§3: Def. of "capital".
Turnover
Real mng of mon. phen.

Excellent notes.
→over

Lange, "Price Flexibility and Employment".

The "partial equilibrium" theory is what we all know, supply and demand curves, etc. "General equilibrium" is when we bring in all the variables, especially the circular, and "round and round she goes, and where she stops nobody knows". Now granted that they have a small point there, that reduction of factor demands may lower V temporarily, ~~obviously~~ by even more than the prices are reduced, obviously the general effect of reducing prices is to reduce the cash balances people wish to hold and thereby increase velocity, because nothing has occurred to change the amount of goods over which people wish to have command with cash. Even if V did decrease slightly owing to reduction of factor prices, it still might not decrease in as much a proportion as the prices decreased, hence more production would occur, money demand would be more adequate. ~~If~~ Of course the lowering of prices at very first is going to tend to increase V. Even if demand for the factor is inelastic so that the reduction reduces the total spent for the factor, that does not mean the difference will lie idle. It will rather be spent for other things, so V not reduced. He also emphasizes disemployment of substitutive factors, never mentioning re-employment of complementary factors. He makes it seem very likely that reducing factor price will reduce V by a greater ratio, so that factor price can never be reduced fast enough to even increase the employment of the factor! He thinks it plausible that this may continue until factor price has been reduced to almost nothing, that meantime demand will keep declining faster! Obviously there are narrow limits to the possible increase in hoarding money, and as factors lower their demands in money they will quickly find money demand forthcoming.

There is another question, of lowering demands in terms of real goods. Lowering money demands of course accomplishes this. Another way of lookin at it is in terms of real goods. As factors lower their money demands they will soon be lowering them faster than prices go down, i.e. they will be reducing their demands in terms of real goods. Lange is saying it is impossible in some situations for a factor group to lower its demands of real goods, obviously absurd.

In many such theories, such as Larsen's, if not in Lange's, is the idea that money is actually created when factors are paid, and destroyed when products are bought. Lange manages to arrive at conclusions that are also reached by this more absurd reasoning with his more refined nonsense.

"Substitution of money for goods and v.v." is one of Lange's main concepts. He seems to think that when the economic group he is thinking of decides to get rid of money then somehow the entire economy is rid of money. Obviously it is an individual matter, the whole econ my cannot change its money holdings, and the desire to do so is refl cted in V.

When price of one factor falls, either more money goes into it afterwards or less, (or the same). If more, maybe it is drawn from idle, maybe from what would have been spent for other factors. If less, maybe balance is idle, maybe goes for other factors. This is indeterminate. What you can say, that is important and invariable, is that when all factor prices fall then it becomes possible for the current money supply to pay them all what theydemand with no change of V. ~~More fundamentally,~~ they must fall more than prices of goods products, ~~so that~~

From entrep. nw

- Also, they ~~will~~ may be reducing their demands of real goods, which evidently somehow got higher than their mps. There is no need to worry that such a reduction will mean they will not be able to take goods off the market, for, obviously, if they are demanding more than their mps now, it means they are demanding more money than is needed to take their products off the market, and reduction means simply getting back to the equilibrium situation. They got in the habit of getting more ~~than enough to take their goods off the market~~ when speculation in intermediate products was rewarding them, and investment inspired by rising land values. When the opposite situations prevail, they must accept less ~~than enough to take their goods off the market,~~ usually, to make employment profitable for intermediaries. The opposite situation will only prevail in product speculation, probly, not land.

Lowering prices is just like increasing M without raising prices, i.e. it increases ~~hold of~~ command of real goods by M, which amounts in either case to a further extension of credit. The ΔM method is in many ways better than the $-\Delta P$. - but it obscures fact that fall in demand in real goods required.

Money's role not quite neutral. ~~Lower~~ Higher hps demands are first money demands, (within limits of constant costs production may vary much just by changing pp attributed to M supply - by ΔM or $-\Delta P$) & limits of M supply are first to be met. The higher hps can't be met because M is lacking - - - .. then?

The factors can get used to getting more than enough money to take their goods off market when the "circle of investment" is working. They get money rewards, and some of them don't spend these for products, but land. (if spent for investment, is it different, inv. in products?) At least they spend it to reward factors, being secured by rising l.v.

Factors can't get "more than enough to take their products off market", unless prices drop between time of payment and time products are to be bought. But there is no definite amount of money required to take products off the market. There is a definite amount required to take them off at a profit, once they have been bought from factors,. But if a fall is anticipated then intermediaries will pay factors less, and won't lose. And the price fall will stop when lower prices makes people be holding more cash than they want to.

So you can't say anything makes factors get more than enough to take products off market. You can say that certain things make them get higher money rewards, tho not real rewards, than otherwise. Production of capital, e.g., which results in factor rewards that are not met by consumer goods, raises prices of consumer goods---but it won't even do that if the capital is bought from old money, and v isn't increased by its production. Only if M or V increases will it increasemoney prices of products and factors.

So about all you can say is that factors get used to higher V and M, not that they get used to receiving more money rewards than would take their products off market. When factors do refrain from spending their m for cons and invest it instead, they are merely buying a different kind of product. What happens when they stop investing is just that V decreases, they hold that m longer before spending it for something. Spending by investing does differ, tho, in that you lend it to someone else to really spend. The circle of confusion comes in when you are working to get back your own money which you have loaned to the buyor, thinking you're getting a good deal when really he isn't going to be able to repay you but you are fooled into thinking he is by rising lv. Factors become adjusted to higher m prices than they could otherwise get,when they are investing heavily. But they aren't then or any other time getting too much or not enough to take their products off the market, for their products have no fixed price. Of course maybe you could say sometimes they are getting more than enough to buy their products at cost---that would only be when they are borrowing new m. Sometimes they are not getting enough to buy their products at cost, because before they can spend the m for products they must repay banks.

Investment increases v, probably, but at the same time it definitely decreases mp2 (I have come to see that it may be wise to divide mp2 into two components, the money gotten for the product, and the goods gotten for the money. Esp. in dealing with money questions) by raising prices more than it raises factor rewards---well, in terms of real goods it means the same current rewards spread over more factors, so factor rewards are reduced. In price terms, this will mean factor rewards won't rise as much as prices. But the factor reward that is a claim on the capital being produced has to be considered of some significance. We can say that factors are consuming less, because more factors, or the same factors working harder, are producing fewer consumption goods. --or some variant of that. But the claim on future products is

certainly part of the "reward" of a factor---I must be careful in using the word. Those factors who spend everything they earn will be getting as much current rewards as before, only those factors who save will be getting less current rewards, and they'll be getting as much total rewards. So the decline of mp2 is not a fact, and production won't be discouraged at all by that. The fact that factors are going to save their rewards after they get them doesn't mean they'll work any less hard to get them.

At the same time investmentopens up new opportunities that increase labor's mp. I don't refer to its complementary effect, which is important, but its allowing wealth to be produced on previously idle land. At least to be placed there. When a plant is built, factors are paid in parts of the plant.They can produce plant segments of much greater value, psychologically at least, than they could produce consumer goods. Their productivity is thereby enhanced. New land has be be used to put the plant on, or old land used more intensively. Investment has put that land to use. Of course any sort of expenditure might have put it to use, ---tho no, for a permanent improvement must be put onit to put it to use, sometimes. (anyway an important aspect of this is that any inflationwill put new land into use. But that's not all)---- Investment of course after it matures increases mps. But I mean in the process of creation,factors build a product of more value (maybe) than they would have if money had not been diverted from consumption to investment.

When factors first lower demands in money, it will be a lowering of demand in real goods, too. But maybe prices will fall just as fast. Will it then do any good? Sure, it means the money being spent will employ more factors, and that more money will be spent.(When factor prices are reduced ~~n/p1/p/1y~~,the same m exp. will hire more of them. So a"positive money effect"not necess? What is a pos. money effect? Lange defines it as when lower prices make community "substitute goods for money". This is meaningless as put, but evidently he refers to "consumers", whether the fall of prices will make them spend more. Now actually the fall in factor demands will increase production unless it is accompanied by a decline in money demand greater than the fall of factor prices. Actually it will be probably accompanied by an increase in total money demand.) (inelasticity and friction and insensitivity are favorite weapons of those who want to make all economic a alysis based on reason seem useless and prove any point they want to).

Money prices can keep falling as long as factors will reduce their money demands, and this will mean not that factors are reducing their demands in real goods, but they are producing more. Clearly if prices fall, and my doesn't change, more is being produced.--and this with no change in factor holdout prices in terms of real goods. But is it possible? As productionincreases mp falls, and factors must accept lower returns in real goods. Their rewards must fall more than prices, of goods. (which means, incidentally, that mr must fall). Each time you lower price you are extending so much more credit to those who hold M, increasing their money s value. Thus for that reason each time you reduce prices you have to produce so much more to make up the increase in money's value. You must also keep on at the higher level of production afterwards, to keep prices down. Aside from the product that goes to money holders as prices fall, increased product goes to factors who do more work. Were it not for physical dim returns factors could just keep on working more and more and getting more and more for it. But actually they must lower their rewards more than prices fall to increase production.

permanently
So it is impossibleto increase production/by lowering ~~prices~~ factor demands the same amount as prices. In fact it is impossible to do it at all. If factor demands are lowered so more are hired, prices won't fall quite so much, because of dim ret.

But if factors are not in dim returns but just don't know it, then if they decrease money demands production will increase and prices will fall as much as demands did, and they can increase production without decreasing real rewards, just by decreasing money rewards.

The reason, in usual situation, that they can produce more, is not because they've lowered their money,but their real, rewards. Or let's say that if they lower their money rewards it is inevitable that their real rewards be lowered as mp falls, as production increases, as it must when they lower money rewards.

When factors demand more than what their mp is expected to sell for, both concepts in money, they are unemployable.

(Interjection: when you talk about locating an industry in a city you often get to a situation where the plant can only find one or two good sites in an entire city like Portland, and one of them may be zoned for another use. So many things conspire to keep land idle!)

Leigh thinks entrepreneur's decisions are most important. I say they are just a part of whole picture. Entrepr. is intermediary between factors and consumers. He gives his offer to each, which is really the offer of each to each, and they give their offers to him. When they meet, production occurs. In his intermediary functionhe has no determinant effect, he is merely the agent thru which others express their wishes. As a factor himself, he is the same as the others. He has a central position, but not a determinant one. Leigh emphasizes his psychology. It is his anticipations of what consumers will offer that determine his offers to factors, of course, and his psychology comes in there. But that is not a very large effect---tho circularist could make it into one.

