Minister Vanoni and his colleagues, is to bring about, not an increase in tax revenue, but a better distribution of the aggregate load, with the gradual elimination of the regressive and anti-productive features of the present system. The cumulative impact, through time, of such changes upon both the volume and the pattern of investment and production can hardly be overestimated.

17. — Monetary policy as such (let it be said once more: disregarding the complications of the post-Korean situation) does not have to play a paramount role in the framework outlined above. Unquestionably, there is a great deal that could be done, gradually and through time, to bring about a more effective use of the nation’s savings, and to help create conditions under which more capital could become available, or at any rate be released for investment. Some useful object-lessons in that respect might be drawn from recent United States experiences. Admittedly, it took many years in this country, and the spur of an unprecedented industrial expansion generated by World War II and the following boom, to bring about conditions which finally attracted on a large scale new capital into business investment. Such a stimulus cannot be expected in Italy, under the most favorable conceivable conditions. There have been, however, certain developments, such as the growth of mutual funds and the increasingly vast and aggressive part played by life insurance companies in the capital market, which might be paralleled to a certain extent even in different environments. Moreover, there has been a slow but cumulative and highly effective impact of 15 years of cheap money, and other Central Bank policies, which have powerfully stimulated the recent upsurge in investment. All this would require a detailed analysis which cannot be offered here.

ECA financing has helped to bring down long-term interest rates in Italy, and to weaken somewhat the still inadequately high structure of short-term rates. The process should be continued, and, with respect to the short-term structure, intensified. For the time being, the inflationary pressures originating chiefly from the primary commodity markets and unleashed by the international emergency, require, of course, special caution and vigilance on the part of the Bank of Italy. Generally speaking, however, it may be worth while to emphasize that the contribution of monetary policy to the growth in the rate of investment involves far more than mere quantitative changes in the volume of bank credit, and that its effects can materialize only slowly, through time.

18. — Despite all, Italian Treasury and Central Bank policies have been, in the past few years, toward the acceptance of a more advanced view. National accounting methods are beginning to take root, and as additional experiences gain a fairly accurate and reliable picture of the various segments of the economic structure will become available. This, in turn, will give better tools to the central authorities, and will enable them to plan and implement their policies with greater assurance. The immediate future is, of course, overshadowed by the international tension and the defense emergency, the effects of which may involve — it is to be hoped, only temporarily — some departure from the development trends ushered in by the Marshall Plan. Ultimately, however, the trend should be resumed, in a spirit of sober but definite confidence in the progress that lies ahead.

19. — In the last analysis, of course, the future of Italian production and of the nation’s economy will be largely shaped by trends and policies originating from the United States. This adds a further element of uncertainty and unpredictability to the picture. Yet, it may be stated confidently that it seems most unlikely that the United States will turn its back on the broad trend of international economic cooperation, the beginnings of which have already unfolded under our eyes. And while, in any specific situation, it is most difficult to get advance commitments pledging the United States to this or that specific course, or to this or that specific measure of assistance, there are strong grounds for believing that a long-term Italian effort directed toward improving the quantitative and qualitative structure of investment and production will enlist the appropriate and necessary degree of American support.

A Pseudo-Problem of Monetary Theory: Analysis of the Rate of Interest (*)

by OTTO VETT

No other subject of the theory of money has caused so much fundamental difference of opinion as the analysis of the rate of interest. There is disagreement as to whether the rate of interest is a monetary phenomenon, or whether it must be defined as a phenomenon of barter economy. According to Karnaas and the loanable funds theory represented by Robertson, Ohlin, George Haim, and others, the principal determinant of the rate of interest is a certain proportion of the supply of money to the demand for money. Most of the other theories, which may be termed classical or neo-classical doctrines, consider a certain kind of disposal of money to be the factor determining the rate of interest. Some variants of this initial position are: increased productivity; comparative over-utilization of present goods; comparative under-utilization of future goods; restraint or impotence in the consumption of goods; the entrepreneur’s disposal of means of subsistence; increase in the value of productive factors; taking away of the additional value of production created by the workers, etc., etc. While monetary explanations converge in the point that

(*) The April issue of the "Zeitschrift für die gesamte Staatswissenschaft" will contain a study by prof. Otto Vett on "Pseudo-Problems of Monetary Theory" with the following subdivisions:

1. First Pseudo-Problem: Money and Commodity Money
2. Second Pseudo-Problem: Limits of the Concept of Money
3. Third Pseudo-Problem: Money-Capital-Savings
4. Fourth Pseudo-Problem: Analysis of the Rate of Interest

This Review is glad to publish the English version of the chapter on the fourth pseudo-problem.

