Study Questions for George Reisman's *Capitalism: A Treatise on Economics*

CHAPTER 16. THE NET-CONSUMPTION/NET-INVESTMENT THEORY OF PROFIT AND INTEREST
PART A. THE POSITIVE THEORY

1. Describe the treatment of interest in relation to profit in Chapter 16.
2. "The amount of profit in the economic system is essentially the difference between the demand for the products of business and the demand for factors of production by business." Discuss.
3. Explain why the determinants of the average rate of profit in the economic system as a whole are different than the determinants of the rate of profit of an individual company.
4. Explain the different significance of an individual company earning a given high rate of profit, such as 50 percent, and the average rate of profit in the economic system being that high.
5. Why is the interest rate on government bonds probably not a good indicator of the average rate of profit in the economic system?
6. What is meant by *net consumption?*
7. What is meant by *net investment?*
8. Given that profits in the economic system equal aggregate sales revenues minus aggregate costs, show why the algebraic difference between profits and net investment is business sales revenues paid by consumers minus productive expenditure in payment of wages, i.e., net consumption.
9. Describe the role of productive expenditure both as a source of business sales revenues and as the source of business costs.
10. If productive expenditure were the only source of business sales revenues, what would be the implications for the amount and rate of profit in the economic system?
11. Define net consumption in terms of the difference between business sales revenues and productive expenditure. Why is that equal to the portion of business sales revenues that is paid by consumers minus the portion of productive expenditure that goes for the payment of wages?
12. Define net consumption in terms of the difference between the demand for the products of business and the demand for factors of production by business. Why is that equal to the difference between the demand for consumers' goods from business minus the demand for labor by business?
13. "The principal source of net consumption is the consumption expenditure of businessmen and capitalists, made possible by dividend, draw, and interest payments." Discuss.
14. "Dividend and draw payments, to the extent that they are consumed, are the source of business sales revenues that have no counterpart whatever in productive expenditure and thus the generation of business costs. Thus they are the source of sales revenues exceeding productive expenditure and costs." Discuss.
15. "Interest payments by business, to the extent that they are consumed, are the source of business sales revenues in excess of the productive expenditure and costs that we are considering." Discuss.

16. Explain the role of net consumption in generating an excess of demand for products (sales revenues) over demand for factors of production (productive expenditure) in Tables 161 and 162.
17. In Figure 161, explain the connection between productive expenditure in any given year and the aggregate costs of the capital goods and consumers' goods that appear in the following year.
18. What in Figure 161 determines the allocation of any given year's total productive expenditure between the production of the capital goods and consumers' goods of the following year, and thus the specific aggregate costs of the capital goods and consumers' goods of the following year?
19. What are the two overall categories of demand for the products of business in every year of Figure 161? What are the two basic sources specifically of the demand for consumers' goods each year--that is, what are the two basic sources of the money the consumers spend each year?
20. Identify what it is in Figure 161 that allows business to sell each year for more money in toto than it expends in buying the factors of production.
21. Explain the relationship of Table 163 to Figure 161.
22. How does Table 163 treat productive expenditure in relation to business sales revenues and business costs?
23. Why is net consumption the source of aggregate profit in Table 163?
24. Why is net consumption the source of an aggregate profit in Figure 161?
25. How does Figure 161 differ from Figure 155?
26. How does aggregate profit differ from national income? How does the expenditure counterpart of profit differ from the expenditure counterpart of national income?
27. How does Figure 162 differ from Figure 161? How does Figure 162 make possible a calculation of the average *rate* of profit in the economic system as well as its overall amount?
28. How does it happen that in every year of Figure 162, business both spends all of its cash and yet ends up with exactly the same amount of cash with which to begin operations in the following year?
29. What is the aggregate amount and average rate of profit in every year in Figure 162?
30. Describe other possible sources of net consumption besides the consumption expenditure of businessmen and capitalists.
31. Explain why, in addition to its previous formulations, net consumption also equals total consumption expenditure that constitutes sales revenue *or* wages, minus total wages paid in the economic system.
32. Explain why it is reasonable to assume that all the wages paid by business have a counterpart in the demand for consumers' goods from business, even though wage earners save.
33. In the light of Table 164, explain how a rise in the amount and rate of net consumption raises the amount and rate of profit. Explain what would happen to the amount and rate of profit if all businessmen were to consume 100 percent of their sales proceeds.
34. Explain the implications of your answer to the preceding question for the analysis of Adam Smith's and Karl Marx's contention that in a society without businessmen and capitalists, in which manual workers produced and sold products none of the sales

proceeds from which they productively expended and all of which they consumed, all income would be wages and no income would be profits.

35. Explain why businessmen and capitalists cannot arbitrarily increase the rate of net consumption and the rate of profit.

36. Explain why capital tends to gravitate into the hands of those businessmen and capitalists whose rate of consumption relative to their accumulated capitals is below average and out of the hands of those whose rate is above average.

37. Describe the two principles operating to determine the growth and decline of individual fortunes relative to the total wealth of the economic system.

38. Explain the influence of accumulated capital on net consumption and thus why net consumption exists even in the face of general business losses.

39. Explain how seeing the consumption of businessmen and capitalists as determined mainly by their accumulated capital helps to explain the relationship between *relatively* high incomes in the economic system and high rates of saving, and, at the same time, the lack of relationship between rising *average* real incomes and the rate of saving.