Back to Lange: his idea of "the monetary effect" is fuddled. He says if effect is neutral, and I judge he means by this that as result of lower prices no more money demand is forthcoming, result is to lower all prices but with no effect. Actually I say it would increase the flow of ~~products~~, as the same money demands lower priced products; this would increase production, lower mps, etc. Only in that very unlikely situation inwhich lower prices decreased money flow by more than prop. to price drop would production be stopped by price fall, and this could not continue if factor prices continued to drop. Only friction would make it occur once, and a strangefriction at that. Reduced v mainly. It would be natural for factor rewards to fall in such a situation, since lower prices prevail---just the same as when lower prices are the first variable, and fall of factor prices is effect.

Chap 4, analysis of the monetary effect.

He correctly says that falling prices reduce desire to hold cash. But he has some idea of the "excess" demand for cash balances. which is affected by changes in amount of m as prices change.

(cont. from back of p.1)---With constant costs, the volume of production would be adjusted by money demands of factors. So if they demanded more, fewer would be hired (perhaps more and perhaps less total money would be forthcoming to hire them). Due to the

constant costs the prices of their products would rise just as much as factor hps, so their real rewards wouldn't increase, basically because their mp hasn't changed. (this is isolating the money effect) Hence their higher money hps result in a changing of the volume of production, not in mps. The money evaluation, per se, then, is a way of regulating volume of production. When factors demand more money, they are saying they want to work less and/or get more for their work units. With constant costs it simply means they want to work less.

Raising prices is a withdrawal of credit. It means less goods will be forwarded on basis of money. (note we must integrate this view of how money's value is affected with the cash balance view) It means the factors won't produce for promises so much, but insist on real goods. (thus ties in with lower desire for cash balances)(as prices rise, cash balances will be increased, which stops the rise; and v.v. This is what makes prices stable, stops all money spirals) Nothing in the process of change is very extra-important. As prices fall those who hold money will gain, but the important thing is that after they have fallen the total stock of credits is worth more, people are producing more. So a money equilibruim exists, determined by the desire to hold cash, i.e. to give liquidcredits. Prices will be raised whenver people want to extend less credit, b working less and also reducing their cash balances. etc---all refinements on what I've already said, with which I have no quarrel. Note there are two distinct equilbria, the money and the mp. Each can be figured independently, but they work together. When people are satisfied with their mps, they cease to raise or lower their money hps. If mp didn't change, people would alter their production as their mus altered. If mu rose, they would work more, prices would fall more than factor rewards---not more than factor rewards per unit of work----really prices and factor rewards would fall the same, people would be working more because mu had risen, this would determine the fluctuations in amount of work done. So money doesn't set the volume limit, either. It happens that when factors rise hps then the given amount of money will employ fewer, less time; that people express their lower mu by, their refusal to work more, by making the stock of money command less work; or that in refusing to work more they make the money stock command less work---that is an incidental effect, not an integral part. The main thing is they want:a, to get more for what they do, b, to do less. They will work less until mp and mu rise. In the process money becomes worth less. When the money stock does become worth less it cannot be the proximate cause of the employment of so many factors so long as before. At the same time that money is being adjusted in this way, it also must satisfy the desires of people to hold money. But there is no conflict. --well, there is too. If liquidity preference remains constant and mu falls, then as prices rise people will have to try to hold more and more money to keep the same liquidity, v decreases, preventing the rise of prices. But at the same time it prevents price rise, it makes it to that extent unecessary, because it reduces money demand. So the two interact without conflicting. The ~~ffffc~~ desire of the factors to be less sensitive to the call of money is effected in two ways: reduction in command of money over them, and reduction in use of what command the money has. Similarly if the desire to be liquid fell, that desire could be satisfied by rising prices, at thesame time the constant desire of factors to be subject to money's command in each time period is kept by the rise of V and fall of money's value just compensating.

Money is a limitor then in this sense only: there is so much you will do for the constant (in this hypothesis) am't of goods you will get in return for each unit of work, money is the proximate incentive for doing it, so by limiting the command the money has over you you limit the amount you will do. If there were no money, something else would be the limit---the next step, the amount of goods you get for your work. They limit you in the sense that you won't work for less than a certain amount of them, and only a certain amount is to be had. It is the measure of the limit you put on yourself, not the limit itself. It is the measure and the proximate implementation.

Money creation by private system also works in with the scheme. When hps fall, M may be created to take advantage of the new opportunity. 3 things work together here to produce the desired result: ΔV, ΔM, & $-\Delta P$. As each of the 3 does the same thing, one tends to think of them as preventing each other from operating. - of lower prices as preventing ΔM. But as there is a 4th factor, lower hps, which determines them all, they all change together at once. - in this hypothetical situation.

So vigorous is the ΔM & ΔV reaction to lower factor prices that oftimes they will cause prices to rise when factor hps fall. A mass psychology proposition.

But if further fall anticipated, (tho this can only in thin limits in ~~only~~ any situation counteract tendency of lower price to increase total money demand & thus doubly increase production) a fall will not increase production? Well, only if the original fall causes anticip- ~~a fall~~ ation of fall. - it may often be anticipated anyway.

Bond prices must vary inv. with others, assuming k mr

I mean they won't change as others change. Not the prices of bonds already issued, i.e. The reason of course is because a bond is not a claim to goods, but to money. So, just as a dollar's money price doesn't change, neither does a bonds'.

People save two ways, or there are two poles of the saving methods, liquid and unliquid. Either method constitutes an increase in the goods offered for loan, and therefore reduces mr. If one saves by lending his m out (not as opposed to hoarding it, but as opposed to not getting it for real goods in the first place), that is if one parts with real goods and then lends out the money so obtained, he is lending those real goods to the market, the money he lends out will buy the goods he put on the market, he isn't affecting prices at all, the stock of money will command

the same amount of goods, but part of the demand to borrow has been met. If he saves by being more liquid, i.e. he gives real goods to market and saves the money proceeds, he increases the command of money over goods, and thus increases the real liquidity being offered for hire in money market by a, increasing value of nominal money now for hire, b, making people want to reduce their nominal liquidity, thus increasing money for hire. So any method of saving lowers mr, supply price of capital.

Interest is paid for both goods and liquid claims on goods and the things that produce goods. It is, then, the price paid for the use of money, not capital. Anything that increases effective suppl of money will lower mr then, without necessarily increasing supply of capital goods. Tho it increases them inthe sense that what may be had by money, which is the effective supply of capital , is increased. If with money you can get labor services at your disposal with no return in real goods, that is more capital in a sense. When labor and land lower their reward demands, they increase this effective supply of capital, by increasing value of given am't money, and thus reduce demands of capital necessarily. Capital is, in this sense, not distinct from land and labor. The amount that land and labor standr eady to produce on demand, i.e. for the money supply, is capital in the sense that it affects the mr (and ir?) as much as solid capital."Surplus" was my previous concept for this. Interest is paid for use of a surplus, which may be just a surplus of claims on factors, not on real goods. Thus an unliquid claim on labor to work is a surplus. It is not as good as a liquid claim, and is even less good if it is for a particular product. In those cases the claim would not be worth as much as the labor product itself because you would have to wait for the product, and thus it would not bear quite as much interest as otherwise. (would it bear any?) A liquid claim is as valuable, to the market, as the good itself, over the waiting period, because of the advantage of being liquid. The advantage of being liquid is just as valuable to the market as the advantage of having goods, because if liquidity were more advantageous people would hold onto money longer and borrow more money without spending it for goods, etc. It is not true that interest is paid for liquidity alone, that is only one of many things, and ~~ppppppp~~ as intermediary the most important proximate thing. (the unliquid claim would bear interest if the goodscould be obtained before the thing had to be paid off, etc)

The ir is something else again, the return for the use of real capital. Of course we might define it as the return for the use of money in production. Let's define ir as return for use of real products, rm as return on use of money. (them certain sections back a ways where I discussed ir as demand and mr as supply must have rm substituted for ir) If ir exceeds rm and hence mr, it will be profitable to produce real capital. But how can ir exceed rm, when ir is part of the opportunities for getting a return on money? It can't. But what can happen, and what I'm trying to express, is that opportunities for getting returns on money may be hire if the money is used to produce real capital than if used to buy oldcapital or land or claims(the only alternatives) or to buy services(an alternative)then money will be so used. I had thought this might be of some significance, but I don't think it is, except in regard to the use for buying land and old capital, already well developed. The service-capital distinction is of little use.

(you can't speak of ir in regard to old capital, for its reproduction cost under its yield must be the basis, and so you might just as well speak of the return on new capital)

So let's define rm as return for money, counterpart of mr. And ir as return for money when used to buy products or other use in production, as being liquid. But when used to speculate in land or money, these are not ir uses.

Back to Lange: and the bond prices. As factor prices fall, mr falls, because money commands more. Bond prices will rise therefore, not just stay constant, in money terms. As their liquid funds command more goods, people will try to get rid of them, increaseing v, increasing effective m. But as mr falls, they will keep more of their savings in liquid form, so their desire to get rid of money will not be as great as it otherwise would be. They'll want to get rid of some savings, to save less, in money, but their liquid savings will not go as soon as their unliquid ones, due to the lower mr. If this went so far as to mean that the fall in factor prices hadn't resulted in any increase in effective m supply, i.e. that lower mr had increased cash balances so as to overcompensate for increased value of money, (if that's possible), then factor prices would just drop some more until effective money was increased, that's all.

In other words, people have not just a constant desire for savings in liquid form, but in all forms. (not necessarily constant, but at least the desire for liquid savings is not utterly independent) Of course when factor prices fall not all of what they regard as their savings will increase its command over goods. All their savings which are ownership of factors and goods, will rather fall in their command over other goods. We may assume that the general desire of factors to have goods and claims on them has increased, because they have lowered their hps. Anyway, we can't say that the increase in ~~holdings~~ -----they will want to hold fewer claims to money, and a higher % of their claims to money in liquid form, after the change. But what of their claims to goods? --wait, it is not sure but what a fall of mr will make them want to hold a higher ratio as unliquid, due to perverse elasticity, but that is only possible if an unstable equilibruim preceded the change, in general is impossible. --- Their claims to goods will command less money than before, probably thesame amount of goods---undoubtedly the same amount of goods, in general.As they want to increase their claims to goods, and/or their current consumption, as shown by their reducing their hps, they will probably not want to reduce their claims to goods, i.e. probably the reduction won't be entirely because they want more consumption and want it so much they will be also willing to reduce their claims to goods, but will be because they want to increase both.--tho the other is possible, in circumstances. Their claims to goods will bring less interest than before, however. So they will be inclined to reduce them, also, and keep more assets as liquid.

