00 to .90, drop 10%

u rises from 5 to 8.5, or 3.5 points.

(Actually, that's a $\frac{3.5}{5}$ = 70% increase in unempl. so this is a confusing formulation. Better to choose the % employed, which dropped from .95 to .915.

But that sounds fishy. a 3.5-4% drop in empl. goes w. a 10% drop in Q!? How can this be? Maybe they jack up Q^*, but if so, shd. tell us. Maybe capl. went out of use more than labor. Maybe Gordon erred.

8-5



Same idea as 8-3, but different abscissa.
This is usual form for Phillips Curve.

Note large fudge factor. When p rises, but u rises too, you just say 'The SP shifted.' Finally, they arrive at saying LP is vertical, i.e. p has no effect. (It may even be worse than that.)

But if so, then we are back to classical ecs, which said money is just a veil. ≠
We shd. focus on what dets. u^*

At last, a defn. for u^*, p. 212. It's when actual inflm. = expected inflm.

p. 214, ~~begins~~ backs away again, blames term on M. Friedman. ~~Last~~ Last, causes of u^* - next ~~chapter~~ Chap.!

≠ La Maja Desnuda v. La Maja Vestida

8.2
p. 216

$$q = y - p$$

$$y = q + p$$

y is "demand growth". If p uses up most of y, there is not much q.

q^* is growth of long run eq. output, $\hat{=}$ 3,5 %

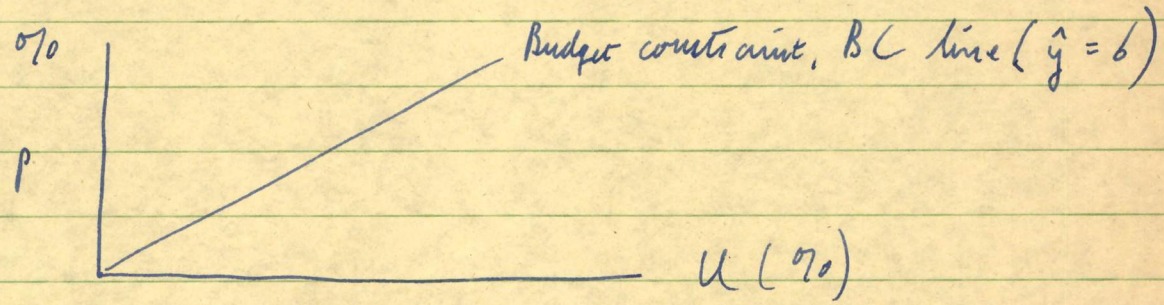
$q - q^* \equiv \hat{q}$ The hats are deviations from q^*
$y - q^* \equiv \hat{y}$

$\hat{q} \equiv$ "adj. output growth", ~~i.e. growth of adjusted output~~
$\hat{y} \equiv$ " " demand " "

Demand regs. ~~[illegible]~~ control $\hat{y}$; but $\hat{q} + q$ depend on how much ~~[illegible]~~ of $\hat{y}$ is used up by p

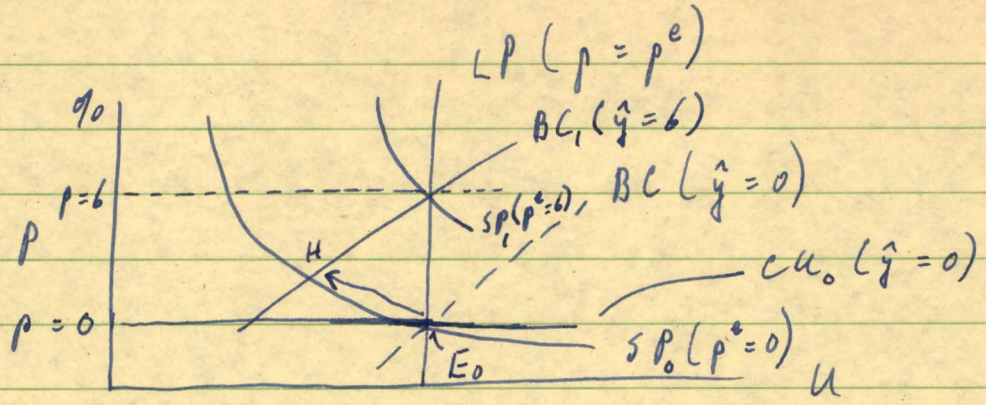
(Value of this — our indep. term for demand, y.)

8-6



Here we hold $\hat{y}$ const. So p reqs. cost push infln., and higher p ~~[illegible]~~ means higher u.
$\hat{y}$ of 6 has to pay for both $p + q$, hence $p +$ empl.

8-7



Comparing 8-7 with 8-5, this just adds a specific ass. about the source of infln. It is demand-~~pull~~, shown by shifting BC curve up to left, or NW. 'Cost-push' or resistance, is shown by higher p.

Old wine in new bottles, again & again.

There is a third line, Const. Unemplt. CU, where $p = \hat{y}$. It is horiz.

p. 219 is complex & formalistic. Do not follow all its arbitrary assms. & movements. Basically, he's imposed several requirements for eq. & the model doesn't come to rest until all are satisfied. He cd. put this in form of 3 simul. eqns., & solve. Instead, he's walking us through it by an inf. no. of steps — tedious & exasperating. Is of value mainly to model builders.

Let's go straight to punch line.

1. The SP curve shifts up, bcs. SP_0 presumes $p^e = 0$. New SP_1 ($p^e = 6$). We get back to LP ($p = p^e$). $u = u^*$

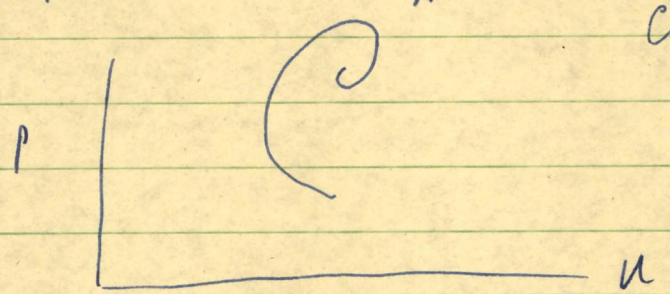
2. How low & long can u be pushed. "Everything depends on the speed at which expectations are adjusted." But we already knew that. So all we have is a more elaborate model.

One telling error is the assm. that the vertical LP curve is the extreme case. Actually p^e can shoot way ahead. History of land booms, this has happened often. It cd. be happening to i right now. Gordon underest. real damage from high p^e.

The upshot: there are narrow limits what we can do w. $\dot{y}$, or demand mgmt. That may seem obvious, but it rep. progress in many, bcs. for yrs. it was a magic cure-all.

