HEA Part II Ch 6 #5 Credit and Banking 317-322

318 [(a) Credit and the Concept of Velocity: Cantillon.] ... a strictly metallist conception of money invited, if it did not absolutely enforce, the attempt to draw a sharp dividing line between money and the legal imstruments that embody claims to money and operations in money, and to bring the latter into the picture by means of auxiliary constructions for which the legal concepts alluded to above offered suggestions. To some extent such a course is always possible, in our case even more so than // usually. The auxiliary construction that is needed consists in an extension of the concept of velocity. The banker who issues notes in excess of his cash holding is not thought of as crating or increasing means of payment, let along 'money.' All he does is to increase the velocity of that cash, which, by proxy, as it were, effects many more payments than it could settle by going from hand to hand.; and the same applies, of course, when he directly loans part of the cash deposited with him. The clear perception of the truth that a bank note and a checking deposit re fundamentally the same thing is in fact one of the strong points of this theory. Thus money remains very strictly defined. Credit, particularly bank credit, is merely a method of using it more efficiently. I cannot stop here to show, but the reader may easily see for himself, that most phenomena that go under the heading of credit, can be described in this way. Government paper money may then either be includedwith full-weight coin in the total of the quantity of money or else construed as a government debt -- that is as a pormise to pay in coin at some time or other. The latter view predominated and throughout the nineteenth century there are instances of governments issuing notes with the legend: 'This note is part of the government's floating debt,' suggesting an analogy with treasury bills, especially when the notes carried interest, as they frequently did.

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The outstanding authority for this theory is Cantillon, who carried it out in detail and with as much common sense as brilliance. The bankers are essentially intermediary lenders of other people's money. They lend the deposits they received, and by so doing speed up things and lower the rate of interest. The logical difficulties that lurk in this apparently sikple statement are somewhat reduced by his emphasis upon the case in which bankers only lend what depositors, for the time being, do not need -- the case of time deposits as we should sat -- so that a given sum of money does only one service at a time. Moreover we must not forget that Cantillon lived in an environment where, wholesale trade apart, payment in specie was the overwhelming rule, so that people incessantlyfetched and brought bags of coin to and from the bank; and where it was as usual to acquire a deposit by actually depositing coin as it is now to acquire one by borrowing or by transfer from another borrower. At any rate his teaching stands at the fountainhead of what remained official banking theory practically up to the First World War. Galiani and Turgot -- independently or not --held the same doctrine. So did innumerable minor lights such as Justi, and 'business economists' such as Marperger.

But to say the least, this is not the only way of interpreting the facts ofbanking practice. Even the banker who lends by handing out actual money deposited with him does more than collect it from innumerable small puddles, where it stagnates, in order to hand it to people who will use it. He lends // the same sums over and over again before the first borrower has repaid: that is to say, he does not merely find successive employments for the sum entrusted to him,