Conclusion: reduced factor demands mean people will want to decrease their total claims to money (nominal money), (but also their desire to hold total claims to goods and money will increase by the same force that made hps fall, desire to have more), they will, due to lower mr, hold a higher ratio of their assets as liquid. The lower factor prices mean a greater desire to lend, as well as to consume. So the lower mr isn't an original cause which will reduce lending below what it was before, but is the result of increased supply of loans. In money terms, total effect is to increase total assets people wish to hold, and increase the % they wish to hold liquidly. So? Lower mr results from increased desire to lend, does it then reflect

back and determine the type of lending, its allocation between liquid and unliquid? Well, an increased desire to lend, if not discriminate between liquid and unliquid, will result in a situation in which liquid lending is more advantageous than before, and more lending will be of that kind.

maybe have to resort to this

Further variants are possible in considering what if the lower hps meant just increased desire to consume, even if to the point of reducing total assets held. And if it were just increased desire to hold assets, even to the point of reducing consumptio . Generally neither of these extremes will occur, tho.

So: lower hps mean that total holdings of assets will be increased, and that a higher % of them will be liquid. On other hand, as to nominal m, a smaller am't will do the same work, so the result may be to reduce holdings of actual money. --I mean, to reduce desire to hold in actual money. Then, of course, the v must increase and prices rise until this has been accomplished.

My argument that total asset holdings will want to be increased thus is in favor of the argument that maybe result of falling hps is to reduce v. Except that it wouldn't be the result of falling hps, but the result of the same thing that made hp fall, namely desire to hold more assets. Result of falling hp alone is to make people want to hold less nominal money.--it is really result of falling hp, not of desire to hold more assets, the fall in mr.

When hps fall, money prices will rise because people will increase v until their cash balances command no more goods than before. But it won't get to that point, because people do want their cash balances to command more goods than before, , probly. But it can't be they want them to command so much more that prices will not rise, because

If when hps fall people don't want to hold more liquid assets they will increase V so they won't hold more liquid assets. This means that money won't command more goods, so mr won't fall. (how can it help commanding more goods then?) When mr doesn't fall, there is no motive for decreasing the ratio of unliquid to liquid assets. But as soon as m does start to command more goods, then that lowers mr and makes people keep their assets more as liquid, which further increases command of m over goods, but-aha-doesn't lower mr further because despite the fact that total money now commands more goods, less goods are commanded by the money off ered for lending. The desire to increase the ratio of assets held liquidly

When hps first are lowered, increased dommand of m over goods won't lower mr unless the same am't of ~~money is offered for lending~~ money is offered for lending as before, i.e. a larger am't of goods.

When production has increased, obviously someone must keep more command over goods than before, because more are to be commanded. It is a quation of the form in which commandis to be kept, liquid or unliquid, or direct ownership.(assuming it is not all taken up by increased consumption, but even here there would be increased land values to own. Anyway, that is a 4th alternative, consuming.) Community must choose consuming, owning, liquid assets, unliquid claims on money,(or on goods? that is owning)

When money comes to command more goods, mr won't fall just for that reason, but only if people find themselves in result holding more liquid assets than they want to and they therefore increase the money they offer for loan. That will depress mr and prevent the movement from going further. But mr can't by falling make people want to hold more liquid assets than before, because it only falls in response to their desire to hold less, or the same. If, in response to increase of m's value, people chose to consume more or hold more liquid assets, i.e. to use their liquid assets for other than lending, then mr wouldn't fall. It is not the increase in money's pp that lowers mr, but increase in am't of m offered for loan. Hence the fall of mr cannot reduce the am't of command over goods offered for loan, because it is not independent. So fall of mr cannot increase liquidity preference so much that result of falling hps is to reduce total command over goods used to buy goods.

So: hp falls, and in result v increases, because people are holding more cash than they wish. But with the fall of hp goes an increased desire to hold cash, as well as other assets, so that after v has increased cash still commands more goods than before, probably, but, if desires are such, not necessarily. Besides increased desire to hold cash is to hold assets unliquid, so that the same M will be offered for loan, and even more probably, since with richness the % of liquid assets to be held will decline, and in result mr will fall. (Note mr falls as result of desire to hold less liquid assets, and cannot therefore cause people to hold more) So result is that people will hold less % as liquid, tho more absolute am't.(still, mr would fall if they offered more absolute on mkt, even if less %) The reason people hold less % as liquid is that they will be richer. Of course if they took up all the increased production in consumption, they probably would hold more % as liquid, in which case mr would not fall. But mr could fall in spite of their holding higher % as liquid, so long as they offered more absolute am't for lending. In any event, the lower mr would not cause less to be loaned, because it is itself result of more lending. It stops the increase true, but the end result is a situation of more lending. It is possible, then, tho improbably, that the % of liquid assets to unliquid would increase, and still mr would fall.

Should this bother me? Does it make it possible that lower hps could fail to encourage production? When factor hps fall, what factors can decrease the money offered for the factors' services? Lower i.r. seems to, but actually i.r. can only lower if more m is offered for factor services. If prices fall and so m has more command over goods, that won't lower mr until the money is put on the market, i.e. until "invested", until put in a position where it can be used to buy factor products. If it is just hoarded, mr won't fall, and so there's no incentive for hoarding. (what of the lag between putting money on market to be loaned, and spending it? Well, it can't lower mr just by being loaned and not used by borrowers, for, until it was used, opportunities for using it would still be as great) (except the liq. pref. opportunity, which is part of the demand for money. But that is satisfied even before the lending occurs, it is not the lending that changes it but the previous rise in money's value)

So nothing then overshadows the fact that when factor prices fall, people will find themselves with more cash balances than they want and will spend more rapidly.

Two aspects of falling hps should be investigated, by reductio ad extrema: where desire is to consume more, and to hold more assets.

Where to consume more, there are various degrees and categories of that. Maybe it is to consume not only the amount produced, extra, but old savings and income previously devoted to saving too. Etc. Well, in every case, money demand forfactors incréases as their hps fall, so not worth bothering with here.

Is there anything about reduced hps that could increase desire to hold money? Anticipation of future fall is irrelevant we décided. Changed income distribution? That won't occur of course until after the first expenditures with the lower hps, is irrelevant at first. Afterwards, it depends on the assumptions. If one factor lowers hp, then complementary factors will get more, substitutive less, and itself---who knows? In general the first period will be of elastic demand in money, for the reasons develo-ed, so general money expenditures will increase. Whatever factor lowers its demands will get more. Since the ones who lower will be in general the meedy ones, the ones with smallest surpluses, they will spend their money quicily. So the newdistributionwill encourage more spending, not less.

Back to bond prices: people will find when prices fall that their assets in money and claims to money are higher than they wish, as cf with their assets in goods owned, either as stocks or outright ownership. So they will xfer credits to those forms. Buying products outright means encouraging production; buying stocks doesn't, except that the stock sellers will undoubtedly spend proceeds for production or land. So the distinction of buying stocks or outright is unimportant, the old distinction of land or products is. This is a further thing encouraging spending of money when prices fall.

As bonds go up, people will find they hold more of their assets in this form, as claims on money, than they wish, and this will put a slight premium on stocks, limiting the rise of bonds.

The changes involved will require the use of some money, in the xfers of ownership.

Chap 5: Price expectations

Here and elsewhere he adds little, I guess.

Money, Investment,
& Employment.

INTRODUCTION

To meet the pressure of time this paper has been presented almost in outline form. Apology, elaboration, illustration and, I fear, clarification, have been neglected. If the paper seems unduly didactic, immodest, and unqualified, it has been to save time. Let me make all my apologies here in the introduction. My excuse for such a style is that, in my opinion, the things I would have to have left unsaid had been more conventional are of greater value than the things I did leave unsaid. I shall leave the paper now to speak for itself, and hope the reader will agree with me.

M. Mason Gaffney
Econ 235 B
12 May 1949

comment at end
HSE

INVESTMENT, MONEY, AND EMPLOYMENT

I. Investment and employment: the non-monetary relationship.

The denotations and connotations of the word "investment" in the writings of various economists are so varied that I hesitate to describe them. Suffice it to say I think they have tended to depart from a literal interpretation of the word, as well as from one another. Analyses of the effect of investment on employment are even more varied. Rather than criticize any one, therefore, I should like to submit a literal definition of "investment" and start anew. or, better, to receive as income.

"To invest" I shall define as "to produce more than one consumes in any time period". It can be immediately concluded that investment, so defined, bears no necessary relationship to employment. For if a person spends the equivalent of his income for durable consumer goods instead of perishable ones, he is investing in those durables, yet this investment has no effect on employment. Even if he invests in goods which he intends to resell, by refraining from consuming his real income, this will have no effect on employment until he actually does resell them. Until that time it is just as tho he consumed his real income. Whether a person invests, by taking his real income as a house; or consumes, by taking it as food; has no effect on employment. I mean, as cf. to cons. expenditure

There is another process, to which the term "investment" is often roughly applied, which is closely related to employment. This is the transfer of existing capital, usually consumer goods, from its owners to factors of production, in return for current services. This process I shall call "conversion" (because the existing capital is economically "converted" into the current product for which it is exchanged). No net creation of assets is involved, but simply a shift of assets from "converters" to "factors". Of course a net creation of assets is possible, if the factors do not consume all they receive, but this is an additional process of new investment on the part of the factors, not an integral part of the conversion process.

"Conversion" is the process most closely linked to employment. Most factors give their current services in return for existing capital. The amount of existing capital offered is practically the entire demand for the current services of factors. This process will command most of our attention in what follows.

The only services not "financed" from existing capital are, 1: Those reciprocated immediately by other services. This is obviously rare. 2: Those "financed" from current investment. This is sometimes considered to be as common as new investment itself, but I think if we are literal we will see it is rare. One who produces more than

Unclear, because I have not yet mentioned role of money. I.e., when barber takes m/o haircut, he is investing in it, the food, -- no net cap creation -- tho his wife may be simul. lowering his c.b., & that night he will consum

he consumes usually takes his pay in the regular way, and then "invests" it. But the literal investment occurred when he refrained from consuming his real income. The step of "investing" it, then, by paying it to currently productive factors, was, literally, a conversion of existing capital, and not new investment itself. The only time new investment can finance factor services is when the actual physical thing produced is taken, unconsumed, by the producing factors, as payment. In this case they are supplying the investment as well as the other services going into production. This sort of thing is not common in our society, altho by no means unknown. A farmer who builds a barn is financing his own labor, for example.

I don't know if I was aware at this time that by accepting S.C.B. labor incurs anew.