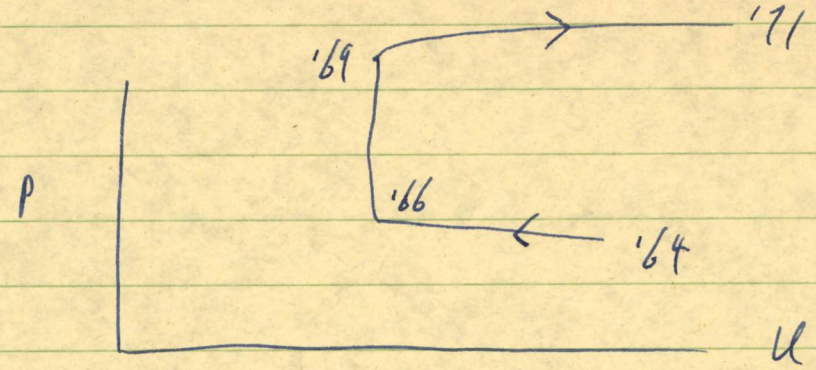
8-8 Adj. paths under different assms.

Clockwise spiral.

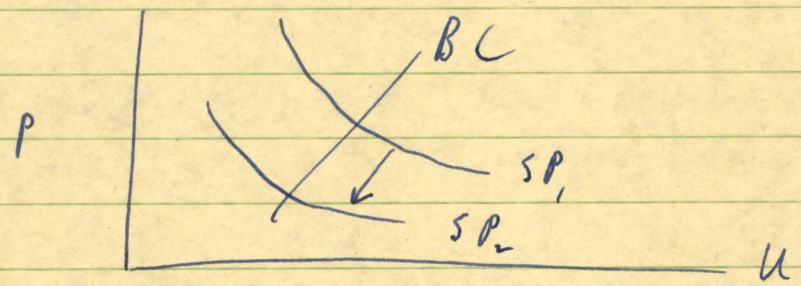


Stagflation. He's definition, p. 226. He's built a model to simulate 1964-71. Trouble is, he did it after it happened.

8-9



8-10 Price Controls.



✓ So if you control P, + also manage demand, OK.

But when you remove controls, ~~Big~~ big ΔP occurs, instability is bad.

Supply shocks – the mirror image. Skip.

Govt. deficits + inflm.

Govt. deficits are same as pvt. borrowing. (Not quite – use diff. collateral.)

~~+ g + t, w~~

Friedman is too sweeping. '74 is an e.g. of inflm. w/o ΔM. Effort here is to integrate ΔM + other factors. (i.e., ΔV)

(MV = PT still sums up well.)

On to u^*.

Nov. 1. Gordon, Chap. 9: Unempl. causes.

He has become disenchanted w. demand mgmt. We always get back to U*. The ec. regulates itself, in spite of FMP.

After 30 years they've realizing that demand mgt. is too shallow. FMP is overloaded. Back to the drawing board.

So this Chap. shd. be heart of book. U* is not natural, it is what FMP can't handle. But still pretty shallow. All about mismatch of jobs + skills. Nothing about basic need for labor + need of men for work, to be useful, to assert, affirm one's self as a vital, functional person.

Three go w. unempl.

Nothing about declining real wage levels in U.S.

— other countries gaining on us, w. many fewer res. While we approp. + use world res. Our relative wage rates have fallen. We are a cheap labor country, for some, e.g. Germans in S.C.

— Δ edn. + trng. needs. Much now is return to human capl., not labor proper as such.

— Short time to use up human capl. — early retirement

— Δ commuting time + cost. $\frac{1}{3}$ of work day, on ave. Like puncellement. Hi death rate, too, on highways.

— need for frequent movers, esply. hard on women.

Nothing about divorce of worker from land + tools, reduced job satisfaction.

Something re how unempl. rate is figured. Bismarck, laws + damages. Same w. ec. data.

He gives us mainly reasons why U is overstated. Not to worry. Friedman influences. "Job search", like opt. vacancy rate. Teenagers, who want milk shakes + rock + roll. Patronizing, unsympathetic. Women – who cares about them.

There are other reasons, why U is understated. Part-time work, you're employed.

Welfare dependency, you're out of labor force. Drifters, bums, criminals, profnl. students, personality problems (Ralph G.) (Emily Ch.), alcoholics, blind, ... Millions of people. Add illegals.

+ reforms the anti-social types.

If system is right, it makes jobs fit for those people; Gordon emphasizes bad of Procrustes approach, people must fit the jobs niches. "Blaming the Victim."

Enumerators taking sample are only human. They don't chase down the real bums; stay in better parts of town. Illegals don't answer.

We are concerned w. unempl. rate only as a symbol of the hardness of finding a good job; + the rewards of work. A meaningful no. wd. be much higher.

Why is it a problem? Much worse than Gordon says.

Damaging policies adopted bec. of fear of unempl.

Inflation -- eff. by price + wage controls

Fed. debt, rationale for endless Δ of fed-spending.

Loss of freedom: price + wage controls; socializing inv. by massive gov. control; fear of change, clinging to security; stunting creativity. Suppressing compet., e.g. agric.

Polluting: env. degradation

Territorial expansion

Urban sprawl. Wasted commuting time, etc.

Invading wilderness; destroying greenbelts, farms

Foreign inv. + appropriation: multinationalism; dependency

Imperialism

War machine -- inefficiently supplied.

Waste: Boondoggling; subsidies to subec. inv., public + pvt, to create jobs; along w. inadequate supply of labor-saving things; slowdown featherbedding; hi-pressure sales; planned obsol. + breakdown. Consume capl., stop saving, divert inv. instead.

Premature exhaustion of nat. res. Alt. max. gross rather than net.

Excessive job security, tenure, seniority, limited entry, etc.

Huge welfare establishment, people conditioned to it as way of life.

Tolerance of crime.

Long apprentice-ship, eff. by early retirement, geriatric ghettos.

Other damaging effects.

Decline in work ethic, moral fibre, character. Apotheosis of non-work, primitive attitude toward work as vs. play.

Alienation, counter-culture. Develop class of vagrants, bums, drifters, equipped w. rationalizn. for anything.

Destruction of personal responsibility.

Bread + Circuses. Breakdown of civilization.

Causes of unempl?

London's approach is shallow. Mix & match. Leaves out enormous & growing inst'l. bias.

1. Tax system.
   Most anything that moves.
   Tax paybills
   As to capl:
   Quantity. Offsetting biases, net effect on quant. is uncertain. Savers discouraged. Intermediation profits encouraged.

   Form of Cap.: Clear anti-labor bias. E.g. of timber.

   Land. Preference for virdicure. Costs of holding recognized before income is.
   Unions make it worse. They strike vs. the person who employs them, not the one who holds land idle, or uses fewer workers.

2. Subsidies in form of cheap loans. Make-work for capl.
   Housing; munics.; farm credit.

   FRB ΔM, "forced saving".

   Exploitation of small savers by Reg. Q, + infln.

   Use of low i on p.w.

3. Reg. bias, x-subsidy, + Averch-Johnson
   Rates based on cap. invested.

4. Rwy. & truck rate reg.
   Higher rates on goods of higher labor content.
Value-of-service, not cost-of-service.

5. Cartel allocations based on capacity, i.e. capl.
   Fishing rights; Tobacco warehousing.
   Oil wells: compete ed. drill, but allowance only 7 days/mo.
Resource tenures allocated same way, e.g. wtr. rts., based on diversion capacity. Sovereign, based on front-money.

6. Logrolling, partial funding of p.w. Stretchout.

7. Territorial scatter -- a universal pattern.
   Undersize of central land, plus premature use of urged land. Huge capl. needs, of urged land.
   Pattern found in agric., cities, oil, water, etc.

