BSM 477

DR. GEORGE REISMAN **SYLLABUS SUPPLEMENT 4**

Money Making and the Concept of Productive Activity

1. The need to earn money to participate in the division of labor; earning money thus an essential aspect of productive activity in a division of labor economy. The vital distinction between the labor of an unpaid housewife and a paid housekeeper.
2. The purpose of money making or not money making as the distinction between production and consumption.

a. Consumptive production—consumers' physically productive activity versus that of business

b. Productive expenditure and consumption expenditure

c. Capital goods and consumers' goods

d. Classification of capital goods and consumers' goods not based on physical characteristics—machines that are consumers' goods

e. Producers' labor and consumers' labor

f. Why government a consumer

g. Producers' loans and consumers' loans; nature of government borrowing

3. The concepts of imputed income and opportunity cost.

a. Fictional incomes and costs based on the idea that the saving of an expense is an income and the absence of an income is a cost. They require the introduction of counterbalancing fictional costs and incomes. E.g., the fictional income of the homeowner and his fictional cost. Fictional housewives' income. The "income" of not having cancer.
b. "Opportunity cost": the successful businessman who runs at a loss; the "gains" of closing down your research department and reducing the alternative opportunities open to you. When to buy a yacht or jump from a skyscraper.

AGGREGATE PRODUCTION AND AGGREGATE SPENDING

A. Aggregate Production

1. Classical economists' view of what is produced—see *Capitalism*, Figure 15-1, p. 675
2. Gross product, productive consumption, and net product.
3. Contemporary, Keynesian economics' view of production as merely the *gain* from production—the net product, which it mistakenly regards as the *gross* product.

a. Alleged production of "product differences" —quote Reynolds , p. 678 of *Capitalism*—underlies procedure of measuring the "gross product" as the sum of values added or as the value of the final product.

b. Final product view follows because every product except the final one is subtracted from production in the next stage. E.g., the notion that bread is the total product of wheat farmers, millers, and bakers follows from viewing the production of each of the producers as the difference between his product and his productive consumption. Thus, over Years 1 - 3 combined: $x_1 + y_1 - x_1 + z_1 - y_1 = z_1$

c. Note: *production is being conceptually obliterated insofar as it is productively consumed.* Only the production of consumers' goods is considered as real.

d. Accompanying confusion of who produces what.

e. Nonsensical implications about what producers such as the bakers, millers, and farmers allegedly do and do not produce; about what economists allegedly write and their wives cook.
Contradiction of obvious facts and of authoritative statistical sources.

4. Contemporary, Keynesian economics' Platonic-Heraclitean view of entities.

a. The notion that the total product in the sense of total product additions (or product differences) is the final product supports the confusion that the final product is the total product in the sense not of mere "product additions," but in the sense of *actual physical entities.* See *Capitalism,* pp. 679-680.

b. On this view, a loaf of bread is not conceived of as a thing that exists independently, out there in reality—that is, as a simple loaf of bread. It is conceived instead as a bundle of abstractions: bread minus flour, plus flour minus wheat, plus wheat minus zero (zero, for the sake of brevity and simplicity).

c. If all three of these abstraction are held together, as indicated by the placement of the brackets and use of italics, then bread is conceived of as bread.

d. If the abstraction bread minus flour is placed on dim, as it were, and allowed to fade from consciousness (as indicated by its removal from within the brackets), the result is that the loaf of bread now appears as flour minus wheat plus wheat minus zero—that is, it now appears as flour.

e. If, finally, the two abstractions bread minus flour and flour minus wheat are both placed on dim, (as indicated by their removal from within the brackets), then the loaf of bread appears as wheat.

f. In this way, a loaf of bread appears as a loaf of bread, a quantity of flour, and a quantity of wheat.

g. It is on this basis that the value of the loaf of bread appears to count the value of the loaf of bread, the value of the flour from which it was made, and the value of the wheat from which the flour was made. And on this basis, counting the value of the bread, the flour, and the wheat separately appears to imply counting the value of the flour and wheat more than once. (See Table 15-1 on p. 681 of *Capitalism* and the equation on the next page showing how contemporary, Keynesian economics views $775 as counted by $300.)