320 but many many employments which that sum then fills simultaneously. If he lends by paying out notes -- or by crediting the sume lent to theborrower in a checking account -- for which his cash holding acts merely as a reserve, the same fact stands out still more clearly. And so it does if he loans coins received as a deposit, which the depositor proposes to use exactly as he would have used the coins if he had kept them. There surely must be other ways of expressing these practices than by calling these bank notes embodiments of velocity of circulation -- a velocity so great that it enables a thing to be in two places at the same time. More important than this terminological inconvenience is the fact that the velocity of circulation in the technical sense of the word is not increased at all; the banker's loans do not alter the 'stations' through which a unit of purchasing power has to pass, or abridge the time it takes in passing them, or - in themselves - affect people's habits of holding certain amounts of what they consider to be ready cash. Therefore, it may, perhaps, seem more natural to say that bankers increase ot the velocity but the quantity of money - of those means of payment that, within limits, serve as well as money if one wishes to reserve this term for coin or for coin and government paper. This accords perfectly with practice -- borrowers do feel that they get additional liquid means that are normally just as good as money. Banks are no longer said to 'lend their deposits' or 'other people's money,' but to create deposits or bank nots: they appear to manufacture money rather that to increase its velocity or to act -- which is a complerely unrealistic idea -- on behalf of their depositors. In any case it is clear and actually beyond dispute that what the banker does with money cannot be done with any other commodity -- for no other commodity's quantity or velocity can be increased in this way. The only answer to the question why this is so is that there is no
321 other case in which a // claim to a thing, within limits to be sure, serve the same purpose as the thing itself; you cannot ride on a claim to a horse, but can pay with a claim to money. But this is a strong reason for calling money what purports to be a claim to legal money , provided it does serve as a means of payment. As a rule an ordinary bill of exchange does not so serve, and belongs to the demand side of the money market. Sometimes however certain classes of them do; then, according to this view, they are money and form part of the supply side of the market. Bank notes and checking deposits eminently do what money does; hence they are money. Thus credit instruments, of some of them, intrude into the money system, and by the same token, money in turn is but a credit instrument, a claim to the ojly means of final payment, the consumers' good. By now this theory -- which of course is capable of taking many forms and stands in need of many elaborations -- may be said to prevail.

[(b) John Law: Ancestor of the Idea of Managed Money.] Manufacture of money! Credit as a creator of money! Manifestly, this opens up other than theoretical vistas. The bank projectors of the seventeenth century, especially the English land-bank projectors and Law, who was one of them originally, had glimpses, varying in degree of distinctness, of the theory adumbrated above. But they fully realized the/potentialities of the discovery that money -- and hence capital in the monetary sense of the term -- can be manufactured or created. Their reputation at the time and later suffered greatly from the failure of their schemes - Law's schemes in particular -- just as in the nineteenth century the reputation of fundamentally similar ideassuffered from association with wild-cat banking and with the failures of schemes that turned out badly without being fraudulent or

business/

321 nonsensical, such as the Credit Mobilierof the brothers Pereire. But since there is a far cry from an economic principle to a banking project, these failures are not evidence in the court of theory.

Interpretation of John Law's theoretical position in metters of money and credit (on his theory of value, see above #2; p. 295) presents difficulties quite apart from the fact that some of his arguments may have been no more than tactical moves. From the way in which he deduces the phenomenon of money -- which, in the first instance, makes money a commodity -- it seems he must be classed as a theoretical metallist. The diagnosis derives support from his antagonism to debasement or devaluation -- which he called an unjust tax, on the doubtful ground that it tends to hurt poor people more than the rich -- and also from his practice, for he kept up redemption of his notes as long as he could. Since this seems to clash rather badly with the rest of his views, historians have brushed aside this evidence. But it is quite possible to arrive from the metallist principle at conclusions that seem to violate it, as the American example of our own time suffices to show. Law's argument admits of the following reconstruction: he first observed -- a clear gain to analysis --that the use of a commodity as a means of circulation affects its valuel from this it follows that the exchange value of the monetary commodity as money can no more be expalined by its exchange value as a commodity than the latter can be expalined by the former -- although of course, as long as the monetary // commodity can freely move between its monetary and 322 its industrial uses, the two must be equal; therefore he explained, quite logically, the exchange value of silver as money on lines of the quantity argument (abondance of money as compared with abondance des produits; but since silver that serves as money has no other use than tp buy goods, it might just as well be replaced by a cheaper material, in the limit[ing case] by one that has no commodity value at all, such as printed paper, for Money is not the Value for which goods are exchanged, but the Value by which they are exchanged [J. A. S.'s italics]. This however cuts the cable that so far [has tied money to a commodity having] intrinsic value. Now he draws the conclusion that there is an advantage other than the cheapness and absence of worry about how to get and keep [an adequate supply of money] -- it is that the quantity of money is fully manageable.

[The preceding paragraph was unfinished with notes at the end which were filled in by Arthur W. Marget.]