That "Consumption plus investment" equals payments for current services is not inconsistent with this. "Conversion" is subsumed in this formula. If consumption from existing capital should occur in excess of replacements to it, this would be disinvestment, and the total be reduced. Ordinarily "consumption" is assumed to cause a corresponding replacement at the other end of the pipeline, keeping capital constant. However it is dangerous to subsume an important process in definitions, for its workings may be obscured, as I think they have been by those who stress "consumption" as the basic motor of economic activity. I prefer, therefore, to speak of "conversion plus investment" as the source of current incomes; or, for convenience, simply "conversion", investment being a very small contributor to payments to factors.

The amount of conversion depends on the amount of capital, and the speed with which existing capital is "turned over". The amount of capital in existence changes but slowly; the speed of turnover is highly variable. It will be concerning variations in the latter that this paper is primarily addressed.

It might seem that the speed of turnover of capital is to a large extent determined by the nature of the capital, durable goods turning over slowly, perishables quickly. However money makes it possible to turn over durables quickly also, a point which will be discussed later, so for th s non-monetary analysis I shall just assume that all capital can be turned over at rates unaffected by physical limitations.

It is, to me, a most remarkable economic phenomenon that capital, simply by being turned over faster, can be more useful to society, even tho this represents no greater sacrifice of time preference on the part of capital owners. By converting their assets from one form into another they can make them complementary to other factors, while when they are not doing so, but simply holding them idle, they are keeping them virtually useless to society, at least for this purpose. Society can almost get something for nothing by increasing the speed of turnover of capital. What

this means in practical terms will be discussed later. Now I simply point to the possibility.

Changes in the rate of conversion are by no means the only variable affecting employment. Secularly they may be less important than some others. Cyclically however I think they are the most variable, hence some of the most striking changes in economic acitivity can be attributed to changes in the availability of capital for conversion. One should not forget, as I think many economists do, that capital, so used, is only one of many complementary factors of production. Changes in the availability of the others may have equally great effects. For the present paper they will be considered constant however.

The capital which is used to finance any given production is a factor of production which enters production under the guise of demand for the other factors. It is set off from other fac~~from them~~ as the thumb from the fingers: facing oppositely, but performing the same tasks, in cooperation. Variations in the supply of this factor of production, therefore, appear to other factors to be changes of demand. When more capital is available for conversion, "demand" for other factors appears to have risen, and vice versa. This gives the appearance of a general change in demand. It has been often said that general changes of demand would be impossible without money, and that with money the inequality of saving and investment makes general changes in demand possible. It seems to me there is a "real" basis, as well, for these seeming general changes in demand, which is a change in the supply of capital for conversion.

Poorly written sentences some words misplaced make meaning unclear -- many reforms not clear

In the case where the increased supply of capital is due to a willingness by converters to accept lower returns, the seeming general increase in demand is actually just a transfer, from capitalists ~~that~~ currently converting, to other factors. Hence if we consider the capitalists, too, there has been no general increase of demand, save as there is actually more production. The letter of Say's Law has not been violated in this case, therefore. The spirit of it probably has been, however.

The spirit is broken even more strikingly in the case where anticipated yields increase. Again, converters come forward and offer more capital to other factors in return for their current services. But in this case the converters are not doing so because of willingness to accept less residual return, but because of an expectation of getting more. Hence the increased payments to hired factors are not a transfer from the residuum of converters, but a net gain.

The letter of Say's Law is still complied with, however. Either the anticipations are correct, in which case the increased demand is simply increased productivity; or they are incorrect, in which case it is a transfer from the residuum of the converters.

Another way of looking at this same process is in terms of capital values, as Wicksell did. When anticipated yields rise, or the interest rate (as supply) falls, capital values rise. Capital being produced by factors of production, this increases their productivity in terms of short-lived goods, without reducing the productivity of producers of short-lived goods in terms of short lived goods. In simplest terms, it is as tho Robinson Crusoe decided that the durable goods he produced would yield more in the future than he had originally thought they would. All his labors would then be more productive in his own estimation. So it is with a society that decides its durable products will be more productive in the future.

This view of the process is hardly different from that originally presented, for to translate itself into action the higher estimation society places on durable goods must translate itself into increased conversion into durable goods. Owners of capital offer more to other factors for their services, and all factors create more capital to convert into durables. This amounts to an increased demand for hired factors.

Changes in the real rate of conversion, then, are a genuine phenomenon, in no way dependent on "the money illusion", by which overall changes in demand for hired factors can occur. Such changes will be initiated either by changes in the anticipated yields of capital, or the willingness to convert (the supply price of capital, or the interest rate). Employment theory should not, therefore, proceed on the assumption that changes in the spending of money are the only significant variables, or that constant price levels can assure stability. Changes in real conversion can occur despite the constancy of spending, or of prices. However it will be seen that constant spending combined with constant price levels usually is tantamount to constant conversion. This,is something that must be proved, not assumed. The relationship of monetary phenomena to real conversion will occupy the remainder of this paper.

Good

The real income of hired factors of production will equal the amount of conversion. This is quite another matter, however, from saying that the amount of employment is determined by the amount of conversion. If factors offer their services for smaller amounts, a given amount of conversion will hire more factors. What is more, lower prices of hired factors will increase the residuum available for [redacted] converters, and thereby call forth more conversion. There is no strict determination of employment, therefore, but only of real income. It is often assumed that factor prices are so rigid that whatever determines [redacted] income payments determines employment, but this assumption is just as

unrealistic as the opposite, that factor prices are completely flexible.*

To complete this sketch of the non-monetary relationships of conversion and employment, it should be noted that a large proportion of the capital available for conversion is not used to pay factors rendering services currently, but to buy other capital. A business must have raw materials as well as labor. Buying raw materials does not directly employ hired factors, since the raw materials already have been produced. The ~~larger amounts~~ more ~~of~~ capital *is* tied up in financing transactions between capitalists, the less remains to pay hired factors for their current services.

This has two important bearings on our subject: first, the amount of capital necessary to finance transactions among capitalists may change, thus affecting the amount available for conversion payments to hired factors, and thus affecting real income of hired factors; second, any given increase in capital available for conversion payments will be partly tapped off for financing transactions among capitalists, hence partly lost in effect on real incomes.

Henceforward I shall refer to payments of capital for any purpose "turnover"; and payments to hired factors in particular as "conversion".

So much for analysis in non-monetary terms. Perhaps I have already carried it too far, for the foregoing has been made more difficult by its discussion of phenomena which could not occur without money, in non-monetary terms. It was worth the effort, I think, to show that "general changes in demand" can occur independently from the "money illusion".

*The argument that lower factor prices will reduce velocity and thereby discourage as much as they encourage employment is neglected here, for it is a monetary argument.

II. The role of money

A. With fixed money supply

1. General turnover of capital

"Turnover", it will be recalled, is my general term, referring to payments of capital for any purpose. Without money, such payments would be barter. With money of intrinsic value, such as gold, barter is avoided. When gold is replaced by paper money a further advantage is achieved: capital in existence for other purposes can also serve as a medium of exchange, and it is not necessary to accumulate capital, in the form of gold, solely to serve as a medium of exchange. Money is simply a claim on goods in general that is widely acceptable, hence it is, really, turning the capital on which it is a claim into the medium of exchange. As that capital is also serving other purposes at the same time, it is doing double duty, and a great economy effected. Passage of money from firm to firm, then, is a transfer of a claim on capital. This is the process I have labeled "turnover".

Turnover might also be, and often is, financed by creating credit instruments especially for the occasion. This is a clumsy process however, compared to the simple passage of money. It is worth noting that every passage of money between two firms or persons is the equivalent of the net creation of that much new credit between them, and has the same overal economic significance: it finances a transaction; increases the liquidity of the seller; reduces the liquidity of the buyer. Money times its velocity, then, is an equivalent of credit creation of similar value. Increasing either money or its velocity is equivalent to increasing credit.(assuming prices constant)

No exchange between independent economic units can occur without barter, credit extension, or money transfer. In our society this consists primarily of money transfer. Hence the great significance of this phenomenon.

The amount of money, in this connection, has meaning only in reference to the real command it has over capital. The amount of turnover is not MV, but MV/P. It follows directly that increasing M or V or reducing P, cet. par., all increase turnover.

2. Conversion in particular

Conversion, which is particularly closely related to employment, is a form of turnover, and subject to almost everything said of turnover. A different velocity concept is necessary however. "C", or income velocity, represents the amount of spending in return for current factor services, and is appropriate here. It must be adjusted slightly however. The usual concept of C includes the residual incomes going

to converters as part of net income payments, but these payments must be excluded from the present use. Having adjusted C for this, MC/P is the amount of conversion, where P refers to the prices of things in which the hired factors are interested.

It follows that increases in MV need not always increase conversion and real incomes. Increased spending by consumers does not directly increase any net income if it is not matched by conversion expenditures by those who sold the goods to the consumers. Consumers might turn all their cash balances into goods and not increase net incomes at all, if the money were simply held by those who sold the existing goods to them. Hence it is dangerous to assume that consumption expenditures will always increase net income.

If the price level were constant when conversion expenditures increased, the money increase would always be a real increase. However if all "other things are equal", prices will have to rise, and real conversion will not increase. In actual fact I think some other things are usually not equal, and allow considerable changes in conversion to occur. One is the amount of cash balances held by hired factors. When conversion payments increase, hired factors are likely to keep some of the increase to replenish their cash balances, not spending it all for goods immediately. This keeps the price level from rising, and allows conversion to increase. Another is the tendency of merchants to increase quantity, rather than price, in response to the first increases of money demand, thus keeping prices from rising. The first process amounts to an increase of the cash balances of hired factors; the second to an increase in the balances of converters. If one or the other or both of these occurs, real conversion can increase. If no group consents to an increase in its cash balances, velocity will increase as all parties attempt to reduce their balances, and the price level will rise.

It might seem that, in harmony with the "real" approach employed in this paper, the actual passage of title to goods to the hired factors should be counted as "conversion", rather than the mere receipt of money by them. Or one might even go farther, after Irving Fisher, and wait for the physical consumption of the goods. But in view of what I said above about money as a claim on capital, it seems clear that when money passes to the hired factors they have become economic owners of the converters' capital, and this monetary phenomenon is identical with the conversion discussed originally in non-monetary terms.

This point becomes clearer when it is considered that hired factors can deplete their cash balances. An unemployed laborer could live on his money savings for some time, and be receiving real goods, yet do nothing in return for them currently. It would not do to call this conversion, since conversion is receiving goods in return for services currently

rendered. Furthermore, the phenomenon most closely associated with employment is the giving of claims on goods -- money -- in return for current services -- employment; and not the redemption of those claims in goods.