h. In all of these four formulations of its value, the $300 value of the bread at retail still actually counts *only* itslef. But it is mistakenly viewed by contemporary, Keynesian economics as counting in addition the value of the bread at wholesale, the value of the flour, and the value of the wheat as well. Keynesian economics counts the value of these things in addition to that of the bread on the basis of t*wo major violations of the laws of mathematics*: i) it impermissibly jettisons parts of three of the alternative equations showing the value of the bread at retail, and then ii) it equally impermissibly adds to the value of bread at retail the remainders of those three alternative equations, which, being merely different formulations of the one and the same value of bread, are mutually exclusive and thus not properly addable. Its conclusion is then that somehow $300 = $775. Ironically, it is contemporary, Keynesian economics that double counts: it counts the $300 value of the bread at retail as though it were $775. (More specifically, it double, triple, or quadruple counts the value additions the sum of which represent the value of bread at retail.) This, of course, leads to the failure to count the value of the bread at wholesale and of the flour and wheat, in the mistaken belief that they've already been counted.

i. What is present in contemporary, Keynesian economics is a *Platonic-Heraclitean view of entities.* It is a view of entities not as independently existing physical objects which man's mind must grasp, but as the creation of the human mind in the form of bundles of abstractions which can be put together and taken apart at will to form different entities. I call it Platonic in that it views entities as consisting of abstractions. I call it Heraclitean, in that it presents a kaleidoscopic flux, in which a thing is alleged to be simultaneously itself and other things. Instead of the Aristotelian formula that *A is A*—a thing is itself—we have the formula that *A is A+*—a thing is itself plus more than itself.

j. Contemporary, Keynesian economics' confusions about "double counting" and its belief that the final product counts the total product—that it *is* the total product—leads it to *ignore most spending in the economic system*, along with most of production. (Its confusions are supported by the confusions of many non-economists about the nature of entities and about what one buys when one buys it.)

B. Aggregate Spending

1. What is bought when it is bought?

   a. The buyers of goods do not buy the means of producing the goods they buy, nor the means of producing similar goods in the future, nor the products that may be produced from those goods.

   b. E.g., the buyer of a loaf of bread does not buy the flour, wheat, or labor services that were used to produce his loaf of bread—those things were bought by the producers at the various stages.

   c. Nor does he buy the flour or labor services that the seller of the bread may subsequently buy, nor make the latter's research outlays, political or charitable contributions, or any other such outlay.

   d. Nor does he buy a loaf of toast in buying a loaf of bread. He buys only the loaf of bread.

2. Absurdities of the Platonic-Heraclitean view of purchases:

   a. Shadow purchases. Bread, flour, and wheat—all for the same money, all in the same wrapper, and all for the same calories. Contrast with *real* combined expenditures.

   b. Amazing digestive powers.

   c. The ice in the steam.

   d. Why do producers need capital if it is the consumers who buy what they buy?

   e. If you buy the inputs, you don't have to buy the output—you already own it; you buy the output because you *haven't* bought the inputs.

3. The implicit Aristotelianism of the Classical Economists. John Stuart Mill's explicit recognition of the entity issue in his proposition "demand for commodities is not demand for labour."

   Mill's proposition should be restated as "*the Demand for A is the Demand for A.*"

C. Saving and Demand

1. Saving vs. hoarding

   a. Belief that consumption expenditure buys everything implies that there is nothing for savings to buy. Thus, promotes the view that saving is hoarding.

   b. Saving does not mean hoarding as per Keynes and today's financial press: "leakages"; presumed effects of higher saving rate; corollary doctrine of investment out of nowhere; same idea for taxes and government spending.

   c. Idea that saving is hoarding represents fallacy of composition; aggregate nominal saving implies equivalent increase in nominal value of assets, since cash hoarding by any individual just represents an equivalent dishoarding by someone else (the extent to which the money supply increases is the only exception).

   d. Genuine "hoarding" (i.e., increase in need and desire to hold cash) has nothing to do with saving—represents an attempt to change composition of existing savings from assets other than cash to cash.

e. Precipitated by preceding credit expansion, which causes business firms to become illiquid and thus to have to restore their liquidity later on. Result is financial contraction and simultaneous wiping out of nominal net saving, which may become negative.