This then seems to have been the work that gave birth to the idea of Managed Currency, which subsequently lost to the large majority of economists until it forced itself upon them after 1919. The evident importance of the event makes it worth our while to stay for a moment to consider it. First, he relevant passages in Law's tract (Money and Tradensidered... 1705) acquire additional meaning by his practice, or rather one aspect of it. We are not concerned with his particular schemes, from that of the Banque Generale (1716), which looks so innocuous and almost orthodox, to those of the Compagnie des Indes (1719), which look more and more visionary, and finally those of 1720, which were the ultimate resort of the strong swimmer in his agony. But one great plan was behind all this, in fact, well advanced on the road to success: the plan of controlling, reforming, and leading on to new levels the whole of the national economy of France. This is what makes Law's 'system' the genuine ancestor of managed currency, not only in the obvious sense of that term but in the deeper and wider sense in which it spells management of currency and credit as a means of managing the eocnomic process. And this is what interprets and glorifies the modest passages of the tract.

[see footnoes 4 and 5 p. 322]

322 The word Capital had been partof legal and business terminology long before economists found employment for it. With the Roman jurists and their successors, it denoted the 'principal' of a loan
323 as distinguished from interest // and other necessary caims of the lender. In obvious relation with this, it later came to denote the sums of money or their equivalents brought by partners into a partnership or company, the sum total of the firms assets, and the like. Thus the concept was essentially monetary, meaning either actual money, or claims to money, or some goods evaluated as money. Also though not quite definite, its meaning was perfectly unequivocal, and there was no doubt about what was meant in every particular case. What a mass of confused, futile, and downright silly controversies it would have saved, if economists had had the sense to those monetary and accounting meanings of the term instead of trying to deepen them! Before the eighteenth century howeverthey hardly used it at all. Waiving such questions as whether or not St. Antonine of Florence evolved a capital theory, we merely note that in the seventeenth century terms likfe Wealth, Riches, Stock were often used where we should use Capital, and that throughout the eighteenth -- and even in the first decades of the nineteenth -- Stock was favored for use in nascent capital theory.

Stock, more or less in the sense of either durable or productive wealth --the latter examplified by Child's stock of tools and materials -- was, of course, the object of attention and recommendations. But when I said that economists were late in finding employment for it, I meant employment in articulate analysis involving a theory of the nature and functions of capital. Of this there were only rudiments before Cantillon and the physiocrats. It may surprise the reader to find Quesnay credited with laying the foundations of a capital theory, considering his emphasis on the role of natural agents. We must, however, go further than this and simply recognize the presence of one of those of those cases -- they are as frequent in science as they re in politics -- where a man achieves if not the opposite of, yet sojmething quite different from, what he intends to achieve: the physiocrats were even responsible for one of the later theories of the productivity of capital. The whole process described by the tableau starts starts from given advances and, moreover, runs on in terms of the annual advances. These advances are goods -- to live on or to produce with -- though their quntity may be expressed in terms of money, and they are precisely what capital means in one of the many senses of the word. The idea is so important for the general character of any theoretical scheme that adopts it that we may well form a group of the schemes that do os and call it advance economics.

The point was almost immediately seized upon by Turgot, who sketched out the corresponding theory of capital. He emphasized -- one may almost say he 'rubbed in' -- that wealth other than natural agents (richesse mobiliere amassee d'avance) is prealable indispensable for all production (Reflexions LIII), which amounts to offering his shoulders for future attempts to treat capital in this sense
324 as a factor of production. In his own way, A. Smith did // the same thing. But one of the reasons for believing that he did not know the Reflections (publ. in the Ephemerides, 1769-70) is that his exposition, though infinitely more prolix, falls far short of Turgot's. It looks to me as if Chapter I of Book II of the Wealth represents what he himself made of Quesnay's suggestion. The 'advance' idea is there and so is a hint of the productivity (necessity) of