8. Cartel price-umbrella.

   Or straight monopoly.

Tues. Nov. 6. Ec. 100B

Consequences of Inflation. – Chap. 10.

Is infln. so bad?

It's a gross breach of contract, sneaky, tricky. Erodes credibility of govt., both domestically & abroad. Alienates people. No purely econ approach adequately expresses that.

Gives enormous power to Govt. & Fed., discretionary, unpredictable.

Now it's "built-in." But don't blame the victim. Blame govt. in-groups; & MAMOPS

p. 278. Gordon begins by saying the cost of stopping infln. is unempl. Sees no other way. Dismal

But how will unempl. help? That reduces supply w/o reducing demand, bus. cautionatic & kfr. prots. What we need is to employ same no. of people (or more); but ↓ flow of supply of ripe goods, salable, consumable. The exact reverse of waste economics.

– divert from waste to producing, e.g. boondoggling, whether ~~Korea~~ military or civilian

– divert from future to present.

E.g. maintain & remodel, recycle existing neighborhoods & housing, as vs. unrolling the urban carpet further. (hopeful signs: ITC for remodeling; Filante's prop. tax exemptions for remodeling.)

Effects of Inflm — look beyond immediate or proximate effects. What do people do to protect themselves?

A. Proximate effects.

Losers: liquid investors.

Smaller, on the whole. (except munic. bonds.)

Studies of decedents. The rich go into equities.

Bonds (bills, notes). Esp. long bonds, as i rises.

Savings accts.

Pensioners

S + L deposits

Checking accts.

Includes foreigners, if $ depreciates, as it has after '71.

Fixed salaries

Banks? No, hedged.

But S+Ls can lose when i.r. rises.

Landlords under rent control

Several waves of this in Eng. history, transfer of de facto substantive ownership of land. Tenant right, etc.

Long term lessors

Producers of old oil + gas.

Benefics. of 'conservative' trusts, limited to safe invts.

Took lawyers longer than everyone to catch on to inflm.

Mortgagees (Agmen. 10%)

Businesses w. hi turnover bus. so hi a % of their assets are liquid. Need for liq. is ∝ volume, = K·T

Liq. is a tool of active mgmt. + turnover of K.

Tax losers

Shift to higher brackets, progressive structure.
Personal tax only. Corps. not affected.
Shifts weight from corp. to pers. inc. tax.
Note bias of publicity re this. No one mentions this.

Phantom profits
Long favored over short

Underdepreciation - overstated. It's a variation on the phantom profits theme.

Winners

Equity holders, esp. w. debt. Esp. long term debt! ±
Small corps. do better than large, more leverage.
But large ones have the long term debt.
Plungers in r.e. w. hi leverage.
Have good credit, use it.
Why Doctors stop being doctors

Note how negative cash flow adds to forces screening out small owners. W/o influ. you can cover up. int. from income. Now half yr. income is in form you can't realize. (Citrus econ.)
All debtors.
U.S. Govt.
Tax shelter jockeys

Americans holding foreign assets. Multinationals. Their debts are in U.S. $; their assets in fn. currency or real goods.

± Another r.e. advantage. You can borrow long on r.e., but not on accts. rec'ble. or inventory. Keep the old, low i on r.e. But w. prodn. credit, always a new, higher rate.

Tax Winners

Tax shelters.

Bus. costs are deducted before inc. is taxed.

Deduct hard $, pay tax in soft $.

B. 2dry effects. How people protect selves.

1. Buy real assets

a. Hsg., best of all
We are overhoused.
No phantom profit to tax.
Expense c.c.
Scope for tax-free labor.
Cap. gains treatment, only better.

b. Longer term assets – defer phantom profit.

c. Equities.
Esply. long ones.
Growth stocks

d. ~~Gold,~~ Commods., ~~furs.~~

e. Gold, for currencies.

f. Build prematurely.

g. Land. Stockpile for future use. Cause sprawl.

h. Buy bigger firms – they have more real assets; ~~if~~ longer assets, slower turnover; longer term debt.

2. Borrow.

a. Mortgages. Huge Δ.

b. Cons. debt.

c. Pay debts slowly; also taxes.

d. Tax shelters -- borrow from govt.

Most people only dimly understand essence of tax shelters: Expenses are recognized for tax before the income ~~is~~ which they generate.

e. Business: bond fncg.

3. Demand higher i when land.

4. Escalator clauses in long contracts.

Variable rate mortgages
Leases
Wage agreements
Cost plus contracts

This is all messy in practice.

5. Raise target or min. rates of return.
- Becomes hard to evaluate performance. People count on inflation, everyone looks like a winner.
- Shift into longer assets, to defer tax on phantom profit.

~~[illegible]~~

$$S = 1 + r + r^2 + \dots + r^{n-1}$$

$$rS = \quad r + r^2 + \dots + r^{n-1} + r^n$$

$$S(1-r) = 1 - r^n$$

$$S = \frac{1-r^n}{1-r} \; ; \; n=\infty, \; S = \frac{1}{1-r} \; ; \; aS = \frac{a}{1-r}$$

$$V_0 = \frac{a}{1+i} + \frac{a}{(1+i)^2} + \dots + \frac{a}{\infty}$$

$$= \frac{a}{(1+i)\left[1 - \frac{1}{1+i}\right]} = \frac{a}{1+i-1} = \frac{a}{i}$$

$$\hat{V}_0 = \frac{a}{1+i} + \frac{a(1+g)}{(1+i)^2} + \dots + \frac{a(1+g)^\infty}{(1+i)^\infty}$$

$$= \frac{a}{(1+i)\left[1 - \frac{1+g}{1+i}\right]} = \frac{a}{1+i-1-g} = \frac{a}{i-g}$$

Alt. forms.

1. Higher value. $V = \frac{a}{i-g}$

2. Lower apparent return. $\frac{a}{V} = i - g$

Approximation of real i.r., $\equiv r = i - g = \frac{a}{V}$

Note misuse of $\frac{a}{V}$ by citrus doomsayers.
89¢ per avocado!

3. Capn. of unrealized inc.

$$V_i - V_g = a$$

$$V = \frac{a + V_g}{i}$$

Unrealized is as good as realized. But gets true break. Another reason for buying land, subbing for labor.

4. Neg. cash flow.

$$V_i = a + V_g$$

This screens out buyers w/o outside income. Fosters concn. of control. Hurts new entrants young people. Sin bins are no consolation.

People used to get started faster. When Alex. the Great was my age, had been dead for 56 - 24 = 32 yrs.

Powerful vested int. in infln.

C. Cycle possibility

Forced saving, ff. by flight from $, hi i, collapse.

Structure or form of K gets distorted, dimin pd. of low real i.

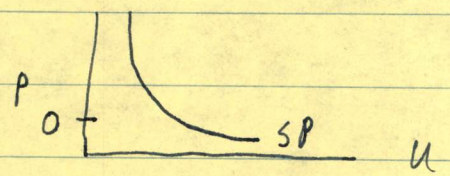
Then, as savers refuse to be exploited, beginn. crisis emmes

Thurs. Nov. 15, '79 Ec. 100B

Gordon, Ch. 11. "Cures for Inflation: Recessions, Controls, + Indexation."