(1) As to the coordination of theories considering the rate of interest to be a monetary phenomenon, e.g., Basean P. Halley, Value and Distribution in: Howard S. Ellis, A Survey of Contemporary Economics, Philadelphia 1947-49, p. 204.
possibility of choosing the most favourable moment for purchasing consumers' goods; at the same time there is the chance of being able any time subsequently to make up for the consumption previously deferred. Due to this facility, the utility of the monetary unit is greater than the utility of the consumers' goods which can be acquired by means of this unit. The additional utility takes the place of the yield from the monetary unit. The latter has an intrinsic utility. There is no need for interest to be added.

Thus an explanation is supplied of the fact that money is the only investment goods which does not bear any interest, even if the total investment, of which the money forms a part, promises some profit (natural interest, marginal efficiency of capital). This explanation, however, must be supplemented. While it is based in the first line on the difference in degree of money as compared with all other goods, that is to say, a quantitative factor, the absence of interest may at the same time be considered to be a quality of money. Quantitatively is changed into qualitative. The reason for the absence of interest in the case of money may at the same time be used as a clue to the accrual of interest in the case of other investment goods. The fact that securities which are similar to money bear interest is explained by J. R. Hicks as a consequence of imperfect moneyness (3). Savings deposits and other interest-bearing monetary claims are equivalent, in this sense, to securities, while payment of interest on sight deposits, which are of purely monetary character, appears to be an anomaly theoretically. Wherever interest is paid in this case, this is determined by historical circumstances.

A peculiar revision of the same fundamental idea appears in the theory of interest set forth by Keynes. Understanding of relationships is rendered unnecessarily difficult, however, by this revision. For Keynes, «demand for cash» and «liquidity preference» are synonymous. He who curbs these, who renounces cash, is content with imperfect moneyness. He renounces liquidity. By way of compensation, he is paid interest.

There is a fundamental difference between this purely monetary liquidity concept and the economic theory of liquidity advocated in my study. Liquidity is not a function of money but, on the contrary, money is a function of liquidity. A case of demand for capital (Kapitaltheorie) is explained by the prerequisite of production, the convergence of capital and liquidity becomes obvious. Disposal of capital is economic liquidity of the entrepreneur. This leads up to a conclusion which sounds revolutionary. The great contrast between the monetary and the classical theory of interest, which later was based on equation of demand and supply on a capital market understood in the sense of goods transactions, completely disappears. Being the price of liquidity, the rate of interest is at the same time the price of capital. Since in the modern economic system liquidity chiefly consists of money, the convergence, in theory, of equation of liquidity on the capital market (money market) and equation of capital on the market (capital market) is explained by the convergence of money, capital, and savings, as demonstrated previously (3). If we trace back the phenomenon of liquidity, and consequently the phenomenon of money, to their actual roots which lie in the barters of goods, the rate of interest is nothing else but what it was maintained to be by the classical school, namely, the premium for real savings devoted to production. If, finally, we add the creation of money by the banks as a determinant on the side of supply, we arrive at the interpretation given by Wicksell. The demand for liquidity is replaced by the natural rate of interest, that is, the yield of the investment capital expressed by the entrepreneur. The rate of interest, on the other hand, arises from the supply of liquidity offered by the banks. Thus we have the same contents in three different forms (Keynes-classical school-Wicksell).

If finally, we set aside the whole quid pro quo of the various theories on interest, there remains the following train of thought:

From the outside, every owner of property has the alternative of either consuming directly, or investing in some form or other. If he chooses to invest, he has another problem—the choice between various degrees of liquidity. If he prefers the highest degree of liquidity, he does not obtain any interest rate, in spite of his foregoing consumption. Instead, he enjoys liquidity. He obtains a compensation to the extent only to which he renounces higher degrees of liquidity and chooses a lower degree, when investing his property. Therefore, after the first renunciation of income from consumption, he has to put up with another renunciation, namely the renunciation of a certain degree of liquidity (4).

Thereby, at the same time, he foregoes the possibility of making up for the consumption originally postponed. For this renunciation of later effecting the deferred consumption, that is to say, for another deferment, he is compensated by obtaining an interest rate.