324 capital, but instead of a theory of interest, as in the case of Turgot (see below, #7), only a taxonomy of capital comes from it--Quesnay's primitive advances may have suggested the concept of fixed capital, Quesnay's annual advances may have been transformed into 'circulating capital,' and A. Smith then proceeds to enumerate the various categories of goods that form the one and the other and to discuss what should and what should not be included in each category. It has often been pointed out that, owing to his different confusing points of view, this taxonomy is not quite satisfactory. We need not go into this. All that matters is that a physical or 'real' capital concept--which however included money, the acquired and useful abilities of all the inhabitants, and also, though this is not obvious from Smith's catalogue, the means of subsistence of 'productive' laborers--was handed down to the theorists of the nineteenth century and, with but minor criticisms, accepted and further developed by most of them.

And so was the Turgot-Smith theory of saving and investment. With tremendous emphasis A. Smith lays it down (ch, 3 of Bk II) that 'parsimony and not industry is the immediate cause of the increase of capital'; that it puts into motion an additional quantity of industry; that it does so immediately (without lag) for what is annually saved is as regularly consumed as what is annually spent, that is, the saver spends as promptly as the prodigal, only he does so for different purposes and the consuming is done by other people, that is, 'producitive laborers' and 'every frugal man is a public benefactor.' Turgot, only with a lighter touch, had written all this before. But not Quesnay,/nor Boisguillebert,/nor Cantillon./ Turgot evidently broke away from an anti-saving tradition established in his circle. Nor do I know of any earlier French economists-- with the possible exception of Refuge--who could be credited with genuine predecessorship. Among English economists only Hume had any claim. No doubt, a host of writers, in the seventeenth century and before, declaimed against luxust (and the mischief of idleness), especially imports of luxuries, called for or approved sumptuary laws, and commended economy, at least for the bourgeois

325 and the workman. Among Spanish // and English economists this was, in fact, quite a fashion. The latter in particular held that inadequate propensity to save was one of the reasons that made it so difficult for Englishmen to oust the Dutch--for whom they felt so much resentful admiration and who were supposed to be so frugal--from their leadership in international trade. But this linked up with a conception of saving and investment that stopped in most cases at the accumulation of stocks of durable goods, gold and silver, in particular, and at a favorable balance of trade--the mercantilist angle to be considered in the next chapter. Nobody saw, or at ny rate bothered about, the modus operandi of saving and capital formation per se. Turgot, then, must be held responsible for the first serious analysis of these matters, as A. Smith must (at the least) with having it inculcated into the minds of economists.

Two points should be noted for future reference. First, in the face of frequent criticism, Turgot's theory proved almost unbelievably hardy. It is doubtful whether Alfred Marshall had advanced beyond it, certain that J. S. Mill had not. Böhm-Bawerk no doubt added a new branch to it, but substantialy he subscribed to Turgot's propositions. Second, the theory was not only swallowed by the large majority of economists: it was swallowed hook, line, and sinker. As if Law-- and others--had never existed, one economist after

325 kept on repeating that only (voluntary) saving was capital creating. And one economist after another failed to look askance at
326 that word 'immediately.' // But in effect--whatever the benevolent interpretation might make of it--this came to mean that every decision to save coincides with a corresponding decision to invest so that saving is transformed into (real) capital practically without hitch and as a matter of course or that, to put it differently, saving practically amounts to supplying (real) capital. The reader need not strain his imagination unduly in order to realize what a difference it would have made to doctrinal history if the possibility and, in depressive situations, the likelihood of the occurence of hitches had been pointed out from the first--of hitches that may paralyze the mechanism described by Turgot and cause saving to become a disturber of the economic process. hence possibly a destroyer instead of a creator of industrial apparatus. Not only would such an admission broken off the spearhead from modern attacks upon the theory but it also would have made it a more effective analysis within the situations for which it is quite true. There
327 was the less excuse for refusing to recognize the necessary // qualifications because they could have been taken from earlier as well as contemporary economists, especially from Quesnay's Maximes

