shall substitute the proposition that expenditure creates its own income, i.e. an income just sufficient to meet the expenditure. This, we shall find, is a more general proposition than the former. For whilst the former must be taken to mean that a change in the aggregate cost of production will be balanced by an equal change in aggregate expenditure, the latter is consistent with inequality between changes in the cost of production and changes in expenditure.

The doctrine that supply creates its own demand has dominated classical theory during the century since Ricardo established it. Malthus's powerful arguments against this theory were completely forgotten, partly—

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III

The distinction between a co-operative economy and an entrepreneur economy bears some relation to a pregnant observation made by Karl Marx,—though the subsequent use to which he put this observation was highly illogical. He pointed out that the nature of production in the actual world is not, as economists seem often to suppose, a case of $C-M-C'$, i.e. of exchanging commodity (or effort) for money in order to obtain another commodity (or effort). That may be the standpoint of the private consumer. But it is not the attitude of *business*, which is a case of $M-C-M'$, i.e. of parting with money for commodity (or effort) in order to obtain more money.* This is important for the following reason.

* Cf. H. L. McCracken, *Value Theory and Business Cycles*, [New York, 1933] p. 46, where this part of Marx's theory is cited in relation to modern theory. The excess of $M'$ over $M$ is the source of Marx's *surplus value*. It is a curiosity in the history of economic theory that the heretics of the past hundred years who have, in one shape or another, opposed the formula $M-C-M'$ to the classical formula $C-M-C'$, have tended to believe *either* that $M'$ must always and necessarily exceed $M$ *or* that $M$ must always and necessarily exceed $M'$, according as they were living



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The classical theory supposes that the readiness of the entrepreneur to start up a productive process depends on the amount of value in terms of product which he expects to fall to his share; i.e. that only an expectation of more *product* for himself will induce him to offer more employment. But in an entrepreneur economy this is a wrong analysis of the nature of business calculation. An entrepreneur is interested, not in the amount of product, but in the amount of *money* which will fall to his share. He will increase his output if by so doing he expects to increase his money profit, even though this profit represents a smaller quantity of product than before.

The explanation of this is evident. The employment of factors of production to increase output involves the entrepreneur in the disbursement, not of product, but of money. The choice before him in deciding whether or not to offer employment is a choice between using money in this way or in some other way or not using it at all. He has the command of £100 (in hand or by borrowing), and he will use it if by so doing he expects, after deducting his variable costs including interest on the £100, to turn it into more than £100. The only question before him is to choose, out of the various ways of employing £100, that way which will yield the largest profit in terms of money. It must be remembered that future prices, in so far as they are anticipated, are already reflected in current prices, after allowing for the various considerations of carrying costs and of opportunities of production in the meantime which relate the spot and forward prices of a given

in a period in which the one or the other predominated in actual experience. Marx and those who believe in the necessarily exploitatory character of the capitalist system, assert the inevitable excess of $M'$; whilst Hobson, or Foster and Catchings, or Major Douglas who believe in its inherent tendency towards deflation and under-employment, assert the inevitable excess of $M$. Marx, however, was approaching the intermediate truth when he added that the continuous excess of $M'$ would be inevitably interrupted by a series of crises, gradually increasing in intensity, or entrepreneur bankruptcy and underemployment, during which, presumably, $M$ must be in excess. My own argument, if it is accepted, should at least serve to effect a reconciliation between the followers of Marx and those of Major Douglas, leaving the classical economists still high and dry in the belief that $M$ and $M'$ are always equal!



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commodity.* Thus we must suppose that the spot and forward price structure has already brought into equilibrium the relative advantages, as estimated by the holder, of holding money and other existing forms of wealth. Thus if the advantage in terms of money of using money to start up a productive process is increased, this will stimulate entrepreneurs to offer more employment. It may be true that employment will be greater in one situation than in another, although the larger money profit in the first case corresponds to a smaller quantity of product than does the smaller money profit in the second case. For the entrepreneur is guided, not by the amount of product he will gain, but by the alternative opportunities for using money having regard to the spot and forward price structure taken as a whole.

Thus the classical theory fails us at both ends, so to speak, if we try to apply it to an entrepreneur economy. For it is not true that the entrepreneur's demand for labour depends on the share of the product which will fall to the entrepreneur; and it is not true that the supply of labour depends on the share of the product which will fall to labour. It is these fundamental divergencies at the outset which make it impracticable to start with the classical theory and then, at an advanced stage of the argument, to adapt its conclusions to the vagaries of an Entrepreneur Economy.

## IV

The theory of 'appreciation and interest', as it is usually called, chiefly associated with the name of Professor Irving Fisher but first originated by Marshall, is, I think, vitiated by the same considerations. Suppose that £100 rises in value by 10 per cent over a year and is lent out at 5 per cent for the same period, then it is said that the 'real' rate of interest is

* For an examination of this *vide* my *Treatise on Money*, Vol. II [*JMK*, vol. VI], Chapter 29.



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