Gordon considers 3 cures.

(1.) Recession. New dismal science.



Finds this a hard doctrine, bcs. people adjust slowly. Long term contracts. Utilities, reg. prices.

It is a fact that deeds recorded rises in rising mkt. falls in falling.

But mostly it is just expectations. Today most expect Volcker to fail. Pol. bus. cycle. ~~Actually, there~~

There is actually a way to change expectations — tie $ to gold. Redeemable. as a matter of contract. At present, all we have is the fragile consensus of small group of changeable people. Can't change expectations that way.

One key item that changes fast is s.r. i.

(2.) Controls

There cd. be OK if used to ~~this~~ make stable ↑ work. But E. fails to emphasize this.

Historically have almost always been used not to make demand restraint work, but in lieu of restraint. Exploited people.

Recent episodes.

1. WW II. Success story. Big Δ demand, held down pr. + cost, big Δ empl.

Was long cited as success for demand mgmt. But cost control was half the story. Demand-pull w/o cost push.

Mupies broken. Cl. e.g. New firms fostered — as Jap. do today. Groundwork laid by Conc. + Cmodd.

Broken takers of/ produc: ag. program, e.g.

Banks loaded w. frozen assets, cd. use load. Also after war. (Bank examiner bias — hate to recognize a loss.)

Countries, too.

So there was a big supply push. Much of this has been tossed down the memory hole of history. Myth-making.

2. Korean war, 1950 –

Renewed the downward pressure, but lighter.

3. 1962-66, "voluntary guidelines"; Kennedy-Johnson

4. Nixon, 1971-74

Controls have many problems, so they come & go.

Energy price controls, anti-conservation bias.

Steam control: a) subsidies to make prices lower. (The neg. taxes make other prices higher.) E.g., again, oil.

b) Rent control. This transfers ownership, existing asset.

c) Zoning. As land supply in lower use, at expense of higher use.

(3.) Indexation.

Gold clause or CPI clause in all contracts.

We have already looked at problems here.

a) No index is very good,

E.g. T-bill rate

E.g. my ground rent proposal.

b) Profound shock to accty. Bank, tax, accty. Can't handle. Legal system – too cumbersome. Rate reg.

c) Makes life needlessly complex, adds one more deception to see through. Lets the quick & unscrupulous exploit & confuse the slow, naive, young, straightforward.

d) Is no logical stopping place. Shifts S.r. Phillips curve up, invites further $ spending.

(4.) Δ supply.

This obvious route, he just omits.

How do this?

~~Supply~~ ~~Fund~~ of Investable Funds, ~~F I F~~ S.I.F

This is via demand. Has 3 sources:

Recovery from sales (R)
(Includes amin.)

Net savings from inc. (S)

ΔM (ΔM)

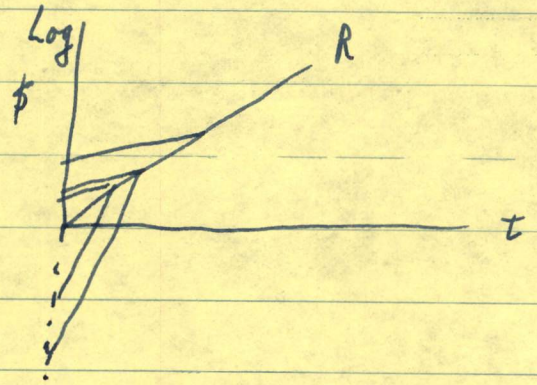
Proposal is to stop ΔM. To maintain ~~S.I.F.~~ ~~F.I.F.~~, must increase R +/or S

But ΔS means -ΔC. So best bet is ΔR.

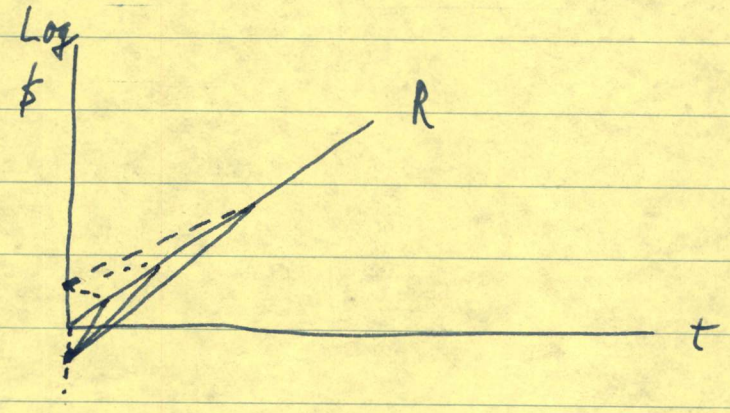
How ΔR w. fixed K? We are speaking of flow of funds, not stock. Also a flow of real K, = K·T, or volume.

When we Δ SIF this way, we are simul. Δ flow of real goods. It is not, ∴, inflationary.

Free mkt. flex. i, makes this happen.



Δi, prefer shorter mats., ΔR



Ch. 12, Gordon. Monetarist v. Non-monetarist debate.

1. "Central role of agg. demand" — a misnomer.

Agg. demand only tells us how much nominal spending there is, to divide between real Q, + ΔP. The actual divn. depends on "condition of agg. supply."

↑ is growth of agg. demand.

Gordon doesn't declare total bankruptcy. He actually makes some sense. He allows that there are ec. thermostats. But they are weak + slow, hence there may be a role for activism — unless it, too, is weak + slow — or clumsy.

He keeps waffling back + forth, tho, which is confusing. Trying to please everyone.

also, keeps to a debate format, back + forth, never resolving anything.

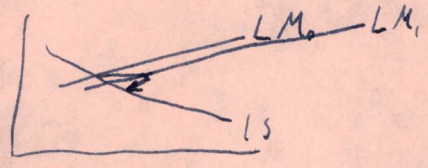
2. Monetarist controversy is not about money.

It's just a new guise for oldest disputes: Is ec. self-reg; or do we need big brother.

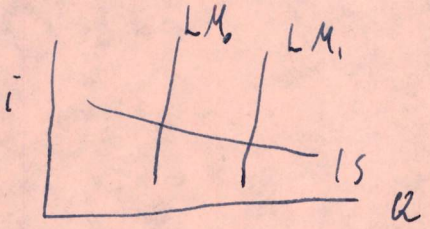
Monetarists say self-reg. They're vs. fiscal pol. Hence, for mon. pol. But not an active or discretionary one; just a stable, predictable one. ff. announced rules.

Monetarists come closer to believing money is a veil, the pre-K. position. There was a time when K-u. mystics had it that spending (money, of course) followed its own iron laws, prices were fixed, so these laws controlled human Destiny.

For a long time, fiscal v. monetary hinged on slope of LM curve. Flat LM, $-\Delta i$ puts fast brake on ΔQ, ∴ no benefit in ΔM.



Mon. policy impotent



Mon. pol. potent
Fisc. pol. weak (crowding out)

But they no longer argue re these slopes. Rather, core issue is, what is source of instability. Mon-sts think pvt. ec. is stable.

p. 336, n. Slope of LM becomes irrelevant, just like s.t. Ph. curve, bus. ΔP makes curve shift.