If saving is allowed such a part in the drama, the 'prince' (that is public expenditure, hence public debts) cannot expect to escape the role of vilain, or one of the vilains, in the piece. The topic of public debts, though interesting from the standpoint of economic sociology and also from the standpoint of financial technique, is of little moment for us, because judgment and advocacy greatly prevailed over analysis. Some indeed went so far as to make them a factor in national prosperity. The opposite tendency prevailed, however--votaries of ideological interpretation are welcome to trace this to the increasing influence of the bourgeois mind, which in fact ad more reasons than one to dislike cavalier finance. It was strongly ponsored by Hume and Smith. From their theory of saving--embryonic in Hume, developed in Smith-- it follows indeed that public or any borrowing for nonproductive purposes spells setback in the growth of wealth. It is less easy to see that the public debts of their time were crushing burdens likely to produce bankruptcy and ruin. They hardly did more, however, than to express current opinion on the subject. The English public was in fact so nervous that the Pitt government in 1786 esumed, on a larger scale and more seriously, the policy of paying an annual sum into a Sinking Fund.

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Part II ch. 6 #7 Interest 327-334

327 The most significant thing to notice in the interest theory of the period is the emergence, and all but universal acceptance, of the propositions (1) that interest on business loans is nothing but normal business profit transferred to lenders, and (2) that normal business profit is nothing but the return on the physical means of production, labor's means of subsistence included. So essential is it for us to grasp the full importance of this development which was to shape the subsequent history of interest theory that, in order to make it stand out clearly, we shall neglect side issues and cross currents as far as possible. In particualr, we shall neglect discussions of interest on loans for purposes of consumption... (incomplete)

328 [(a) Influence of the Scholastic Doctors.] We start again from the work of the scholastic doctors and their Protestant successors to hich the reader had better refer before perusing this section. Their infleunce asserted itself in two ways. On the one hand, they provided one of the main topics of discussion: the controversy on the legality of charging and paying interest went on. In the second half of the eighteenth century, it flagged but it did not quite die out, and even Turgot wrestled, in his tractMemoire sur les prets d'argent, with the Aristotelian position. Into this we need not go again. But a cognate point demands our attention. In most countries the moral issue was partly ousted by a purely economic issue, which turned not on the old question of principle, but on the question of the expediency of reducing the rate of interest by legislation. English merchants especially, looking with resentful admiration on commercial conditions in the Netherlands, embraced the theory that will naturally occur to the untutored practicioner, namely, that one of the causes, perhaps the main cause of the flourishing state of Dutch trade in the seventeenth century was the low rate of interest that prevailed there, and they insisted that legal regulation could confer the same benefit upon England. It will suffice to mention Child as the most eminent among the many exponents of this theory and to glance at the footnote below at what seem to me to be the better part of the ensuing controversy from which the opposite theory, namely, that a low rate of interest is the consequence and not the cause of wealth--not to be seriously challenged until our own time. From this it does not follow, of course, that legal regulation of the rate of interest can have no sense at all. In fact, neither Locke nor A. Smith went so far as this. But in the end this view prevailed.

On the other hand, scholastic doctrine also provided the theoretical (explanatory) ideas about interest from which the analysis of of the seventeenth and eighteenth centuries started. Neglecting minor points, we shall concentrate upon these two: the monetary
329 onception of interest and the proposition // enshrined in Molina's pithy saing that 'money is the tool of the merchant's trade.' The scholastics did not indeed the concept of interest to interest on loans of money, but the latter naturally commanded their attention more than anything else; they never agreed on or developed the idea that prospective porfits are the source of the demand for business loans, but some of the most eminent of them adumbrated it with unmistakable clearness.

