Economics Brief

SEEL-Systems Engineering Economics Lab

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The Real Incomes Approach to Economics 101

Theories of Money

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Unfortunately, monetary policy is flawed because the basic Quantity Theory of Money (QTM) is wrong.

As a result, all conventional economic theory and practice is prejudicial.

The QTM attempts to shown the relationship between money volumes in the economy and average prices of goods & services.

Fisher

The commonly used QTM, proposed by Irving Fisher, is as follows:

$$M.V = P.Y \quad \text{... (i)}$$

Where:

M is the volume of money;
V is the velocity of money circulation;
P is the average price of goods & services;
Y is the quantity of goods & services or, real income.

Keynes

Pigou

Marshall

John Maynard Keynes, Arthur Pigou and Alfred Marshall realized savings would reduce amount of money in circulation and they therefore produced what is known as the Cambridge Equation.

A version of this is shown below:

$$(M - s).V = P.Y \quad \text{... (ii)}$$

Where:

s is savings.

The paradox of quantitative easing (QE) is that based on Irving's QTM, one would have expected this to have caused the prices of goods & services to go up.

In 1975 Denis Healey, the Labour government Chancellor, altered macreconomic policy to one placing more emphasis on monetary policy instruments.

Since then investment and productivity in industry and manufacturing declined and the balance of payments for goods collapsed.

The aggregate demand paradigm promoted by Keynes was taken up by monetarists making use of the Quantity Theory of Money identity (QTM) the guiding principle for monetary policy decisions with the objective of steering a path between inflation and deflation in the prices of goods and services.

The net result has been declining real wages and rising wealth of those dealing in asset holdings and asset trading.

However, at first this did not happen but real incomes, or purchasing power of wage-earners began to fall (Y).

This was because QE money was not flowing into goods and services investment, wages or purchases but, rather, most of it was flowing into assets.

Neither the QTM or the Cambridge Equation contain any variables representing assets.

I therefore, elaborated a Real Money Theory (RMT) to replace the QTM, which includes all of the asset classes as follows:

$$(M - (l + r + p + m + a + h + f + c + o + s)).V = P.Y \quad \text{... (iii)}$$

Where:

l is land;
r is real estate houses & buildings;
p is precious metals;
m is commodities;
a is rare & art objects;
h is shares;
f is financial instruments;
c is crypto currencies;
o is overseas money flows;
s is savings.

The only asset that did not exist when Fisher, Keynes, Pigou & Marshall worked on these identities was cryptocurrencies. The question therefore arises, why were the other money flows never included in assessment of the impact of money volumes on the prices of goods & services? After all, governments, Bank of England functionaries, and university economics research and teaching staff, to this day, assert that the Quantity Theory of Money is the essential tenet or explanation for monetary theory and & monetary policy decisions.

As long as monetary policy decisions have been taken for well over a century they have been justified in terms of the logic of the Quantity Theory.

It is time to abandon this flawed identity and therefore the logic of monetary policy.

McNeill

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