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Finance, Funding, Saving, and Investment

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Finance, funding, saving, and investment

One of the most difficult aspects of monetary theory is to distinguish between the necessary (short-term) financing of an investment project while it is being constructed and the (long-term) funding of an investment project after it is completed. In a monetary economy, real investments flows are not usually undertaken until short-term bank financing arrangements have been made. Once undertaken, the real savings comes into existence *pari passu* with the real investment flow. Once built, the investment goods exist whether the long-term funding process is successful or not.

Since a clear distinction is rarely made between the short-term bank financing and the long-term security market funding concepts, confusion regarding the roles of saving, investment, and the banking system in a monetary production economy is rife in the literature.

In an earlier book (Davidson, 1982), I attempted, apparently unsuccessfully, to draw the distinction between short-term construction fund finance and long-term investment fund finance. I am grateful that Professor Asimakopulos's latest analytical interchange with Professor Kregel in this issue of *JPKE* gives me the opportunity to clarify my view of the role of the banking system whose function it is to create additional short-term finance whenever entrepreneurs wish to increase the flow of real investment. This bank-created (non-resource using) finance must be distinguished from the role of long-term financial markets which require the public to give up an amount of liquidity equal to real savings (i.e., unexercised income claims on resources) in the process of funding the investment.

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