During the seventeenth century and far into the eighteenth, the large majority of economists upon interest--as many of os do again now--as a monetary phenomenon. In particular, this is true of Culpeper, Manley, Child, Petty, Locke, and Pollexfen, not to mention any continental writers. In the case of Petty, direct scholastic

329 is not inconceivable, since he had received part of his education t a Jesuit college. Looking, quite in the spirit of the scholastic fathers, for a special reason independent of, and additional to, the mere act of transferring money to a borrower, that would explain a premium, he hit upon, or rather resuscitated, the 'inconvenience' (a damnum) suffered by the lender who bound himself not to call for his money during a certain time. In any case--and in spite of the fact that he related this inconvenience to the rent of so much land as the same sum would buy--it is always money he is thinking of, and it is the quantity of money which is held to determine the rate of interest without there being any indication of the ceteris-paribus rovisoes that would be required to make this true. Locke goes somewhat deeper than this. Owing to his clumsy way of expressing himself, it is extremely difficult to do him justice, but if I have caught his meaning, he may be credited with having introduced explicitly and having developed the second of the two ideas mentioned above. Again interest is a price for money lent. But the supply on the money market must be seen in relation to the debt situation and the state of trade--high profits raising, low profits reducing the rate. Though we cannot stay to prove it, still less to consider objections, I think that, at a push, this may be interpreted as an embryonic form of the Swedish loanable-funds theory: interest is explained and determined by a demand proceeding from expected profits and meeting a supply of loanable funds.

[(b) Barbon: Interest is the Rent of Stock.] But further development did not take this line. There is no bridge between Locke and monetary interest theories of today. Instead there was a new departure, which was to be so successful that even now we find it difficult to be as surprised at it as we ought to be. There are, so far as I know. only the most elusive indications of it before 1690, when Barbon (Discourse of Trade) wrote the momentous statement: 'Interest is commonly reckoned for Money... but this is a mistake; for the Interest is paid for Stock,' it is 'the REnt of Stock, and is the same as the Rent of Land; the first is the Rent of the Wrought or Articial Stock; the Latter, of the Unwrought or Natural Stock.' If the reader is to

330 understand // the history of interest theory during the nineteenth entury, and some part of it during the first four decades of the twentieth, it is absolutely necessary to understand what this means.

At first sight, Barbon's statement might well sound trivial; of course, the borrower does not want the money merely to look at it; what he really wants, if we neglect the purpose of refinancing other obligations, are the goods and services he actually buys with it. Neither do we want for its own sake the knife with which we cut our food, and yet it does not follow that the price we pay for the knife is 'really' paid for the food. For certain purposes we may indeed, for instance by means of the theory of imputation, adopt such a view of the matter. But it would be an astounding as well as important result if it were permissible to adopt it for all purposes. Granting even that business loans are normally used for purchasing or hiring real capital in the sense ofproducers' goods and services, it does not follow that the interest paid for the former is 'really' an element of the price of the latter; interest may bear a particular relation to 'money' as distinctfrom the goods that are bought with it, or it may be a price for something else--the sacrifice involved in saving, for instance--that cannot simply be identified with 'real capital.' To aver that it is possible to brush aside the monetary element without losing anything essential in the process is therefore an extremely bold step--which neither the scholastics nor Petty nor Locke thought of taking,

330 though the triviality above cannot have been unknown to them; in particular, it was the decisive step toward the real analysis of the nineteenth century, according to which money was just a 'veil' that it was the business of analysis to lift, whihc is precisely the center of the analytic difficulties created by Real Analysis.

In addition to the service or disservice Barbon rendered by the impulse he have in the direction of Real Analysis, there is another aspect that is hardly less important. If interest is the return on 'wrought stock'--produced means of production-- exactly as rent is the return on 'unwrought stock'--natural agents of production--then it is goods of some kind or other that the lender really possesses. As a matter of fact, it is the manufacturer or trader who possesses such goods, and he gets them either by producing them himself or by buying them from other producers and not from the capitalist or lender. To neglect this and to reason as if the latter lent goods is another stroke of analysis, the boldness of which is hidden to us only by our familiarity with it. But thne the return on these goods materializes in the hands of the businessman who uses them and constitutes the main --and theoretically basic--art of the profit, at least if we choose to make light of his trouble and risk. Thus we easily slip into a position that may easily be characterized by the equivalnt propositions that the business firm earns interest or that the lender receives profit--not as would seem more natural to the unprejudiced mind, an income sui generis of which profit is merely the most important source.