The usefulness of defining conversion as the passage of money, not of goods, is especially great in connection with changes in the price level. When prices have risen, for example, those who held cash during the rise can buy less with it than before. But it would be pointless to conclude that the returns they had received previously were the less on that account. They were in the past whatever the money was worth in the past, and the subsequent loss has been due to a poor investment: in cash. The actions of the past were based on this sort of consideration, hence our definitions should be also. It would be equally wrong to say that conversion in the present instant equals the expenditures of the present instant. The individual may be increasing or depleting his cash balance, and the present expenditures are not in any sense what he is receiving for his present labors. The cash he receives, at its current value, is that.

This is not to say, however, that the movement of goods onto the market is irrelevant. The goods, balanced against the expenditures of money, determine the current price level, which partly determines the amount of conversion. But only in the case where the cash balances of hired factors are kept constant is conversion equal to the amount of goods bought by hired factors.

It was said earlier that the amount of real income payments were equal to (tho not entirely determined by) the amount of capital times the number of times it was used to make real income payments. It can now be seen what this means in monetary terms. The only capital which is used to make income payments is that which ~~is exchanged by~~ can be bought with money, i.e. which is currently for sale. All money, at its current value, is a claim on such capital, and every income payment made with money is a payment of such capital. Hence the amount of capital times its income turnover equals the (real) amount of money times its income velocity. The similar relationship of money to its velocity and capital to its turnover is striking. The similarity is not an identity however, for the amount of capital is greater than the amount of real money, in our society, and hence the velocity of money greater than the turnover of capital. The turnover of capital equals MC/P, and is therefore proportional to velocity, as well as to the real amount of money (M/P). Increments to the supply of capital will affect real income payments (and hence employment) only if they are thrown on the market and lower prices, therefore. Only thus will they increase real conversion payments.

The all-important process of conversion, then, is a matter of spending money and selling goods. To study the determinants of these processes would be a logical procedure

for employment theory. This paper must be limited to other things however.

3. New investment, money, and employment.

New investment, or the creation of capital, may occur without involving the flow of money payments in the least. If hired factors who spend their incomes for goods refrain from consuming physically the goods they buy, investment is increased. By varying the rate at which they physically consume the goods they own, they vary the rate of investment. If they spend their incomes for durable goods, say furniture, instead of perishable goods, say food, they are increasing new investment. This source of variations in the rate of investment is little discussed in employment theory, and rightly so, for it has little effect on employment. It warns us, however, of the dangers of speaking of changes in the rate of investment as affecting employment necessarily.

Another means of investing is for factors of production to increase their cash balances.* One who receives cash in excess of cash spent in any period has produced more than he consumed in that period, hence, by definition, invested, the increased cash holding being the measure of the investment and the claim to it. A converter who increases his cash holdings has not invested anew, but merely exchanged goods already existing for money. For factors to increase their cash holdings, with a constant money supply, indeed, requires that converters shall have reduced theirs, by taking goods in return for money, net. But when factors of production accept net increases in their cash balances in return for current production in excess of current spending by them, they have invested in the money which they hold.

when $\Delta CB = I$

(= Keynes "finance".

This does not imply that for society to invest continually over time requires continuous increments to the cash balances of factors. They can get rid of the money without disinvesting by investing in other claims than money. They can convert the claims, that is, into other kinds, and let the money get back into circulation. ~~Such an increase in their assets is investment just as much as increased holdings of cash in any period~~. The other sorts of claims might be titles, as mentioned in the first

* Where an individual receives income both as a seller of goods and a seller of current factor services, it may seem difficult to distinguish an increase in his cash balance from one source from an increase from the other. This rule should serve the purpose: the equivalent of any net change in his real goods holdings is an opposite change in his cash balance as a converter; other cash balance changes are due to his interests as a factor of production.

paragraph; or they might be securities, or other claims.

The effect on employment does not come from new investment per se. New investment simply means the accumulation of capital, or claims on capital. The effect on employment comes when the claims created by the new investment are subsequently converted. Increased cash balances of factors represent new investment, but they do not affect employment directly. It is when those increased balances are spent to hire the services of other currently working factors of production that they increase the real incomes offered to hired factors and have their primary direct effect on employment. Investment, per se, simply accumulates capital; it does not use it. Conversion and other turnover, achieved thru spending money, are responsible for putting the capital to use as a medium of exchange, and a source of real income payments.

The reader will readily recognize that if the word "saving" were substituted for "investment", and "investment" for "conversion" in the above, the conclusions would be similar to those reached by monetary theorists, in more usual terminology. The difference is more than merely terminological however, for I think there is a tendency among those who use the word "investment" as I have used "conversion" to identify the creation of capital with the creation of employment. I wish to stress that it is the turnover of existing capital that causes payments to factors, and that the creation of capital is not directly connected with employment.

a main pt of the argument

Another point I wish to stress is that it is not "oversaving from net income" that, proximately at least, reduces employment; but rather the accumulation of cash balances by converters, not from net income, but from selling their goods for cash. The monetary phenomena which cause unemployment have often been dealt with as net income phenomena, while actually the magnitude and the variability of phenomena concerning shifts in the form of holding existing assets are much greater. The terminology suggested in this paper affords a means of dealing directly with such phenomena, while I don't think the terminology based on net income concepts can handle them conveniently, and I am sure it has been used in such a way as to obscure them.

OK

B. Changes in the amount of money

1. Their general meaning.

An increase of spending [redacted] may be caused as much by increased velocity as by increase of money. (henceforth to be denoted "dV"and"dM") Is there any difference? The causes are different of course, and this is important for policy, but are the effects different? I see this important difference: when dM is created an obligation to repay in money is created against the borrower, which guarantees society that sometime in the future he will render services in return for money; while increased spending due to dV carries no such guarantee. The goods received by the spender of a bank loan will certainly come back on the market some day in some form to secure money to repay the loan; the goods received by spenders of previously idle cash balances may never be resold for money.

OK

This distinction only holds for that dM which actually does, in its creation, create a new obligation. Not all dM does create new obligations. If a bank buys an existing bond, for instance, the obligation to pay in money was created in the past when the bond was first sold, and no new obligation is created. If the government issues money to pay its expenses, no new obligation is created that will ever be repaid by selling goods for money.(tho it may be repaid by taxation). These forms of dM are equivalent in effect to dV. They are somewhat more inflationary in the long run, since no guarantee that goods or services will be some day offered for money is created.

Since the causes of dM will differ from the causes of dV there will be other effects that will differ. For instance dV might be caused by a desire to reduce cash balances.It could not be expected to result in increased investment in cash balances therefore. dM might result from a governmental decision, and could very well result in increased real investment in cash balances.

Another important difference is that dM increases cash balances, while dV does not affect them in money terms, and reduces them in real terms.

Finally, the impact of the expenditures will probably differ, increased spending from dV coming from one group, increased spending from dM coming from another. Infinite variation is possible in this.

2. Effect on turnover [redacted]

Turnover, as shown before, is MV/P, and will therefore increase proportionally to dM, provided V and P remain constant. Even with "full employment" it is hardly conceivable that P should rise as fast as M, because M will be spent for some things -- probably hired factors --

before others -- probably consumer goods --- , and the greater payments to the first recipients will be made before any pressure to rise is applied to other prices.

Primarily, however, P will not rise proportionally because individual factors cannot distinguish increased money demand, which is merely due to dM, from any other sort of increased money demand, and will react with their ordinary supply elasticity, whatever that happens to be, It probably will be positive, at least in the short run.

Following the initial impact, if P does not rise proportionally, society will have a larger real money supply. This can keep turnover moving at a permanently higher level, so as to permanently finance a larger number of transactions, which may be, and probably will be, a larger amount of real production.

The pattern of causation is interesting: it is because more factors came onto the market that the money supply was increased and was therefore able to finance the transactions required to employ those factors. The essential element in creating the increased real money supply was not the increased nominal money supply, but the increased supply of factors of production. The increased nominal money supply was only important insofar as it was responsible for increasing the supply of factors on the market. If the factors had come onto the market in increased supply without the stimulus of increased money demand, the real supply of money would have been increased just as much, thru lower prices, as it was in the above case, thru dM. The essential element therefore is the increased supply of factors. The increased supply of money is only important insofar as it is a stimulus, for institutional and pschological and other reasons, to increasing the supply of factors. When more factors come on the market they create the real money supply necessary to finance their activities, either by lowering P if M is constant, or preventing P from rising if M has increased.

Does real supply of money suffer from real supply of goods?

There are limits to this

The "general increase of demand" is, then, also a general increase of supply; and if dM did not increase supply it would not be a general increase of demand, its effects being dissipated in a higher price level.

There are at least three different dimensions to the increase of supply referred to, which should not be confused. First, real conversion increases, and this may be regarded as an increased supply of monetized capital, a factor of production. Second, the supply of hired factors increases, thereby, 1: making permanent the increase of monetized capital by keeping prices down, 2: matching the increase of monetized capital with increased supplies of other factors, keeping the ratios of factors roughly the same, preventing changes in their relative

returns. Third, the supply of different products being increased equally, the exchange ratios of various products do not change. It is this last aspect of the general increase of supply to which Say's Law is commonly referred, but the others are, I think, equally important, in assuring that an increase of supply shall appear as a general increase of demand.

In addition to these general and lasting effects of dM discussed above, the impact effect is important. Those who control the original expenditure of dM are given a claim to existing factors and capital which is rival to existing money claims. Some control of current expenditures is lost by holders of existing money, probably in absolute terms, and certainly in relative terms.

It is therefore a matter of moment how dM is injected into the system. It may be used to buy securities, thus keeping their price up and the interest rate down. But it might be used to buy goods and take them off the market, thus tending to raise the interest rate. It is therefore not correct to say, as sometimes is said, either that all spending tends [redacted] to have the same effect, or that all dM tends to lower the interest rate. It is, on the other hand, very necessary to distinguish between the effects of dM, once injected, and the effects of the injection process itself. The former are subject to a certain degree of generalization, but the latter strictly depend on the means of injection, and many different means are available.

3. Effect on conversion

Conversion being a form of turnover, the general increase of turnover will almost undoubtedly involve an increase of conversion.