ΔP shifts LM curve left, offsetting effect of ΔG, e.g. Only qu. is, how fast does ΔP come.

This shift of LM curve is like shift of Ph. curve. ΔP makes nonsense of both LM & Ph.

Pigou vindicated & Trimmphant at last! Students, bear down on Chap. 86, Flex. P & Self-Correcting Ec. 366 n. tells you, Pigou was right.

4. Instability of pvt. spending

(Note, we've shifted to instability. Not to worry about level, etc.)

p. 344, defines U^* as U which is consistent w. "continuing infln. at its present rate". I wd. prefer 0 rate.

Then he finds that U was above U^* for most years: 1957-64, 1970-79. But we had infln. most of those years. His defn. neatly dodges that one. Very slippery

1948 - 52	Truman
1952 - 60	Eisenhower
1960 - 62	Kennedy
1962 - 68	Johnson
1968 - 73	Nixon
1973 - 76	Ford
1976 - 80	Carter

Unstable components of spending: G, Cons. Durables, ~~Res~~ Producer Durables ("Fixed Inv.")

1. G, bounces up & down w. wars, politics.

1950-53 $\Delta G = 53\%$!

'65-68 " 24%

'68-75 $\Delta G = 0$

But this does not nec. destabilize aggreg., if tax-financed. But any change in demand mix calls for inv. in new plant & hardware, thus requiring bulge in investment. Gordon calls for tight money in war, but nation steers K into war plants by helping to finance them.

2. Producer durables. ("Fixed Inv.")
(I presume this includes housing.)
A bastard concept, includes both Replmt., R, & some net invt. But not all R; & not all I.

So, its changes to some extent do not reflect aggr. changes, but shifts.

E.g: 1) Cities expand, bulge in ~~#~~ bldg. durables. Other capl. is drawn down.

Then, invt. shifts to restocking old shelves plus the new. Inv. in Δ soft goods is not "fixed".

E.g. 2) Build-up of cattle herds. Not fixed invt., bcs. corpus enters into product. But has all the ec. qualities of durable producer goods.

So, data given are of little value.

3) Cons. durables: Autos, appliances, furniture
also invstable. Again, too small a part of whole to be signif. by itself.

They have their eye on wrong ball, anyway.
Flow of investable funds is key variable: sources, not uses.

There are always wars. When sources dry up, something has to yield. It is, obviously, the durable items.

Ec. 100. Tues. Nov. 27

Gordon, Ch. 14

1. Point of Ch. 14 is to emphasize that I is very variable. Cycle of its amplitude. (Define Amplitude.)

Thus he justifies "activism." (Intervention, Dirigisme, Directing, etc.)

Does this mean Socialism? Not egalitarian. "Rockefeller socialism." Ber. main policies he recommends are Δ tax breaks for property; to Δ K/Q ratio.

Known in trade as reactionary Keynesianism.
Keynesian ben. of demand mgmt. mindset.
Reactionary ben. benefits to labor all trickle down thru benefits to K.

2. Begins w. one firm, Δ hand inv. is unstable
True, we can add e.g.
a. Large dam. Constn. camp syndrome.
b. TAP line, Algeria.
c. Constn. boom in new, growing towns, regions.
Taking in ea. of this's washing.

d. Cattle boom, stocking new lands
e, Irrn. boom, Cal. in '20s.

But these e.g. are all micro, or regional. Depend on inflow + outflow of funds — open ec. Can they be nationwide; worldwide? If so, not for same reason. Bec. different booms offset ea. other, variations are pooled.

What the e.g. do tell us of value is that hand K creates jobs seldom.

But do not explain instability in macro world, closed world ec.

3. Demand urgent, mindset. He is escaping from it elsewhere in book, but not here.

He has inv. change due to Δ inv. opps. — i.e. desired cap stock. First, bec. ΔQ; later, bec. $\Delta \frac{K^*}{Q}$ (latter is more macro.)

But where does all this new K come from?

There is no fund floating in the air, to be tapped whenever demanded. Demand for K is not the bottleneck, but supply.

Sources of ea inv. funds: R, S, ΔM, F. (Foreign) F only applies in open ec. On p. 400 he generalizes from first e.g. to whole ec. But can't do that. In whole ec, there is no F

4. Law: people invest bcs. they have the funds

Corollary: bottleneck is supply not demand

Defn. + explication: bottleneck is flow, not fund.

5. Prodn. of kind K is variable. 3 reasons.

a. Replmt. is deferrable
b. " " small part of whole stock
c. Very sensitive to Δi

But there don't mean it causes instability. Rather, it reflects changes in supply flow of investable funds. a balance wheel.

Decline of flow causes higher i. This screams out hard K, 3 ways to see this.

i) $V = (1+i)^{-n}$

$$= -n \frac{d \ln(1+i)}{di} = -n \frac{1}{1+i} \cong -n$$

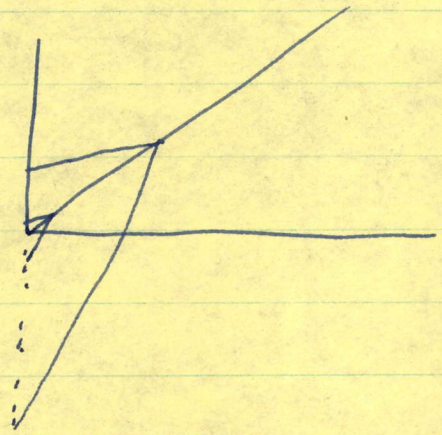
Correct

$$\frac{dV/di}{V} = \frac{d \ln V}{di} \overset{\uparrow}{\cong} -n \frac{d(1+i)}{di} = -n$$

$$dV/V = di \times (-n)$$

E.g. $di = .01$, $n = 50$, drop is 50%

ii)



---

i) $V = e^{-in}$; $\ln V = -in$; $\frac{d \ln V}{di} = -n$

iii) User cost = $i + d$

If $n = 1$, $i = .05$ U

If $n = 20$, $d = .05$, $i = .50$ U

6. What wd. cause tightening of funds?.

Rpt. 7. Burst of invt. demand caused by lower i is tempo.

Δ R demand caused by higher Tuition is permanent.

Gordon, Ch. 14, ideas.

They base Acc. on assm. of fixed K/Q.

My Acc. is based on lowering K/Q. Get more Q from same K.

They emphs. instability. True, give e.g.

1. Large dam. Constr. camp syndrome. 5. Foreign boom
2. Algeria pipeline
3. Constn. boom,
4. Cattle boom, stocking new lands

But these are micro, regional. Can they be nationwide? Worldwide? What the "hard K" e.g. tells us is that this frozen capl. creates jobs only seldom.

Acc. is based on demand mgmt. mindset.
The bottleneck is invt. opp., rather than flow of K supply.

Law: People invest bec. they have funds to invest.

The bottleneck is supply, not demand or oppy.
" " flow, " stock.