2. What is saved is spent and actually accounts for *most* spending in the economic system

a. Expensive consumers' goods

b. All the spending for capital goods—*viz.*,all the spending for goods at wholesale, all the spending for machinery, equipment, materials, components, and supplies, and all the wage payments made by business firms. These expenditures are made *by business firms, not by consumers*; they are not consumption expenditures, but *productive expenditures*—viz. expenditures made for the purpose of making subsequent sales. (Consumption expenditures, in contrast, are expenditures made not for the purpose of making subsequent sales.) The productive expenditure for wages, moreover, is the source of the great bulk of consumption expenditures.

c. Thus the great bulk of spending in the economic system is productive expenditure, not consumption expenditure.

d. Productive expenditure depends on saving—on the portion of their revenues and incomes that people do not consume.

e. To the extent that people consume more of their revenues and incomes, and save less, their ability to make productive expenditures is less. If everyone did nothing but consume, there would be no productive expenditure.
E.g., the case of buying goods from a store, whose owners used the proceeds to consume, which is followed by repeated rounds just of consumption out of sales revenues. Only additional consumption would exist in such a case. The only additional income would be *profit.*

3. The "Macroeconomic" Dependence of the Consumers on Business—"money comes to goods"

In contrast to the "microeconomic" dependence of the individual company and industry on the consumers. The two opposite dependencies are consistent in that competition is present at the microeconomic level, but not at the macroeconomic level.

a. Business as the source of its own demand and profitability: The role of productive expenditure and net consumption in the generation of aggregate sales revenues. (See Chapter 16, Part A, sections 2 and 3.)

b. No need for artificial consumption.

4. Saving increases real demand by increasing production.

5. Saving increases monetary demand by bringing about an increase in the production and supply of commodity money.

6. Saving increases consumption in the long run by bringing about an increase in the production and supply of goods.

D. Aggregate Economic Accounting on an Aristotelian Base

1. The accounting aggregates

a. What national income (Y), net national product (NNP), and gross national product (GNP/GDP) *are*, and their mutual relationships

b. The essential relationship:

$$p + w + i + r = Y = NNP = C + I$$

c. Relationship of NNP and Y to GNP/GDP.

2. Keynesian confusions

a. As shown, contemporary, Keynesian economics obliterates the role of saving and productive expenditure.

b. In its eyes, almost all of spending is consumption expenditure. The only other expenditure it recognizes is net investment or what it calls gross investment, which is actually nothing more than net investment plus depreciation allowances. The allegedly gross investment of contemporary, Keynesian economics is plant and equipment spending plus *net investment in inventories.* It is not truly gross at all.

c. Because consumption spending is quantitatively much larger than net or even gross investment, it is usually assumed that consumption spending *pays* the far greater part of national income and constitutes the far greater part of spending for goods and services in the economic system. This view is present in every depiction of national income as being determined by the sum of consumption plus net investment—e.g., the Keynesian cross. See *Capitalism,* Figure 15-2, p. 700.

3. An accurate conception: recognizing the role of productive expenditure

a. See the step-by-step derivation of the equality between the sum of profits and wages, i.e., national income, on the one side, and consumption plus net investment, i.e., gross national product, on the other, on p. 701 of *Capitalism.*

b. See also the closely related demonstration that productive expenditure minus costs equals net investment, on pp. 702-705.

E. Gross National Revenue

$s + w = GNR = C + B$

From this equation, it is possible, as shown in Table 15-4, on p. 707 of *Capitalism,* to go directly to national income on the left, and to net national product on the right, by subtracting aggregate business costs (d)—the same costs that are deducted from sales revenues in computing profits. On the left, d is subtracted from s, which results in aggregate profit, p. On the right, it is subtracted from productive expenditure, which results in net investment, I.

If, in this procedure, one subtracts all costs but depreciation cost, one arrives at the contemporary, Keynesian concept of GNP/GDP. That is, one has profit gross of depreciation on the left, and "gross" investment—i.e., plant and equipment spending plus the *net* investment in inventories—on the right.