The impact effect is not so certain, but depends on what the money is first spent for; and, beyond this, how it affects other expenditures, and what various supply elasticities are, and what groups are ready to increase their cash balances. The maximum increase of conversion would occur if all the dM were spent to pay hired factors, and the dM were all absorbed into idle balances of factors so as not to raise prices. This maximum would be reduced by various things, like increased spending of money for goods, low supply elasticities, etc. The minimum effect in increasing conversion would be had if the money injection were all spent for things other than hired factors, and these things had low supply elasticities so that prices rose. Then existing conversion payments would command fewer goods and conversion would be reduced. [redacted]

The impact effect may have a permanent effect in reducing conversion in cases where no obligation to repay by production is created along with dM. This is the case

when the government creates the money, and, if it repays at all, will do so by taxation, not by putting goods on the market in exchange for money. If, now, the dM is spent to buy goods for the government, these goods are permanently lost to private markets. They will never be placed on the markets in exchange for money. Hence goods prices will perforce be raised, and real conversion financed by the given nominal money supply reduced. This is not to say the goods taken by the government will necessarily be lost to society. But that, government services generally giving benefits that are not received in exchange or as incentives, but are simply available, the goods taken are lost to the exchange process, and as incentive payments. And conversion comes in the latter classifications.

Where dM is used to make payments to hired factors, or to firms who are thereby stimulated to increase their payments to hired factors, conversion is increased. This conversion in part takes the form of an exploitation of holders of existing money. The goods which they command with their cash balances are in part wrested from them. From a short run point of view this is all to the good, for the goods they would receive are analogous to quasi-rents, serving as no incentive to further production. Hence the stimulating effect of dM on production: goods which were previously available to cash holders for consumption without further effort are suddenly taken back from them and are only available thru further productive service, and become incentive payments. Whether this is socially desirable in an overall view is another question, of course; but there is no doubt that it stimulates employment.

4. Effect on new investment

Following dM, someone's cash balance must have increased. It need not be the recipient of the first payment, but it must be someone. Whoever this is has invested in the money.

If converters' balances have increased* no new investment has occurred. Converters have simply traded existing goods for new money. This is not to say that the overall effect in this case is necessarily neutral, for the overall effect depends on what those who spent the dM do with the capital they receive. At this juncture I merely say that money recipients have not invested newly if they merely accept the money in return for existing assets.

If the cash balances of factors increase, they have invested newly in the dM. They have produced more than they

*A previous footnote has explained how this may be determined.

consumed, during the interval in which their balances increased. They may have increased their production, or reduced their consumption, and in either event succeeded in increasing their cash balances.

Generally speaking it seems likely that dM would be more often held by factors than by converters, for dM presages rising prices, and converters are likely to want to increase their inventories in such times. However, where the general desire to reduce inventories is stronger than the desire to increase them that may be created by dM, dM will certainly find its way into the balances of converters. In a time of great pessimism, where large stocks of goods are being held off the market awaiting a fixed money price, ~~to be met,~~ dM may very likely be taken by converters and not respent. Such a situation seems to have thwarted the pump-priming plans of the thirties, and led to various bizarre economic theories postulating "infinite liquidity preference" and the like. Such theories, I believe, have overstressed hoarding from net income, and understressed hoarding of money by converters.

The overall effect on new investment depends on more than what the recipients of dM do, however. It also depends on what the spenders of dM do. They receive goods for the money, and they may ~~spend~~ consume them or not.

If they do not, then net effects are as follows: if dM goes to converters, no net effect on new investment; if dM goes to factors, new investment occurs. If the money spenders consume the goods they receive, the net effects are: if dM goes to converters, disinvestment; if dM goes to factors, no net effect.

If the money spender is one who has borrowed from a bank for business purposes, the proceeds of the loan will almost undoubtedly not be consumed by the borrower. Even if the loan is for consumption, the individual who borrows will in the future have to render services in excess of current consumption to repay the loan, and the "consumption" may be regarded as having been stored up as capital in his body or mind, and not lost to society as capital.

If no new money obligation is created, however, we have the possibility that the money spender will consume the proceeds of the loan and never make restitution, at least by producing. As noted before, government issues of money, and government borrowing from banks, and the purchase by banks of existing bonds, or any kind of equity ownership, create no new money obligation.* In these cases the spenders of the money need not refrain

*Government borrowing creates obligations, but they will be redeemed by taxation, if at all, hence are not obligations to produce more than is consumed, hence not obligations in the sense relevant to the above statement.

from consuming, altho they may.

dM results in new investment, then, only in the case when the spender does not consume the proceeds, and the dM increases the cash balances of factors. When the spender consumes the proceeds, or the dM is held by converters, new investment is impossible, and if both these happen together, dM means disinvestment. The last is more than a hypothetical possibility: it occurs whenever the government creates money to buy existing assets from converters who decrease their inventories. This conclusion follows directly from the definition of investment as a production in excess of consumption. Those who speak of dM as synonymous with investment have therefore strayed a long way from this meaning of the word, how consciously I do not know.

If those whose cash balances have increased subsequently decide they wish to reduce their balances, they will succeed mainly in exploiting themselves. They will try to spend faster than they receive money. This, for a whole economy, is impossible. They will succeed in increasing velocity. This will increase prices, lowering the value of money (unless it increases transactions proportionally, a case not considered at present). Money holders will have smaller claims to existing assets, i.e. a smaller "investment" in money.

This does not mean that disinvestment has necessarily occurred. Those with money obligations have gained at the expense of those with money. The investment that was once done is not necessarily undone by the reduced value of money.

Those with money obligations are now free to consume a portion of what they previously had to hold for sale, and this may result in some disinvestment consequent on the dV. In most cases probably most of the new investment made by those accepting dM would not be subsequently disinvested if prices should rise, however.

If, as is most unlikely, prices should rise in anticipation of the spending of dM, before it ever was used to buy anything, this would only slightly reduce the new investment that would be made by those factors accepting dM. Due to the higher price level the nominal money spent would command fewer goods. It would still be true, tho, that whoever increased his nominal cash balance in any interval would have to give more goods and services than he received.

The above considerations tell us whether dM results in investment or not. It remains to show what, if anything, this has to do with employment. My answer is that it has nothing to do with it directly, that conversion is the source of real income payments, that new investment is only significant as it increases the amount available to be converted. (and of course as it creates new factors of production, of varying degrees of complement-

arity with old, this being another aspect of the question) Investment is a decision made by those who have received money or goods, after they have received them from converters. Conversion is a decision made by those who make payments to factors of production. These payments, being the incentive to take employment, are most closely related to the amount of employment.

Using too few words can be an affectation too. Always ~~use~~ use enough words too make yourself clear.

III. Adequacy of the money supply.

The question to which this section is addressed is this: is the money supply ever a limiting factor that prevents expansion of production and employment, or causes contraction? The answer will be that literally, or potentially, it is not, or need not be; but in actual practice it may be one of many limiting factors.

If a given amount of nominal money is inadequate to finance a desired amount of turnover, the real money supply may be increased simply by lowering the price level. A given amount of money will finance more transactions at a lower price level, is another way of looking at the same thing.

In recent years the validity of the above statement has been questioned. As I will show later on, its force is reduced in a period of transition to a lower price level, and I believe this is what its critics usually stress, in their own language. I do not think many would deny that in the long run a reduction of the price level will increase the number of transactions that can be financed with a given nominal money supply.

The number of transactions that can be financed will only be reduced if velocity falls by more than the price level. The general tendency of lower prices, however, is to increase velocity, by increasing the real value of money balances and making people desire to reduce them. Looking at it another way, those who own goods and services will be bidding up the price of money and thereby drawing more of it onto the market. ~~at any one time.~~

There may be some question as to whether it is socially desirable to entice more money onto the market by lowering prices, because to a degree this policy is one of luring money into production by offering higher returns to converters at the expense of other factors. To fully resolve this question is far beyond the scope of this paper, but generally it seems clear that suppliers of money, as such, are less monopolistic than hired factors as such, and it would therefore be desirable to lower the prices of hired factors.

There are many valid objections to increasing the money supply by lowering prices:

1. It is difficult to lower prices. This objection has been given much weight. I think myself it is not very strong. The difficulties that must be overcome to lower prices are largely the same difficulties that must be overcome to prevent prices from rising inordinately, and to prevent the growth of monopoly. They consist to a large degree in removing institutional props to monopoly, and creating institutional barriers to monopoly. These are

difficulties which must be met anyway, if our economy is to be saved from stagnation and socialism.

2. When prices do fall, in our society, it is the more competitive ones that fall easiest and farthest, the monopolistic ones least. This is unfair; it encourages monopolization of remaining competitive industries by discrediting competition; and it reduces investment opportunities by depressing the industries open to new investment.

3. The holders of cash balances receive a windfall gain. Insofar as this is anticipated it reduces velocity by making money itself a better investment. No one holding money would make an investment yielding less, in real terms, than the anticipated rise in the value of money, plus the value of being liquid.

It would also reduce the amount of money. The cost to the lender bank of making a loan would be as great as ever, but the borrower could not pay as much as before. The borrower would know that in the interval after he spent the loan and before he sold the proceeds, money would have become more valuable. Hence he could only make such outlays as would pay him the regular interest charged by the bank plus the rise in the value of money. Borrowing from banks would be reduced therefore.

Note that these are not effects of falling prices per se, but of anticipated falling prices.

4. Potential holders of goods, expecting their prices to fall while they are being held, will pay factors less for them than they might sell for currently. Thus the prices received by factors of production will fall faster than the prices they must pay. This is the familiar phenomenon of wholesale prices leading retail prices in business fluctuations.

5. Individuals cannot distinguish

None of these is an objection to lower prices themselves, but only to various difficulties of achieving lower prices. They are problems of the transition to lower prices. Everything that makes the transition longer tends to accentuate these problems.

There is some tendency to associate lower prices with depressed business, due to the historical association, and to discredit low price policies because of the association. Historically however, low prices have come as a dependent variable, being forced down reluctantly in response to a decline of money demand. What I have been speaking of above is a decline of prices as the independent variable. This does not usually occur straightforwardly, but it often occurs deviously, when technological advance makes factors more efficient, and their productivity grows faster than their prices.

This is tantamount to a reduction in factor prices. This is one reason technological advance is associated with business prosperity.

The best monetary policy is therefore an anti-monopoly, anti-restriction policy in the rest of the economy. The money supply will certainly be adequate provided the supply of other factors of production is not restricted.

However the valid arguments against reducing the price level are of such weight that it probably is wise to combine a steady price level policy with the anti-monopoly policy. Not only is the transition difficult, but the redistribution of wealth effected is arbitrary, and has besides some bad results, even beyond the transition difficulties. Those individuals who borrow to carry on business habitually will find their money obligations increased in real value. This will make them worse credit risks. This will, in effect, reduce investment opportunities, for the individuals thru whom society habitually channels its funds for investment and conversion will become less reliable. The result will be to reduce conversion and investment.

