To conclude, there are certainly sound arguments supporting the view that the nominal stock of money is partly dependent on the endogenous behaviour of the economic system. This fact, however, does not preclude the existence of two separate supply and demand functions, although it does raise the question of whether the single-equation approach to the estimation of the demand-for-money function is in fact warranted. But the extreme position held by Kelly that it is impossible for the suppliers of money to create "excess" monetary balances, and that the public can never find itself in a position of holding more money than it would wish to hold, does not withstand scrutiny. The Quantity Theory may well be unsatisfactory, or even wrong, but not because of the "basic objection" raised by Kelly.

Basel RAINER S. MASERA

REPLY TO DR. R. S. MASERA

I thank Dr. Masera for his comments. Because space is limited, I shall respond only to his main criticisms of my article[1]

Masera's main objection, not surprisingly, is to my contention that the monetary authorities cannot arbitrarily create excessive money balances in the hands of the public. He first takes the case of government transfer payments financed by printing currency, the same case I examined, and while his analysis of the resulting adjustments is more detailed than mine, we apparently agree on the final outcome, namely, that prices and incomes will rise until the nominal money stock and income are in equilibrium. Masera then concluded that "... this shows that the economic authorities can in fact unilaterally increase the quantity of money, *largely* without reference to demand for it" (italics added). It shows nothing of the sort. Masera, like others before him, fails to distinguish between money and income. The rise in government transfers, in this example, takes the form of money but analytically it must be treated as a rise in the income of transfer recipients. If it is not so treated, no variable in the money demand function ($M^d = kyP$) will have changed and the quantity of money held by the public cannot, therefore, have changed. Incidentally, Masera's use of the word "largely" would indicate that he himself is uncertain of his conclusion.

Dr. Masera's next objection is "... that wealth — and hence expenditure — effects are to be expected... because the community discounts tax

be stable is that there exist both: (a) a stable demand-for-money function and (b) a stable relationship between interest rates and global expenditure. If, however, wealth effects are present, and they have differing impacts on aggregate behaviour, the simultaneous satisfaction of the above two conditions no longer produces a stable money multiplier.

1 "A Critical Note on the Quantity Theory of Money", this *Review*, December 1970.

liabilities concerned with the servicing of government securities", referring to an open-market operation when the demand for money is interest-elastic. His objection overlooks the fact that government securities must be serviced whether they are held by chartered banks, the general public, or the central bank. Shifting securities from one portfolio to another therefore should have no effect on expected tax liabilities.

As to Masera's contention that Quantity Theorists do not advocate monetary cures for economic fluctuations, two comments are in order. First, this is simply not true of the older Quantity Theorists like R. G. Hawtrey.[2] Second, Milton Friedman's suggestion that discretionary monetary policy be replaced by some rule for increasing the money stock is really the monetary policy to end all monetary policy. And as Masera notes, some neo-Quantity Theorists now believe that short-run monetary policy is possible.[3]

I agree with Masera that my conclusion that the monetary authorities cannot arbitrarily create excessive money balances in the hands of the public has far-reaching implications. Specifically, it means that monetary policy is likely to be ineffective and possibly even disruptive. Unfortunately, so long as economists embrace the Quantity Theory, be it an old or a modernized version, they will continue to see in monetary manipulations a means to deal with the basic instability of the modern economy.

Regina. A. KELLY

2 In 1925, Hawtrey wrote: "... the true remedy for unemployment is to be found in a direct regulation of credit on sound lines", *Economica*, March 1925, p. 48.

3 Don Patinkin's recent article, "The Chicago Tradition, The Quantity Theory, and Friedman", *Journal of Money, Credit and Banking*, February 1969, pp. 46-70, raises doubts as to whether Friedman and his followers are even properly described as Quantity Theorists.