---

(6). What would cause a general tightening of funds? Simul fall of 3 sources: R, S, + ΔM

1. R falls bec of:
   a. Accum. of too much hand K
   b. slow sales
   c. Δi, so recovery goes for inc. profits.
      Cap. value falls — a big loss of capl.
      Graphic e.g. ... all goes for inc. on bonds

2. S falls
   a. Stage 1, late boom, hi cap. values, fear of inflm.
   b. .. 2. early recession, inc. falls (including $-\Delta$ L.V.)

3. ΔM falls.
   ? + even becomes negative. Loans repayed, not renewed.

Gordon, Telltale errors.

1. p. 399, has R rise gradually "as cap. stock Δs."
   Thus, he has a fund of K floating about in the air that is brought to earth by Δ inv. demand.
   In open ec., this cd. make sense. But he has ruled that out, all is closed ec.
   In fact, inv. surges result in reducing R, as cap. hardens.

2. p. 396 Favors ITC + Acc. Dep. to $\Delta \frac{K}{Q}$ " + thus stimulate inv."
   In fact, $\Delta \frac{K}{Q}$ reduces reinv. (for given K)
   Again, p. 411

Sources of K Flow: R, S, ΔM, and F. (F = Foreign inv.)

In open ec. F is unstable, too.

14-2. Gordon uses e.g. of one firm (an open ec.) + goes from that to generalize to whole closed ec., p. 400, 14-3.

Actually, prodn. of hand K varies for 3 reasons:

1. Replmt. is small part of stock,
2. Very sensitive to Δi
3. Replmt. is deferrable

$V = (1+i)^{-n}$

$$\frac{\frac{dV}{di}}{V} = \frac{d \ln\left[(1+i)^{-n}\right]}{di} = -n \frac{d(1+i)}{di} = -n$$

$$\frac{dV}{V} = di \cdot (-n)$$

di is very small, of course; the unit is $\frac{1}{100}$

$$\frac{d}{dx} X^a = a X^{a-1}$$

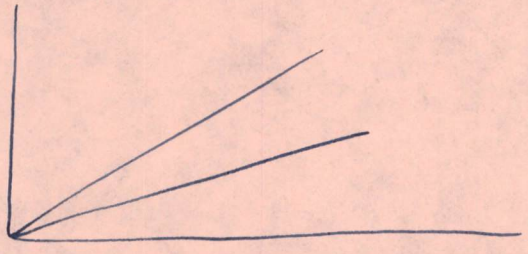
$$\frac{\frac{dV}{di}}{V} = \frac{-n(1+i)^{-n-1}}{(1+i)^{-n}} = -n(1+i)^{-1} = \frac{-n}{1+i}$$

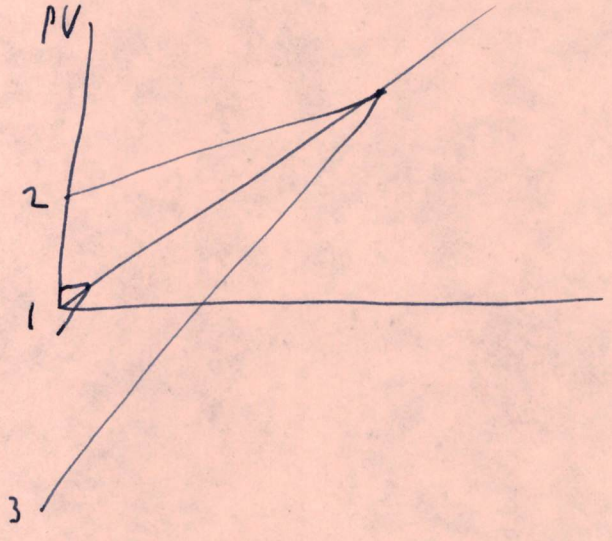
$$\frac{d}{di}(1+i)^{-n} = -n(1+i)^{-n-1}$$

$$\frac{d}{di} e^{ni} = ?$$

Work it out.

$$\ln e^{ni} = ni \cdot \frac{d(ni)}{di} = n$$





3d way of exposition: Then cost of K = i + depn.

Hard K, i = 95% n

Soft K, i = 5% n

Hand K is useful, a vera. of great capacity for absorbing large K flows; + giving back when needed. Problem comes when can't recover it when needed

---

Desired $K/Q \equiv v^*$. 14-5 recognizes this too, can change. p. 405, he wants to raise it.

p. 407. Burst of invt. demand caused by lower i is temporary. (This is how he generates bogeys of instability)

Fails to note, Δ invt. demand caused by higher Tomorrow is permanent.

---

p. 405. Useful ~~concept~~ of "user cost" $\lambda = i + \text{deprecn.}$ of capl.

---

p. 408 attributes Depression to drop in desired K/Q, while inherited K remained fixed.

I say rather, an acute crisis shortage of cap. flow caused high i. This devalued K stock. Net invt. dropped bec. there was nothing to invest, no flow of capl. supply.

p. 412. "Paradox".

+ hist. correlation between "bus. invt." + i.r.

This suggests:

a) Mstmt. bias, e.g. leaving out housing + munic. bonds from invt.

b) Demand changes more than supply.

c) Cum. swings dominate.

d) Hi i choker off invt. (necy. to happen bcs. sources are slower.) then lags on downswing.

e) Mstmt. bias on i -- choosing wrong one, e.g.

Gordon concludes: invt. is unstable, activism is ∴ justified.

Ec. 100B. Thurs. Nov. 29. Last day.

Ch. 16, Fed. Res. Monetary Control.

A	L
Cash	Dep.
Inv.	Equity

~~Ex~~ ~~One bank can expand~~

1. Intuitive. Create deps. by depositing.

2. Counter-intuitive: Bank creates dep. by lending

3. Expansion + limits

a. One bank can expand indef., if many. Until all cash goes out of system.

b. One of many banks can expand little, bcs. called on to pay cash.

(Do. for one country, if on gold standard. We took liberty of devaluing $, in effect repudiating.)

c. Banks expanding in concert can do what one cannot.

~~They might go~~

All the concert needs is a conductor.

- General Δ inv. opps.
- " release of brakes

d. Limits are:
Cash for reserves
Res. requirts.

e. What is cash, how controlled?
Cash used to be gold, "specie".
Gradually, came to be F.R. notes + deposits

p. 453

F.R.

A	L
Gold	Notes
Secs.	Deposits

Pvt. Banks

A	L
Cash	Deposits
Loans + Invts.	

a. Cash control 1: Rediscount.
Change the rate.

2: O.M.P. Fed. buy Tsy. secs, new or used.
No limit. Its deposits never cashed - not since we went off gold standard

This is monetizing debt. Tsy. pays int. to Fed, enormous income. Tax free. Not too clear what happens to all that. Bankers are very powerful.

(NAREB, NAHB, up to MBA, ABA ... ABA says, OK to pump in into r.e., but you have to use our pump.)

f. Control of res. ratio
Fed. has none, can run wild
Fed. has control of members.

g. Hist. sections are useful, will be covered.

Summary: Have looked at state of the art. In bad shape.
Bottleneck today is supply of funds.
Is it by removing instit. bias vs. soft capl. + labor.

Why it takes a long time for a credit crunch to self-correct.