Monetary policy should be coordinated with ~~monetary~~ anti-monopoly policy therefore to keep a steady or rising price level. The advantages of these policies are:

1. Individuals cannot normally distinguish a real increase in demand from an increase of money, and are apt to react to increased spending with their normal supply elasticity* ~~just as to reduced spending~~. As the prices of unemployed factors are reduced, bringing them into employment, the increase of transactions resulting will take money spending away from presently employed factors. It would be wise to keep the money supply increasing fast enough to avoid this.

2. Where anti-monopoly policy has not been completely successful, rising prices favor competitive sectors as opposed to monopolistic ones, for monopoly prices are often rigid upwards as well as downwards. This increases investment opportunities.

3. If the money is injected as bank loans to entrepreneurs, it will increase conversion. The quasi-rent of those factors with cash balances will be partly taken from them and turned into an incentive payment, as explained before. The increase in real money supply will come as an incentive, rather than as a windfall to holders of balances.

*Supply elasticity will almost certainly be positive in the short run, altho in the long run it is less likely to be.

4. The anticipated rise of prices will cause people to try to hold their assets as goods rather than money. This will increase velocity, and thereby increase turnover. It will cause converters to be willing to buy assets of lower yields than otherwise, thereby increasing conversion.

5. Anticipated rising prices will make wholesale prices rise faster than retail. The money payments to hired factors will rise faster than their cost of living.

6. The real burden of money debts is reduced, making habitual borrowers better credit risks, encouraging lending.

A third way of increasing the effective money supply is to increase velocity. Velocity is increased by:

1. Increasing the real money supply.
2. Raising the yields anticipated from other assets.
3. Reducing the implicit yields anticipated from holding money.
4. Increasing time preference in general.

Owing to the pressure of time I can present these only as assertions. The purpose in presenting them at all is to round out the logical development of this section.

A

I was at first skeptical whether your new terminology was not merely a difficult and unfamiliar way of saying familiar things. But I have concluded — provisionally — that it is a help in bringing out some new aspects of the earning - spending - investment nexus, especially at point where I have marked "good" in the margin.

This is a "think" paper — original, and provocative, hence worth an A.

HSE.

Addendum

I regret that in this paper I have only had time to outline what I believe to be a useful system of analysis, and not to put it to use. I had hoped to describe and analyze the results most likely to follow from some major independent variables of the business cycle: anticipated yields, money, velocity, prices, and others. Time has run out, however, and this must await another occasion.

Inflation lets tax delinquencies be picked up,
unfreezes much land.

It isn't net inv., but conversion that is compl. to labor. & conversion may be net disinv.
- as with depletion.

Construction makes a given amount of land & cap. much more complementary to labor than otherwise. Labor is more productive, altho not of ultimate consumables - save residential construction. Hence attrition of cap makes land more compl. to labor, allows more genuine claims to be paid as rewards, tho less immediate consumables, thus employs labor, clears mkt. of consumables, prepares further complements to labor.

Inflation takes from past producers who have saved -- creditors & m holders -- & gives this in reward for current production. thus it simul. converts what we have into something we don't have, but can get by working. So As production.

Money is a factor of production (an aspect of capital), & it is limitational. It cannot be Δd by -ΔP, alone. Therefore ΔM was a necessary condition of emerging from depression. My quarrel is with those who say it is a sufficient condition, to solve, e.g., unemployment.

The non monetary analysis makes it look as the L cons. automatically caused reinv., if cons. means passage of eg 50 factor. With m, is clear it doesn't. — another effect of the bifurcation of exchange?

Add 'earned' incomes to my inv. scheme, ft 1

com.

If people convert their services into m, (net, after considering all) is new inv. If just convert assets into m is not. But may be conversion to services; if m passes thru will be factors' hands en route. The net inv. effect may be pretty 2 dang, turnover being so important.

Fixed m debts assure production & sale. Moratoria interfere with m's real backing. Also loans to help keep goods off mkt.

Inv. in personal cons. goods, as has characteristics
20s, results in Lemur claims, is still inv.

Conv. in things by owner, w/o borrowing,
results in no claims, is conv

Taking a ticket to theatre is like returning
m to a bank. It is cancelled.

The stimulating incentive effect of inflation is negated by its lowering i.r. (if ΔM comes that way), & Δing cap. values.

Lending or investing is not cap. creating, but just disposing of cap. you have already acquired. Even true of ΔM -- you acquired cap. by commandeering it.

In 20s, if land values were rising at c. $20b per annum. & stocks, consider effect on V; & on desire to really invest.

problem, aside from P rigidities. It only involves consumers being reconciled to smaller real gap, which is just what real new inv. would do.

'Oversaving' in real terms could mean by consumers refusing to consume, or factors refusing to ~~buy~~ consume, but not to work

Diagram.

In real terms 'inv.' means factors don't take anything from consumer, just claims on what they produce. In real terms this would mean consumer not nec. at all. But in m, he still must pay factors in m, & then not be able to sell it, so one for less M, if factors inv. takes form of holding M. But this is no real

~~The~~ A big % of bank loan to small retailer goes to buy goods, may never employ labor, if hoarded.

Leigh had a good point, that I could not say -dM caused m to be worth more and hence people who demanded same am't of money to be demanding more in real terms. It is not quite that simple. For the very fact that some are in fact not lowering their money hps means that the value of money has not risen proportionately to the decline in its amount. And if none reduced at all, money would not be worth any more than before. And any segment that produced as much as ever would find its money prices lower, but p.p. of money ~~xxxxxxxxx~~ no higher, so real exchange value of product lower. Of course if all lowered m hps at once, none would suffer. But the first to do so does suffer in a sense. This gives a vivid picture of the difficulties met ~~by~~ in lowering real hps in deflation, or in preventing them from rising.

Analytically, I am still correct that it is a rise of hps for, as shown before, if the real exchange value of industry's product is no different than before, and fewer are producing, both money and real returns being the same as before, hps of those not producingmust have risen. But it is by this, and not by the simple reasoning that prices are lower but money hps are the same, that one must prove the point. And this has the added value of showing deflation to be a hard problem for hps -- given some rigidity, deflation makes it very hard to keep real hps the same without lowering them!

Fellner, 3

A very unsatisfactory analysis.

(consider, e.g., inventories. If no demand for them, people stop investing in them. Other reactions are simply more delayed) (But this is all hypothetical anyway. As long as people work, they want the things they produce in some form. They will invest in things that bring them direct pleasure if other forms fail -- & that is the big danger to economy, with land & other complements thus taken from us.

Also that they can keep their claim by increasing their money holdings, which may create deflation problem. NOTE THAT IT CANNOT CREATE SUCH A PROBLEM IF CORRESPONDING TO THIS INCREASED MONEY HOLDING IS INCREASED CAPITAL HOLDING. AND THIS IS ASSURED IF THE DM IS CREATED BY LOANS TO INDIVIDUALS WHO ARE THEREBY OBLIGED TO HOLD MORE CAPITAL, THRU PRESSURES PREVIOUSLY MENTIONED.

Leigh's problem: if money demand falls but holdout prices remain constant, why has production stopped. Because holdout prices have risen in real terms I say. But, he says, since things are not cheaper, no one can get any more than he could before. True, I say, but neither need he take less, that is why I say his real hp has risen. He could get the same as before, since prices have not changed, yet he does not produce.

~~Not a good answer. Maybe Leigh is right. Figure it out~~

ΔM means lower mr as long as prices don't rise, because as long as they don't it is more than nominal, but a real increase of command over goods. Well, it only lowers mr if offered for loan. Then it is real increase in ~~$~~ command over goods offered for loan. If prices rise, no more real command is offered than before, no reason to change mr — no Δ supply. It is not that the individual loan of money will buy less that ~~real~~ prevents ΔM from increasing supply of loans, & ∴ lowering mr, for the m received as interest has same value; but that total supply of pp loaned is not increased.

It may very well decrease, if ΔM used for cons., so P rise with no Δ loan supply.

V also involved, & effects on demand for loans of ΔM.

Now with this clear picture can criticize S-Inv., as contributing nothing not in old analysis by MV P&T, & obscuring costs, &c. - They consider only mp2, not mc. Lester's articles an effort to discredit mc.

All they ever ~~$~~ even tried to prove about saving is that supply is inelastic. But that doesn't mean it won't meet demand (or would, if they didn't include hoarding as saving. But even here, we can say they are investing in the goods they gave for the M. All M held, the unspent balance, is so. But here MV PT is far better, for they speak of increased cash balances & increased hoarding as tho this actually meant increased M held by individuals, while really it can only mean ~~$~~ −ΔV, or ΔM. Likewise a desire to dishoard won't result in reduced cash balances but higher V, which lowers value of cash balances thus bringing desired results.)

(over)

What do they think they gain by sav-inv. approach over MVPT? When did it start? They gain a seeming sanction of importance of a process which, when described in M terms, is revealed so accurately as to show its frictional nature.

3(7) If mr falls, says IS, M increases, so more M is saved, further depressing mr. A circle. If Δ M raised P, no more would be saved, & also ~~that~~ the same am't of m savings would be less real, real supply of loans falls, mr rises. View is valid then that higher P increases demand for M, raises mr.

I want to condemn s-i as way of analyzing, also the conclusions of its analysis. First show that it expresses nothing not better expressed in terms of MVPT & mp mc; that it slurs over some important matters; & finally that the conclusions reached by use of it are wrong, not only in mp mc analysis but even s-i analysis.

Why should I be interested in monetary or cycle theory?

In cycles, because fluctuations are an outstanding ec. phen., and obviously one does not understand ec. if he doesn't understand them. To what project of mine is this study related? One project is the book or paper: "Money", in which I will explain what money is and what monetary policy the country should follow. This is a subject of great practical importance, of great interest to me, and great professional possibilities.

My general viewpoint has been started in that paper for Ellis. Real investment is independent of money, and can fluctuate w/o reference to it. ~~Xxisxtxxxxx~~ Creation of M is also inv. usually. Inv. is a factor of production. Gross inv. the important term in which to analyze. M is a factor of production. Inv. occurs when M passes to factors. etc etc. Credit is extended when m is created, & when it changes hands. MV is credit. dMV increases production until P catches up. --& P needn't catch up, it may simply become cheaper to hold M, & V fall.etc

What is purpose of this? 1, just to explain the role of M, & thereby give a basis for sane discussion of money policy, & understanding of what goes on.

2. ~~kxxdsxtx~~ Basis for showing disrupting effect of land values on money system. But this is really independent. could be shown under ~~xxx~~ present vague concepts. However that shows I must master present vague concepts, so I can speak in terms of them instead of my own. & recall how I once thought that land spec. would swallow up m -- need analysis to lay that sort of thing.