[(c) Shift of Analytic Task from Interest to Profit.] For the whole of the nineteenth century and beyond, this shfited the analytic task from interest to profit.// With the partial exception of abstinence and psychoogical-discount theories, the phenomenon to be explained was the net surplus of business, which, in turn, was essentially a surplus arising from the use of an assemblage of certain physical goods; that this surplus, cleared of accessories such as compensation for trouble and risk, had to be handed to some other person, if this person and not the business manager was its real (though not legal) owner, hardly required independent explanation. This applies also to Böhm-Bawerk and Wicksell, though the latter made the first step beyond this theory and even now must be kept in mind when we compare such a theory as Keynes's with other interest theories: the object of analytic endeavor is different.

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It is not too much to say that this was the dominant feature of the theorist's general picture and even of economic sociology for everyone: the businessman became the capitalist. Fundamentally his income was income from ownership of goods, an impersonal source.

[THE two preceding paragraphs were on a single page with notes (both shorthand and longhand) to indicate how the argument was to be continued. This section on interest was more fragmentary than any other part of this unfinished chapter. It was obviously an outline that would have to be filled in an completed had the author lived.]

A. Smith substantially accepted this theory of interest and of the capitalist process. The nineteenth century in turn accepted it from him. However before considering the precise form which he gave it, we must glance briefly at its development between 1690 and 1776.

Barbon's Discourse, on this point at all events, did not meet with success. The tract seems indeed to hvae been forgotten very soon. Thus, Barbon's fundamental idea remained in abeyance until 1750, when it was again expounded--for all we know, independently rediscovered--by Massie [Joseph Massie, Essay on the Governing Causes of the National Rate of Interest, 1750] , whose analysis not only went further than Barbon's but also gathered force from its criticism of the views of Petty and Locke. Two years later, in his volume entitled Political Discourses, Hume published two essays ("Of Interest' and 'Of Money')

331 that do not seem to have received due tribute from recent historians. It is indeed true that, on the surface, we see little more than synthesis and effective re-exposition of ideas that had been put forth before. This impression is particualrly strong with authors who attend primarily to certain practical results he drew from his analytic set-up, such that interest is not simply a function of the quantity of money, that low interest is is a consequence and not a cause of wealth, that it cannot be determined by legis lation, that it is correlated with profits in a relation of mutual interaction, and that it is a barometerof the state, low interest being 'an almost infallible sign of prosperity' (which, of course, is not true of every instance of prosperity)-- none of which was novel. But the analytic set-up with which Hume backed all this, though sektchy, can be called synthetic, only in the sense in the sense in which synthesis may transcend coordination and be creative. It amounts to accepting Locke's expalanation of the demand for loans-- definitely loans this time, not 'money'--
332 by the needs of // spendthrift landowners and by the profit expectations of businessmen, and to replacing Locke's supply of money by the supply of savings. This allows for the close relation between profit and interest without identifying them, and admits the monetasy asoect--particularly as regards short-run effects of variations in the quantity of money on the rate of interest that were also recognized by Ricardo--without making it dominant. In short, we have here a schema that need only have been worked out in order to produce a much better and complete theory of the interest phenomenon than can be found in Ricardo or Mill. But precisely the most valuable points were lost.

