Economics Brief
SEEL-Systems Engineering Economics Lab
THE GEORGE BOOLE FOUNDATION LIMITED

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.

From: Twitter: Posted 10:18 PM · Apr 6, 2023

Twitter Search title:

The Real Incomes Approach to Economics 101

# Theories of Money

Hector W. McNeill, SEEL

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:

$$M.V = P.Y \ldots (i)$$

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

## The Cambridge Equation

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.


*Pigou*

A version of this is shown below:

$$(M - s).V = P.Y \ldots (ii)$$


*Marshall*

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.

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.

# The Real Theory of Money

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

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

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.

The Real Money Theory, also referred to as the Real Theory of Money, was upgraded by McNeill in February, 2024), to include productivity which counteracts the inflationary impact of anticipatory pricing/.

Anticipatory pricing occurs in a widespread fashion where goods and service producers augment their prices to compensate for rises In input prices in order to preserve profits to guarantee future activity and employment.

The other objective of anticipatory pricing is to ensure that cash flow rises to be able to purchase all required inputs, facing rising prices, can be secured for the next production period.

In summary, anticipatory pricing tends to raise inflation which reduces consumer purchasing power.

The relationships between percentage aggregate unit input costs and the percentage unit output price responses can be summarised in the Price Performance Ratio (PPR)

$$PPR = dUP/dAUC \quad . \quad (i)$$

Where

dUP is the percentage unit price response to;

dAUC the percentage change in aggregate unit input costs.

This measures the degree by which companies contribute to inflation.

## Price Performance Ratios (PPRs) & Anticipatory Pricing

In terms of anticipatory pricing there are three key PPR values:

A PPR in greater than unity (>1.00) raises profits and inflation above the input rate and this it has been referred to by some workers as “greedflation” and the purchasing power of consumers falls as do their real incomes.

A PPR of unity (=1.00) maintains profits and inflation remains at the input rate. Although this is often the aim of companies under competitive conditions, the natural tendency to attempt to lower risks, usually results in the PPR rising above 1.00. In this case consumer real incomes continue to decline at the rate on input inflation.

A PPR of less than unity (<1.00) results in a fall in margins but inflation falling to a level below the input rate. In this case there will be a rise in consumer purchasing power or real incomes.

## The impact of productivity

By using the PPR as a measure of productivity to counter the inflationary impacts of price productivity a weighting or “w” can be used to represent the PPR to alter the price P in the Real Money Theory identity according to the aggregate PPR across the economy in the production of goods and services.

$$(M - ( l + r + p + m + a + h + f + c + o + s )).V = (w.P).Y \quad ... \quad (iv)$$

## The Value Theory of Money

This formulation (iv) has been named ”*The Value Theory of Money*” because the productivity factor “w” enables the identity to be queried to assess the impact of the locational-state of all factors on the value of the currency according to whether prices are rising, stable or declining.

This also enables policy makers to determine the movement in real incomes.

Therefore, if w“” is greater than unity, augmenting inflation and the price, Y or real incomes will decline with currency value.

A “w” of less than unity will result in lower prices, a rise in the currency value and a compensatory higher real incomes (Y).

It is time to abandon the QTM identity and therefore the logic of monetary policy from price .

*McNeill*

Hector Wetherell McNeill is the lead developer of the Real Incomes Approach to Economics. Twitter name: @HectorWMcNeill

He is a graduate of Cambridge & Stanford Universities and Director of the George Boole Foundation Ltd. He is the Coordinator of SEEL-Systems Engineering Economics Lab, the Applied R&D unit of the Foundation.

.

SEEL-Systems Engineering Economics Lab
is a division of
The George Boole Foundation Limited
http://www.seel-telesis.com