3. What are objects of analysis? To show that various popular errors are errors: that no underemployment equilibrium exists; that investment, not consumption, should be encouraged. etc. And to play a positive role in other studies, e.g. my international theory

What good is "nat. inc. analysis"? General background I guess. It is good to have thought about such things.

On each subject studied, come up with tentative conclusions when thru, something to hang on to. Try to relate all to general picture, & specific projects, where possible.

"Exploration" is just a process of gathering info. re land.

advertising is spreading "info" re product.

"Capital" may be invested to create info. — which may be non-material, or at least not incorp in any material outside brain. Likewise, in orthodenture, etc., incorp. in body. This is all cap. — not in mystic fund sense

I,

Good

Coffney

1. Mill's assertion refers primarily to 'circulating', not fixed capital. Circulating capital is the 'wages fund'. Mill's view was that no more labor can be hired than can be paid from this preexisting fund. Smith, Ricardo, & Marx also observed the distinction of the 2 kinds of capital, Mill was really expanding on previous contributions as well as contributing to a contemporary. Smith had said exchange was limited by capital since capital was necessary to carry goods during exchange. He had also observed that capital was complementary to labor. Both of these ideas are involved in the proposition.

Actually it is only current consumption that is limited by existing capital. Mill regarded payments to labor as being all consumed & was thus drawn into this error. Production is not limited by the wages fund because labor can save its own product; it can create a wages fund currently.

Actually Mill might have applied his theory to all factors paid currently, not just labor. All factor rewards must be paid by circulating capital unless the product is consumed immediately. But, even more than labor, other factors can produce more than they consume currently too.

Mill was right in the sense that production does requires capital, but wrong in not seeing that capital can be created in current production. His error was consistent with his subsistence theory of wages tho, for labor at subsistence cannot save. ↳ use of other factors can be increased and ~~that~~ labor without increasing capital. I think this shows Art misses Mill's point. Or does he refer to ↑?

Also limits of by supplies of other factors & their double specifications.

Today we think of 'consumption' only when people consume things for pleasure. Further, we attempt no connection between what they consume & what they produce. Mill thought that what productive humans consume was the same as what was 'consumed' in production. He thought of each as no net consumption but a transfer of capital from the consumed form to a new form. Consumption by non-producers he would call waste. or unproductive consumption.

This view is objectionable because it shows no end to the economic process. It goes against the trend that Smith started when he objected to the mercantilist's emphasis on production rather than consumption as the end of economic processes. It regards labor as a machine, a means only. Marx objected to the attitude but kept the same terminology. The view is further difficult because no one can say what a human is consuming 'wastefully' & what in preparation to produce.

From the viewpoint of the producers of one product the 'demand' for their product is what others will give, in real terms, for their product. Only in the very short run is Mill's point good. Demand for the final product is not, per se, demand for the factors that produce it. Smith observed the same thing when he said that in the short run it is finished products that are more likely to depart from their natural value than factors. In the very short run ~~factors~~ the demand for factors comes from 'circulating capital', which tries to anticipate market demand. Market demand is filtered thru circulating capital before it reaches the other factors. This is what Mill was showing. He would agree I'm sure that in the longer run the investment of circulating capital was in accord with market-demand for finished products. He failed to see, tho, that if existing circulating capital didn't take advantage of its opportunities new capital might be easily created.

From the view of the whole economy Mill's point has the same short run validity, & a longer run one too. the marginal products of factors necessarily, but what circulating capital pays the factors. The demand being considered, by Say's law, as equivalent to the product itself, the demand for factors can thus shift without the demand for final product's shifting. Furthermore this shift can be permanent: if circulating capital permanently increases it will permanently accept a lower rate of interest, which means a permanently higher demand for other factors without a change in their demand for their products. (this is my idea, not accepted in class)

Bringing von Thunen

Ec. 45, fri.

— JB Clark's theory of distribution. Differentiates cap. & cap goods. ch. 9-12, & 20, Distribution of Wealth. Criticizes Bohm Bawerk, started downfall of them.

— To Austrians, cost was opportunity; to classics, human sacrifice. So land had no cost to classics, had one to Austrians.

— Marg. Utility, a time flow idea involved too. So much per time unit.

'theory of marginal utility' is idea of falling utility with greater amount. As applied to consumer behavior, too. – & there it is criticized.

Immeasurability of utility, of utility of m between individuals, welfare ec, soak the rich, idea of utility is misused, the utility itself is ok.

Monday.

— Bohm-Bawerk's capital. Social & acquisitive. Social is productive, acquisitive may be different, he isn't clear on it, wants to say he discusses social capital. Clark's 'capital goods' is similar. All unfinished goods are social capital, goods in production. Clark claims to differ, for Bohm says the longer the process the more valuable the product, Clark says that's irrelevant, capital is a flow, not a fund. B-B says roundabout production more efficient.

'Period of production' – begins no one knows when, ends the same.

—

B-B says time of cap. application determines Δ to tp, Clark says productivity counts, independent of time.

Maybe HG right. Austrian theory invented to confuse land principles, a reaction to him.

~~Special thesis requirements?~~

Ec 45 Wed.

JB Clark. Distinctly mp theory of cap. B-B spoke of Δ to tp, not very clear on it. Thought of interest as a residual. ~~but~~ Clark tried to show nothing was, not even rent.

Equity ? - Today we only think of 'profits' as residual.

— Even B-B didn't have pure residual residing theory, but thought more of mp of cap.

— To Smith, cap. made specialization possible. To B-B, it made roundaboutness & ↑ productivity possible.

✓ The 'period of production' - no beginning, no end, as he defines it.

(Just as tools are an extension of the hand, so capital is an extension of the capital stored in the body)

✓ Speaks of 'lengthening the period of production'

— Some doubt about what B-B means by lengthening period. Maybe he means not increase of nation's capital.

✓ B-B says period ends when cap. is worn up. But Clark says 'cap' doesn't wear out, just individual cap. goods. So Clark says there is no end to period. B-B. didn't think enough about cap. as a fund, but as individual goods.

Th - modern divergence from Say's law comes not only from ~~failure~~ m, but from never having gotten away from segmental view for whole.

example of adding labor to economy, have p.p. Δ, etc.

Idea of rent

Acc. principle - idea of general Δ demand, without seeing Δhp implied, in general.

? — Would Clark say cap. formation involved no waiting?

ECONOMICS 45
ASSIGNMENT

The "Austrian" theories of value and capital

Value: W.S.Jevons, The Theory of Political Economy, pp.37 - 75, 90 - 102, 137 - 142, 161 - 166.

OR

E. Bohm-Bawerk, The Positive Theory of Capital, pp. 133 - 137, 146 - 153, 159 - 189.

Capital: Jevons, pp. 222 - 279, omitting 232 - 238, 245 - 253, 273 - 277.

AND

Bohm-Bawerk, pp. 1 - 3, 17 - 23, 38 - 41, 42 - 43, 92 - 98, 237 - 239, 253 - 255, 260 - 263.

Discussion Questions

Value:

1. State and criticize the theory of marginal utility. What are its weaknesses? What is its usefulness?

2. What is the role of (1) utility, (2) cost of production in the "Austrian" theory of value?

3. Contrast the Jevons - Bohm Bawerk approach to the theory of value with that of Ricardo and Mill. In what way (if any) does it represent an improvement?

4. To what extent is utility subject to measurement and/or quantitative comparison? Same person, etc. --- what it buys, not cash balance.

5. What is meant by the marginal utility of money? Is it subject to comparisons as between persons? Sort of, but not precisely, has been misused.

Capital

1. Describe the nature and role of capital in the economic system according to Jevons and to Bohm-Bawerk. Do you detect significant differences in this respect between these two writers?

2. Do Jevons and Bohm-Bawerk retain the wages fund doctrine? (Not Jevons, in intro. But Leigh says he tends to keep it)

3. Comment on this statement by Jevons (p.243): "Capital is not the railway but the food of those who made the railway." Shows wages fund idea not dead.

4. Are consumers' goods capital? What is the opinion of Smith, Mill, Jevons, Bohm-Bawerk on this question?

5. How do Jevons and Bohm-Bawerk explain the way in which interest is determined?

6. Bohm -Bawerk calls the "productivity" theories of interest "naive". Does he include any element of productivity of capital in his theory of interest?

7. Do you think that people typically tend irrationally to underestimate the future? If so, do you think this fact has anything to do with the rate of interest?

8. What is meant by "roundabout production"? How can the period of production be measured or defined?

9. What determines the length of time for which it is most profitable to allow wine to age or a forest to grow?

10. If the productive system is to be carried on there must be appropriate stocks of all kinds of half finished goods, e.g. sheep, wool, yarn, cloth, suits, etc. What force in the system keeps these stocks in their proper proportions? Do these proportions ever tend to become inappropriate? If so, what is likely to happen?

Clark, J.B. The Distribution of Wealth. NY: The Macmillan Co., 1923
(Originally copyright 1899)

p. 118. "Land is the only kind of capital-goods that does not need to be destroyed, in order that the fund of wealth embodied in it may continue." (He has been discussing how capital must be worn out & replaced when used) pp. 121-22, rpts.

To Clark, "capital" is "A value, an abstract quantum of productive wealth, a permanent fund --- . . ." p. 119. It lives by "transmigration" from body to body. p. 120.

The best concept of it is in value terms -- a man has $100,000 of "capital", now embodied in material form, but potentially fluid, migratory, changeable. Like a flow of water, r the flow of life thru generations. Fund and flow. p. 121

(In my theories, re time-indivisibility, I'm treating of capital as a fund, not a flow.

In my equations, I compared capital and land of identical MP, including gross MP of capital, which meant depreciation was major cost, and interest a minor one. Now some, e.g. J.K., raise question, isn't capital as a flow perpetual, you reinvest depreciation fund, so relation of its income to its price is same as with land. This involves taking a much larger capital, one whose net MP equals land's MP, for comparison. Say the capital is consumed in one year, & i equals 5%. Then capital whose gross income is 21 times the land's gross has same price, and same net/ income. Lo mr will indeed apply such cap. to slightly lower margin; but only very slightly gross margin.

Just remember, treating capital as fund shifts basis of comparison, which do, then continue argument from that viewpoint. But don't let 'em have both at once, that confuses things.

122-23, applies fund - flow distinction to clear up wages-fund theory ambiguities, neatly.

123 Defines interest as what money earns, i.e. capital as a ~~fund~~ flow earns. and what capital as a fund earns is "rent". Rent equals interest, in total, they are two different ways of looking at same thing.

Clark is much more readable and reasonable than Knight, Hayek, and Bohm-Bawerk, more or less in that order. He does not seem to attack BB hard, just applies his fund-flow distinction.

~~Real meaning of~~
~~monetary phenom~~