[(d) Turgot's Great Performance.] Turgot's contribution is not only by far the greatest performance in the field of interest theory that the eighteenth century produced but it clearly foreshadowed much of the best thought of the nineteenth. Like Hume, Turgot argued that the quantity of money does not determine the rate of interest, very nicely emphasizing the conceptual independence of the two meanings n the phrase 'value of money'--its value in the money market and its value in the market of commodities--and even going so far as to assert that an increase in the quantity of money that raises commodity prices might conceivably increase the rate of interest. Also like Hume, he substituted supply of savings for supply of money. And there are other points that Hume made before him. But his theory goes much deeper than all that and is quite different in content as
333 in background. // Canonist influence as we might expect is much in evidence--though of course scholastic ideas are sometimes made to serve exactly opposite ractical conclusions--and one essential feature of Turgot's scheme, the identification of capital with advances, goes back to Quesnay or Cantillon. The hommes industrieux share their profit with capitalists who supply the funds (Reflexions lxxi). The share that goes to the latter is determined like all other prices (lxxv) by the play of supply and demand among borrowers and lenders (lxxvi), so that from the outset the analysis is firmly planted in the general theory of prices. At first blush and on the surface, interest is the price paid for the use of money (lxxii, lxxiv). But why does the use of money command a price or, to it differently, why does the mechanism of supply and demand work out in such a way as to produce normally a premium on present as compared with future money? Turgot realized that it is not enough to answer that money lent is money saved. His answer was that the fonds supplied by the capitalist

333 represent richesse mobiliere or advances, which are an indispensable prerequisite of production (liii): capital yields interest because it bridges the temporal gap between the productive effort and the product (lix, lx). By now, this idea has become as stale as a quotation from Hamlet. Moreover many of us have ceased to believe in its explanatory value. For both reasons. For both reasonsthe reader may find it difficult to admire as he should the brilliance of the stroke by which Turgot, exploiting Cantillon's or Quesnay's concpetion of capital, tied the phenomenon of interest to a most elementary fact about production. The proposition that the rate of interest is the thermometre of the relative abundance or rarity of (real) capital (lxxxiii)--in other words, that the rate of interest is negatively correlated with the rate of saving--and that it measures the extent to which production can be carried (lxxxix) also acquire additional meaning in the light of the theory. The first remained practically unchallenged until our own time, the second remains unchallenged even now.

As has been stated before, A. Smith stereotyped the doctrinal situation. But in doing so he dropped precisely the most promising suggestions oriffered by Hume and (if he knew the Reflexions) by Turgot--still more those that he might have found in Locke-- so that his successors started from a formulation that was much more Barbonian that that of any of these writers. In the Wealth, the monetary aspect of the interest problem is definitely reduced to a matter of form or technique. 'What the lender really supplies...is not the money but... the goods which it can purchase' (Bk II, ch. 4), and there is nothing in the views of 'Mr Locke, Mr Law, and Mr Montesquieu' that an increase in the quantity of gold or silver lowers the rate of interest (ibid.). The tendency of the rate of interest to fall he explained in exactly the same way as the tendency of profit to fall (Bk I, ch. 9), which really deals with the same topics as Bk II, ch. 4), both of which A. Smith seems to accept--with a qualification about 'acquisition of new territory or of new branches of trade'--as unquestionable facts. And this is quite logical for, as should be clear by now, they are, in A. Smith's schema, really one and the same thing. A. Smith does distinguish them: profit also includes compensation for
334 'trouble' and // 'risk', whereas the lender receives his interest without such trouble and risk. But these are relegated to a secondary position. Essentially, profit is 'profit of stock,' and interest which goes to the capitalist employer goes for 'stock' (goods) lent. Whether the stock be his own or borrowed from some other person, to supply the workmen with stock is the businessman's basic function. First and foremost, he is the capitalist and as capitalist he is the typical employer of labor, whose basic function it is to supply the workmen with stock though this capitalist employer need not always do the employing himself, in which case...

This paragraph was written on a yellow sheet still adhering to a pad and was obviously unfinished. The page, which was crowded with notes in Austrian shorthand and in English shorthand is reproduced in the Appendix.