The fact that highest liquidity is not awarded a premium in the form of interest is thus explained, in the final analysis, by the advantage of being at liberty to make use of the most favourable opportunity to purchase. The higher the degree of liquidity, the nearer the enjoyment of consumption proper. The lower the degree of liquidity, the more remote is consumption and the longer is the way from the accumulation of property to the deferred enjoyment. However, the length of the deferral is always limited. No man renounces finally. Accordingly, the owner of property obtains an interest rate only for a limited period—after the period during which he again defers consumption. During this period, the rate of interest will be the higher, the more prolonged the space of time during which he renounces, and the more closely he binds himself during this space of time to the less liquid investment.

Thus the rate of interest, instead of merely being a compensation for renunciation of consumption as such, rather is a compensation for renunciation of consumption and a high degree of liquidity during the period in which consumption is renounced. Interest is paid and received for a double renunciation. The qualitative connection between the two forms of renunciation is shown most clearly in the repeatedly mentioned additional utility of liquidity. The renunciation of the highest degree of liquidity of money is also a renunciation of enjoyment as is the renunciation of the immediate use of income for food, clothing, and other needs. Seen in this light, two similar renunciations of enjoyment are to be made. This bridges the gap in the general conflict.

(3) The only remaining distinction between money market and capital market are differences in the degree of liquidity.

(4) A higher risk involved in an investment also reduces the degree of liquidity. The definition of interest as a "risk premiunm" is therefore included in the definition of interest as presented in this study. Investments at very short term hardly involve any risk, because no change in the debtor's financial position is to be expected. This, in part, explains the low rate of interest charged for short-term lending. On the other hand, in the case of long-term credits the risk is reduced by guarantees in order to prevent the "risk-premium" contained in the interest rate from increasing too much.
A special difficulty arises when savings are made in a medium which determines the value of all other commodities, whose corresponding value in commodities, however, cannot be expressed in any standard. In the case of property investment in money, in savings accounts, or time deposits with a bank, there is lacking the expression of value which otherwise is given by the price or (in the case of securities) by the quotation rate. Nevertheless the owner of a savings or bank account can compare the purchasing value of the money at the end of the investment period with the purchasing value at the beginning. If his decision in favor of an investment in savings or bank account is based on the re-purchasing value of his property, this means that he will take into account, in addition to the nominal interest rate, his anticipations of the development of the purchasing power or the money. This is the theoretic explanation of the widely known fact that whenever a rise in commodity prices is anticipated, there is a falling off in savings with savings banks and banks in favor of real investment and direct consumption.

It is not the confusion of the theory of interest alone which is responsible for the question of the incentive to save being continually misunderstood. An important contributory factor is the lack of precision of the expression "saving." What is meant by this? The renunciation of consumption alone or the choice of a property investment? No one can answer this question in a generally valid manner. If complaint is made about insufficient saving, very often only a particular kind of investment is contemplated, i.e., deposits of money into savings banks. Sometimes, of course, one also thinks that the share of non-consumption is insufficient. As this, however, can also be caused by additional hoarding of cash, it is possible that the renunciation of consumption is precisely what is desired if deposits with savings banks are forthcoming very slowly. The conception of saving becomes still more problematical if real investment is included. Sometimes the latter is considered the opposite of saving, sometimes as a variety thereof. Also in the train of thought of experts there arise problems, which only spring from the choice of a model.

Although it is not possible in economic science to avoid altogether the expression "saving," it should disappear from the Theory of the Cycle. It suffices to state here that temporary renunciation of consumption creates property which will be invested according to liquidity degrees. Such a conception of the Theory of the Cycle can be satisfactorily supplemented by the analysis of the rate of interest as developed in this paper. This makes particularly apparent the one-sidedness with which Keynes demonstrated the liquidity theory of the rate of interest. At the end of the chapter on "A General Theory of the Rate of Interest" he says (6) that the mistakes of previous theories were based on the fact that the rate of interest was regarded as the reward of not-spending, whereas in fact it is the reward of hoarding. Thereby is set up an alternative which does not exist. The rate of interest is the reward for both: for non-consumption and for investment of the utilized funds in a relatively illiquid form (non-hoarding). Out of the large conflict between theories in the rate of interest nothing remains except what results from the diversity of the models used. But these models all have the same content.