

Shifts in the Demand for Money

As economists we recognize that market equilibria can be altered by a shift in either supply or demand. For stability to result from a constant supply, demand must not shift. This, however, doesn't appear to be the case of the demand for money and credit. Desires for liquidity have shifted rapidly. We have just experienced such a major shift. In addition, expectations about future profits also may move rapidly.

Unless we can raise the cost of capital relative to expectations about future profits, we cannot slow the boom without causing grave structural disorders. There are situations in which expectations are even destabilizing for the system. An expected price inflation feeds itself by encouraging people to buy goods and to draw down money balances. This sort of expectation may not be amenable to a rule about the rate of growth of money.

Some expectations about returns on capital may be stabilizing after awhile, but there is little guarantee that the short-run problem will be costless. A sharp reduction in expected return on capital may cause major disruptions. For stability, the use of fiscal policy or discretionary monetary policy may be quite necessary in such a situation. Similarly, if expected returns promise to outpace the cost of capital, especially as in a situation where business firms are particularly liquid, fiscal policy or discretionary monetary policy may be needed to dampen the elements giving rise to those expectations. In neither case should the money supply continue to expand at a constant rate. For it to do so would in the former case not make it easy enough for people to borrow; in the latter case it would make it too easy.