1. Hi $\dot{i}$ do not salvage frozen K

2. Hi $\dot{i}$ prevent completion of salvage of unfinished K.

3. Hi $\dot{i}$ tap cash flows, reducing cap. recovery by taking cash flow for int. income.
   Int. has first crack at c.f.
   Good e.g. is a corp. heavy w. short debt. Its int. cost quickly rises, reducing surplus which cd. have retired debt, or been reinvested.
   But DCF value falls, so int. shd. be reduced for that.

4. Cap. values fall, esp. durables.
   This wipes out this remit of K. It was misinvested; suffers a kind of obsolescence: "interest obsolescence".

3 + 4 are alternative perceptions of the same effect. In 4, we recognize the wipe-out immediately. In 3, we keep up K values, & reduce recovery rates.

Some Robinson types will scoff, there is as much physical K as ever. But ~~this~~ even J.R. probably recognizes obsolescence in other contexts, when demands change.

5. Slower sales, slow recovery rates.

Another kind of obsolescence is local. Hi i reduce this, by reducing challenger values.

b, how do hi i conserve K?

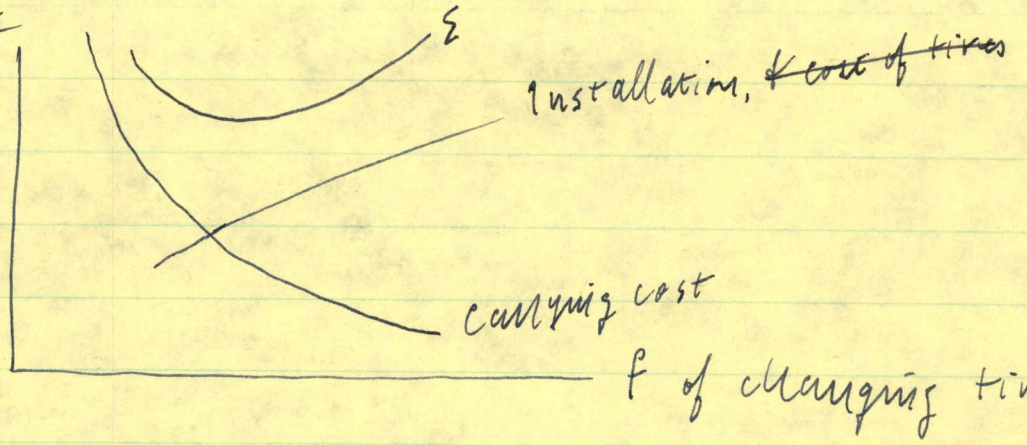
1. Defer replmt.
   Reduce local. obsolescence.
2. Reduce sub. of K for labor
3. advance ~~playback~~ speed ~~obsolescence~~ of new K; plans for fast playback
4. Use K longer hrs, seasons, etc.
5. More men / shifts
   " dwellers / s.f. etc.
6. Salvage going K, reduce inventories

Back to PIPO

1. Expensing.

2. Feinstman

Fig. 1



CC falls w. $ bcs. tire costs less; payback is quicker.
Thin tread makes tire lighter, smaller -- less energy.

Vent. int. model made simul. in 3 ways.

1. View entire process at once as on going.
Water moving down a river; gas thru a pipe.
~~The~~ Applying this to life of tire is strained.

2. Stagger. This requires many tires.

3. Sum up at end of life, all CC. ~~This is~~

4. Annualize. This is what CC means in Fig. 1.
Finance charges, annual basis. Smoothed out.
They are actually higher at first, & drop as you pay off tire.

Fig. 2

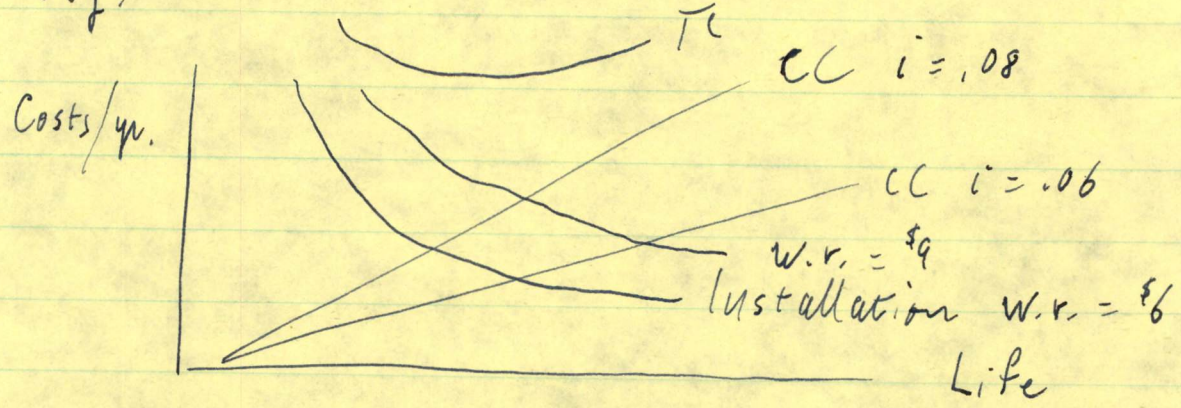


Fig. 1 + 2 are data over life.

W/in one life, there is a reverse effect. You can prolong life of old carcass by matte. But there are epicycle limits of short life.

a Real Multiplier. 6/13/85

"Accumulation ff. by liquidation"

1. Investors seek to ΔK by turning cash into goods: they hire labor; or sell less.

2 But labor buys more, so goods just move faster.

1A They might do it by selling less; or buying more.

a. But selling less means holding goods longer

b. Buying more means selling more? Not if the drive is correctly & fully described as turning M into K. To do that, must plan to hold K longer. (A 2nd choice is to Δvolume w/o changing turnover — but that wd. require more M xctions balanced)

c. So, what makes you want less M?

If higher i, that also makes you want hold less K

If antic. ΔP, makes you want hold more K.

1B If K-ist pays by "advancing subsistence", —

1. Then he knows he is using real K

2. But he is not advancing subs. in form of his own products. They must still be sold to other K-ists who will stock them. Their demands will depend on their having advanced subsistence to their workers. So it is no different than in a money economy.

3. Either way, if K-ists set out to ΔK they will not only buy more, but sell less. I.e. they will hold longer. (Even Δ inventory could be interp. that way.)

4. The magic of the Mult. is akin to the magic of Say; how? Inv. makes people supply more, and Δ income makes them consume ~~what~~ the Δ prodn.

Both are optimistic. This is why Keynes put down Say so hard + often – they were too much alike.

5. The problem is, ~~Th~~ Keynes et al. have the driving force be the incentive to <u>invest</u>, rather than to flow thru, Δ volume. It is a half truth, bec. ~~you can~~ to invest is to accum. K, and you can do so by selling less, holding longer.

They made it sound as tho K-ists were surprised by "involuntary" investment in Δ inv. But in good K-ists ~~they~~ <u>choose</u>, they know what they are doing.

∴ to Δ empl. we must Δ incentive to Δ prodn. <u>volume</u> -- not ≡ incentive to invest.

Macro

1. Policy of flex. i will cause great churning, rioting + scrambling for a while, bcs. people are not used to it.

2. Short rates will move more than long, bcs. when i is high, temporarily, then:
   Borrowers will wait for rate to fall
   Lenders will lend short, for high rate.