F. The Optical Illusion of Consumption as the Main Form of Spending

Table 15-3, on p. 706 of *Capitalism,* is an arithmetical example that clearly illustrates the illusion of viewing consumption spending as the main source of revenue and income payments in the economic system. (The example's relative breakdown of national income between consumption and net investment approximates the actual data found in a typical year.)

1. Questions to test your understanding: Using the numerical data presented in Table 15-5, on p. 708 of *Capitalism,* as an example, answer the following questions:

a. Find total sales revenue and income payments in the economic system.

b. Find the portion of total sales revenue and income payments constituted by consumption expenditure.

c. Find the portion of total sales revenue and income payments constituted by productive expenditure.

d. What portion of wages is paid by consumption expenditure?

e. What portion of wages is paid by productive expenditure?

2. Application of answers to a critique of the Keynesian multiplier doctrine.

   a. The only incomes raised by the successive rounds of consumption expenditure envisioned by the multiplier doctrine would be profits, not wages. Any rise in wages, in the demand for goods at wholesale, in the demand for capital goods of any kind depends on *saving*, which the Keynesians regard as a "leakage" and as allegedly diminishing the amount of subsequent incomes.

   b. See, e.g., Samuelson's multiplier discussion

   c. Plug in his 1000 of initial "investment" into s_b and his implied 2000 of induced consumption into s_c.

   d. State the increase in wages.

   e. State the increase in profits.

   f. Assume 500 of the "initial investment" is in the form of wage payments.

   g. Repeat steps (d) and (e) above.

   h. Samuelson's assumed "marginal propensity to consume" (mpc) in the table is 2/3; rework your answers to (d) and (e) on the assumption that the mpc is .75, .9.

G. Review of Capital Accumulation and thus Real Wages as Dependent on the Relative Production of Capital Goods and the Productivity of Capital Goods

1. The requirements of capital accumulation

   a. Real wages depend on the productivity of labor—viz., on the output per unit of labor, which depends on the supply of capital goods per worker.

   b. The supply of capital goods depends on the demand for capital goods relative to the demand for consumers' goods. This determines the relative production of capital goods, which must exceed the proportion necessary for maintenance, if capital accumulation is to take place.

   c. Capital accumulation also depends on the *productivity* of capital goods—*viz.*, on the output per unit of capital goods. (See Figures 15–5 and 15–6 on p. 710 and 711 in *Capitalism.*) This determines the maintenance proportion and the ability of any given relative production of capital goods to result in capital accumulation.

   d. A sufficiently high relative production of capital goods and a constant productivity of capital goods—sustained by technological progress and innovation—causes a *continuing* increase in the supply of capital goods and thus a continuing increase in the productivity of labor and in real wages.

2. The theoretical significance of giving parity of recognition to the production of capital goods:

   a. This is what makes it possible to see how more capital goods are *themselves* a source of still more capital goods and the role of the productivity of capital goods, technological progress, and everything else that contributes to the productivity of capital goods—above all, economic freedom. For when more capital goods come into existence, it is clear that they are used to produce *capital goods* as well as consumers' goods and that the supply of capital goods *depends on everything that production and supply in general depend on.* These identifications are impossible if one proceeds as though all that is being produced are consumers' goods.

   b. In combination with the assumption of invariable money, the recognition of the parity of existence of capital goods also makes it possible to see the role of saving in terms of force/acceleration, not simple motion. A greater relative production of capital goods, greater saving and demand for capital goods relative to the demand for consumers' goods is not necessary for capital accumulation once a sufficiently high degree of

saving and demand for capital goods exists—as seen, that's accomplished on the basis of the larger supply of capital goods in the year before, coupled with technological progress. More saving and demand for capital goods relative to the demand for consumers' goods would thus serve not to sustain but to accelerate capital accumulation.

H. Capital, the Productive Process, and the Generation of Sales Revenues and Costs—a First Look

a. The Diagrammatic Analytical Framework Using Figures 15–5 and 15–6, on pp. 710 and 711 of *Capitalism.* Reinforcement by means of Tables 15–6 and 15–7 on pp. 713 and 714.

b. The Inverse Relationship Between National Income and Economic Progress in an Economy With an Invariable Money

c. Overthrow of the Keynesian Balanced Budget Multiplier Doctrine and the Doctrine of the "Conservative's Dilemma"