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Chapter 1

THE PROJECT

We may regard the economy as composed of four groups of units that are continuously making and receiving payments:

Families and individuals living by themselves, hereafter called 'consumers'.

Business enterprises, including farms and other unincorporated concerns.

Governments — Federal, state, and local.

Philanthropic agencies not included under government.

Units in one of these groups make payments to and receive payments from other units in the same group and in the three other groups.

For each group, we imagine that a double-entry account is kept. On one side, the account shows all payments received by units in the group. These payments are classified by (1) unit and group making the payment, (2) that for which the payment is received, and (3) form of currency in which the payment is received. On the other side, the account shows all payments made by units in the group, with expenditures classified in a corresponding fashion.

When the accounts for the four groups are completed for a year, they are fitted together. Every payment is reported twice, once in the account of the payer and once in the account of the payee. . . . The detailed classifications of receipts and expenditures should be sufficiently uniform in the several groups to let one add similar items in the four group totals. . . . All economic activities would be represented except dealings of commercial banks with one another, and services rendered or received without pay. . . . A sharp line would be drawn between the payments made and received by an individual as a consumer and as a business man. . . .

. . . these summaries of payments must be distinguished sharply from accounts made to show income and outgo as determinants of profit and loss. Some items are common to both sets of accounts, others appear in both sets but are represented by different amounts, some appear in one set but not in the other. Wesley C. Mitchell, *The Flow of Payments, A Preliminary Survey of Concepts and Data* (an unpublished memorandum, June 1944).

THIS EXPLORATORY STUDY HAS HAD TWO OBJECTIVES: to determine what can be done with the data available for the United States toward providing a comprehensive system of measurements of moneyflows, and to appraise tentatively the significance of such a system of measurements.

The starting point of this project was the unpublished memorandum from which the above quotation is taken. Selecting from among the lines of investigation Mitchell proposed, we have developed moneyflows esti-

mates in the form of a set of accounts for the United States that conforms on the whole quite closely to the specifications quoted. However, we have decided that existing information could be more effectively exploited by increasing the number of sectors and simplifying the scheme of account classification. We have divided the economy into eleven sectors instead of four (Mitchell's fourth sector is a part of one of our sectors), and have classified moneyflows principally by that "for which the payment is" made (i.e., by object of expenditure).

The period covered by the project has been restricted partly by the magnitude of the statistical task, partly by time and funds. Annual measurements have been prepared for the seven years 1936 through 1942. 1936 was included in order to disclose some of the antecedents of the sharp economic recession that began in the autumn of 1937; but it seemed inexpedient to attempt estimates for any earlier year, since the difficulty of handling materials increases markedly each year the measurements are pushed back. 1942 was the last year covered because too many basic data for subsequent years were not available in time.

For the seven years selected, we present a full set of sector accounts of moneyflows and of cash and related balances. The general nature of these accounts is indicated in Chapter 2. Part II is devoted to a more detailed discussion of them. In Part III we explore the significance of this type of economic measurement.

The findings of the project may be briefly summarized. First, a reasonably satisfactory comprehensive system of measurements of moneyflows is possible with existing information. Most moneyflows measurements are necessarily statistical estimates and estimates are seldom impossible — the real question, therefore, was whether estimates that are firm enough to be useful are possible. In the present instance the accounting interrelationships among moneyflows afford, in an unusual degree, the opportunity to crosscheck the various figures. The annual accounts for the seven years are considered sufficiently dependable to admit of various significant inferences. Moreover, with the present accounts as a starting point, it is believed that even with existing data many of the estimates could be materially improved.

Figures for earlier years might be subject to a somewhat wider margin of error. The work on the seven-year period, however, makes it quite clear that reasonably satisfactory figures on a comparable basis can be prepared for each subsequent year as data become available.

With respect to the significance of the system of moneyflows measurements that has been developed, it may be said that they help provide answers to a number of important questions.

There is first a set of quite specific questions to which these measurements give specific answers:

1) Who purchases the gross national product? The economy is analyzed into broad sectors representing groups of purchasers, and the amount of gross national product purchased in each of the seven years by each group is estimated.

2) Where does the money to buy the gross national product come from? The money comes from three sources, and the amount of each source is estimated for each group of purchasers: (a) sales and resales of the gross national product (net of intermediate purchases); (b) net receipts of transfer payments (these are chiefly what we shall call *public purpose payments*, public assistance, gifts to charity, etc.; they include also personal taxes); and (c) net money obtained through financing. (b) and (c) will always be negative for some sectors of the economy.

3) What groups make the transfer payments and advance the money to finance others? The transfer payments made and money advanced by each such group are estimated.

4) What is the relation between the money obtained through financing or advanced to finance others by the various groups, on the one hand, and changes in the equity structure of the economy, on the other? Estimates of opening and closing cash balances, balances of trade credit and debt, and balances of negotiable claims held and outstanding for each sector are related to estimates of the money they advanced or obtained through financial channels.

The answers offered below to these four questions are necessarily summary answers. For many purposes additional detail would be desirable. Our estimates of moneyflows and of cash and claims balances are designed to facilitate their elaboration in such additional detail.

Along with other types of data the moneyflows estimates can help us answer certain broader questions pertaining to the nature of the processes of business expansion and contraction and to the factors involved in particular business cycles. Indeed because business expansion and contraction are phenomena of a money economy, measurements of moneyflows of the type here illustrated should make a substantial contribution to answering questions such as:

1) What part do cash balances play in the processes of business expansion and contraction? What part does credit play? What is the role of the banking and monetary system?

2) How can we trace the cyclical impact of government fiscal policy on businesses and on households? The impact of business policy on households and on government? The impact of household finances on business

and government? How can we determine which sectors of the economy are taking the initiative in the various changes in the level of economic activity?

The usefulness of measurements of moneyflows for questions such as these is only partially explored in Part III, but that partial exploration gives promise of a substantial contribution to current business analysis, if annual moneyflows figures can be provided on a reasonably current basis. And clearly that contribution should be materially increased if some of the more important moneyflows series can be put on a quarterly or semiannual basis. An effort has been made to employ standard series, or derivatives from standard series, whenever possible. Hence a good many current measurements should be feasible, although the task of developing them is a large undertaking.

There are still broader questions on which the type of measurements here presented can be of significant help. Economic theory has usually assigned an important role to money. In the mercantilist tradition this role has been associated with the idea that a 'favorable balance of trade' promotes a high level of economic activity. The classical tradition has been inclined to assume that changes in the quantity of money find expression to a considerable extent in changes in the level of commodity prices. But all monetary theorizing before World War I was perforce carried on with little knowledge of the magnitudes of sector moneyflows and cash balances and it has only recently become possible to give quantitative expression to many of these magnitudes.

Archimedes long ago said that it was useful, when theorizing about quantities, to express them numerically (see the title page). It is true he was referring to astrophysical speculation, speculation about the size of the earth and the distances from the earth to the sun and the fixed stars. Also, he was enough of a Platonist to speak of "magnitudes . . . that . . . should not be left wandering about" (*ἀριθμῶν . . . οἷ . . . μὴ πλανῶνται*) whereas we would say that it is our ideas of the magnitudes that need to be pinned down empirically. But his point is clear, and it is as applicable to monetary theorizing as to astrophysical speculation.

We will contend that the system of measurements illustrated in the following pages has far-reaching implications for those phases of economic theory that have to do with money and moneyflows. We will explore some of these implications and attempt to indicate the lines along which we believe monetary theory should be revised.