   This will happen very fast, shifting capl. flows into short maturities.

   E.g. Nov. '79 prime is 15½%, mortgages at 13½%.

✓ 3. l.r. is det. not mainly by M, but by flow of loanable + investable funds.

   This flow comes from capl. recovery, + ΔM + voluntary savings. Not det. by stock of capl. but flow, i.e. stock × T.

   Thus, we can have a large stock of capl. but a small flow, a small supply of investable funds.

4. ΔM by itself shd. it lower i. If ΔM were dist. as a social dividend; or as a wage bonus; it wd. Δ cons. as much

as or more than S.

ΔM lowers i only bec. the injection comes via bank loans. This temporarily Δ loanable funds. Thus people can consume less, but get more for working.

5. A big problem w. Fed. turning off credit (by Δ res. req. + selling secs. + Δ red. rate) is this: we don't know if the resulting hi i is purely a monetary control measure, or a result of true capl. shortage. If the latter, it will last.

If Fed. had a stable, announced policy, then we could tell.

6. Open ecs. make one more realistic.

If p. country's i drops, funds flow out, currency falls. Thus, a world cap. shortage constrains ea. country to let i rise.

7. ΔM by loans can also find way into C.
When $i < g + r$, where r is real int. rate, then people borrow to buy old assets. Sellers may consume as they cash out.
Thus, ΔM is not 100% an increase of investable funds flow.

5. (resumed)
a true cap. shortage will force Fed to raise i. SIF (supply of investable funds) falls below DIF at fixed i. To meet excess demand, banks ΔM. To slow ΔM, Fed. raises i.

✓

But flight from $ raises DIF. ~~lowers~~
But now distinguish loanable from investable funds.
Flight from $ Δ DLF; but not Δ DIF.
---?

Macros

Sequence of tchq. comp. int. and incentive to invest and payback time.

1. A. Compounding, discounting, PIPO

B. $V = \frac{a}{i}$, Solve for i.

C. Reconcile A + B

2. Solve PIPO for $i = \left(\frac{E}{P}\right)^{\frac{1}{n}} - 1$

Main points to make, using comp. int.

1. IRR, PIPO and cash flow
   Determinants + sensitivity.
   Sales of capital vs. sales of service flow
   a. Speed of recovery
   b. R/K

Payback

2. Effect of rent and LV

3. To show slower payback caused by higher rent or i.e., must have i independent

$$IRR = a\frac{1 - I^{-n}}{P}$$

Here, the ass. is, that IRR > i are imputed to i, as income. This slows down payback, it remains

spread out over n yrs.

The other assm. is that, say $\frac{a}{P}$ rises, you get back P faster — and also have a residual asset at end of the payback yr, A_t.

Thus, a lot depends on imputation.

i) $\frac{a}{P}$ rises, i constant, u const. then P rises — an immediate gain in K stock.

But, (unfortunately), our income, will likely be consumed.

ii) L might rise and absorb the Δa
iii) i " " , higher IRR.

If i falls, K rises, ~~meaning~~ and this has a real meaning. More of c.f. will go as depreciation over life.

But when L rises, for same reason, there is no Δ in cap. recovery, it stays at 0. There is just a net loss.

Thus, lower i do more harm than good, on balance.

4. Δ rent devalues K, if a = const.

$$K + L_0 = a\frac{1 - I^{-n}}{i} + L_n I^{-n}$$

$$K = a\frac{1 - I^{-n}}{i} - L_0 + L_n I^{-n}$$

This uses bldg-rental method of separating $L + K$.

✓ 5. When the ec. needs more K, i rises, But this reduces K!

Proximate effect is offset by drop of L — maybe more than offset. But if L stays high or continues perversely then K is lost.

Drop of L is result of higher i. But a drops — esply for cap-intensive land uses.

6. K is like a gambler's stake. You keep rolling the dice. But when you lose, game's over.

4. (resumed) Do w. PIPO model

7. Effect of Δi, to make K be used better, turn fourth.

a. Inventory model

b. PIPO model, recover the corpus.

Note effect on rent, moderating the effect on recovery.

c. Flow model

i. Mobile K -- no site

ii. Real K -- affected by a

8. General: what dets. pd. of K.

a. PIPO

Combs. of inv. + rent.

- Pd. of betw. labor inputs is diff from land and K inputs.

Land input is steady

K input - what is it? E.g. of AFADC. K is wealth used to produce more wealth. All wealth is so used, even consumer capl. So capl is wealth.

Define K:

(3) Produced - rules out land

Yields services over time - has a pd. of life

Wears out or is consumed

8, a, (cont.)

(4) Incorporates services of factors rendered earlier.
Receives return ex post – bears risk.
Carries products of other factors during lag betw. produ. + cons.
Is advanced to ~~other~~ earlier factors in form of consumable goods up front.

~~(1)~~ K begins w. fact of lag betw. cons. + produ.
K. is the thing of value produced but not yet consumed.

~~(2)~~ K has intrinsic value. Rules out ~~things~~ reps. of capl. or claims on K: securities, money.
Rules out privileges over other people: credits, in personam relations.

What is K?

1. Goods produced but not yet consumed.
Begins w. lag betw. produ. + cons.

2. Has intrinsic value. Rules out paper claims, and in personam relations.

3. Is produced, + wears out. or is used up. Rules out land.

4. Incorporates services of earlier factor inputs, rendered earlier; delivers them for use later (+ perhaps elsewhere).

5. Someone has to defer potential consumption during lag period between incorp. of services + delivery of value.

6. K normally delivers more value than was

originally put in, thus justifying & compensating for the lag.

7. Is continually destroyed & reproduced, a process of "circulation", or Turnover.

8. Has a period of lag which can be calculated exactly, and is (by Landes, esply.)

9. Circn. involves delivery of ripe K to consumn, in return for current services ("advancing subsistence").

10. Return to K is the last to be disclosed in time, hence residual. & Bears risk.

11. Personal distribn. is another matter. Functional distribn. deals not w. who gets pd, but for what functional inputs people get pd.

12. One capitlst. may take interest — another participate. There is no common, unambiguous name for the pure net return on participating. "Profit" includes o.c. of contributed equity inputs, including land & labor, as well as K. "Pure profit" is a good name for return to K above standard o.c. of contributed equity inputs, or "participants."

13. All K is ultimately fungible, when reproduced. But never convertible into land.

14. People have some capital-like characteristics, but importt. diffs:

a. Inputs contribd by parents, repaid to children — the investor is not usually the proximate beneficiary

b. Cupl. is commingled w. the individ.

14, b, (cont.)

prefs. + feelings + genes, has no standard rate of return. Human capl. idea is pure environmentalism. (They wd. say heredity is rent, env. gets interest.)

c. Return depends on individ. response.

d. Environment includes all life + not just paid-up edn.

e. Social benefits > pvt. ones.

f. Humans own themselves; K is owned by ~~humans~~, humans. With ~~K~~ labor, the resource owner is the resource.

g. Labor is more universal. Everyone can labor. Only some own K. The structure of wage rates moves up + down together, so everyone has an interest in labor as a group.

h.