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Laughlin's "The Quantity Theory of Money"

In this article from the *Journal of Political Economy*, J. Laurence Laughlin tackles the controversial turn-of-the century debate over the quantity theory of money as its critic. The theory argues that prices are primarily influenced by the quantity of money, or credit, in circulation, as opposed to changes in production costs or demand, and that prices are determined by the amount of money or credit available to purchase goods and services; essentially, the value of money is based on the amount of money in the economy. Laughlin uses this paper to examine several opposing perspectives and voice his disagreement with this idea that a change in the quantity of money would cause a proportional change in prices. In his view, issues of convertible paper money in any economy would instead lead to the losses of gold through the balance of payments, and the quantity theory of money is too simplistic to explain the complex economic factors that influence the price level.

Laughlin begins by discussing the different factors that affect the price of goods and services, and distinguishes between two sets of forces: those touching the standard of money (such as the value of precious metals) and those touching the demand and supply of goods (such as changes in production costs or demand). He argues that real-life business practices have shown that changes in production costs have an effect on prices. Due to this fact, business owners must constantly strive to reduce production costs to remain competitive, and innovation in technology and production processes can lower costs and lead to lower prices. Laughlin notes that the quantity theory of money does not account for these factors. Furthermore, reproducible goods are subject to conditions of production that limit the fixing of prices. The prices that cover the expenses of goods of production are known and relied upon by both buyers and sellers, setting the general level of the price, and thus essential forces on the side of supply and costs limit price-fixing independently of the quantity of money. Laughlin also argues that the quantity theory of money is flawed because it assumes that the total quantity of money and credit in an economy can be compared to the volume of goods offered for sale to determine the general price level. In his argument, these quantities are unknown until after the fact, as they are outcomes of transactions in goods and are influenced by changes in production costs. Changes in the standard of currency, such as a change from a gold to a silver standard, will also have a direct impact on the general price level, regardless of the quantity of money in circulation.

Overall, the information we have covered in class does more than enough to support Laughlin's critique of the quantity theory of money. It is simply not complicated enough to take into account all of the different aspects of the economy that influence the price level, such as production costs, monetary standard, and so forth.