40. What is meant by time preference?

41. How does a high or low time preference in a society affect the rate of net consumption and the rate of profit?

42. Explain why the absolute temporal extent of the present and future--i.e., whether the present is taken as the coming year, month, week, or day, and the future as everything beyond it, has no bearing on the role of the rate of net consumption in determining the annual rate of profit.

43. "The role of time preference in determining the rate of profit is indirect, not direct." Discuss.

44. "Other things being equal, because of the effect on time preference, the average rate of profit and interest will be the lower, the freer and more rational is a society." Explain by way of the effect on the rate of net consumption.

45. In the light of your answer to the preceding question, explain why the effect of the activity of revolutionary bandits and plundering government officials who rail against the existence of profit and interest is actually to raise the average rate of profit and interest.

46. Explain the distinction between productive expenditure and costs.

47. "Much of productive expenditure is added to asset accounts; much of cost represents subtractions from asset accounts." Illustrate.

48. Explain why net investment is the difference between productive expenditure and costs.

49. Explain why, on the basis of their very mathematical definitions, aggregate profit and net investment are closely related.

50. Explain why, on the basis of their mathematical definitions, the difference between aggregate profit and net investment is net consumption.

51. Demonstrate how, starting with the fact that aggregate profit equals aggregate sales revenues minus aggregate cost, it also equals the sum of net consumption plus net investment.

52. Explain what is meant by the net consumption rate?, the net investment rate?

53. Explain how the average rate of profit in the economic system equals the sum of the net consumption and net investment rates.

54. Explain what is meant by "secondary productive expenditure."

55. Explain how net consumption is reduced and conceivably could become negative as the result of the saving of wage earners being used to finance secondary productive expenditures.
56. Explain why the existence of negative net consumption is unlikely.
57. Explain how net investment makes possible the existence of an aggregate profit even if net consumption is negative.
58. How does an increase in productive expenditure for plant and equipment with a life of many years affect net investment?
59. How does an increase in productive expenditure for plant and equipment that requires several years in its construction affect net investment.
60. Describe the various ways that net investment can exist by virtue of a change in the disposition of a given aggregate amount of productive expenditure between various subcategories of productive expenditure.
61. Explain what is meant by an invariable money.
62. Explain how the existence of net investment can be indefinitely prolonged under the existence of an invariable money.
63. Explain why, for example, the process of substituting the production of 12-year old scotch for the production of 8-year old scotch entails a rise in the aggregate amount both of profit and net investment in the economic system.
64. Describe how the shifting of productive expenditures from points less remote from the making of sales to points more remote from the making of sales operates to reduce aggregate costs in the economic system.
65. In connection with your answer to the preceding question, explain the effect on the amounts of net investment and profit in the economic system.
66. Explain what is meant by the expression the marginal productivity of capital as used in *Capitalism*.
67. Explain how if the marginal productivity of capital exceeds the rate of profit, incentives are created that serve to increase the amount of net investment and the amount and rate of profit in the economic system.
68. Explain why the marginal productivity of capital, in the sense in which the expression is used in *Capitalism*, and the rate of profit tend to equalize.
69. Explain why, under the conditions of an invariable money, the ability of net investment to add to the rate of profit is an inherently self-limiting phenomenon.
70. Explain why, under the conditions of an invariable money, it becomes progressively more difficult to keep net investment in being in the face of any given rate of profit.
71. Present two reasons why, under the conditions of an invariable money, the rate of profit comes to equal the rate of net consumption alone.
72. Explain why, under the conditions of an invariable money, the effect of net investment is to bring about a subsequent rise in net consumption and reduction of productive expenditure.
73. "Under an invariable money, savings and capital would be accumulated up to a certain ratio to income, and then, in the absence of a fall in time preference, further accumulation would cease." Discuss.
74. Explain how the increase in the quantity of money operates to perpetuate the existence of net investment.

75. Explain why the increase in the quantity of money tends to bring about an addition to the nominal rate of profit that is approximately equal to itself.
76. Explain why the net investment rate tends to equal the rate of increase in the quantity of money.
77. Explain why the rate of increase in production and supply adds an approximately equal percentage to the real rate of profit.
78. Explain what is meant by "springs to profitability."
79. Describe the various "springs."
80. Describe the various ways in which a lower rate of profit encourages capital intensivity.
81. Explain how wage-rate rigidities operate to block the operation of the most powerful spring.
82. Does the increase in the quantity of money that is the by-product of economic progress operate to reduce the degree of capital intensiveness of the economic system? Discuss.

PART B. THE NET-CONSUMPTION/NET-INVESTMENT THEORY AND ALTERNATIVE THEORIES

1. Describe the explanation of the rate of profit/interest that is provided by the productivity theory. Be sure to include Roscher's famous example of the boat and net.
2. Explain the productivity theory's view of the role of diminishing returns and technological progress in connection with the rate of profit/interest.
3. Diminishing returns and technological progress determine (a) the rate of profit/interest, (b) the rate of capital accumulation in real terms. Explain.
4. Among the difficulties encountered by the productivity theory of profit/interest are (a) a reliance on the doctrine of opportunity cost,(b) the problem of having to subtract mathematically incommensurate quantities, such as loaves of bread forgone versus extra fish produced, (c) a confusion of more physical output with more money revenue, (d) the fact that the rate of profit is highest before there is any capital or productivity of capital, (e) all of the above, (g) none of the above. Explain.
5. "The productivity of capital goods, such as a boat and net, can explain a virtually corresponding addition to the profits of an individual enterprise if it is alone in adopting the more productive method; even then, it cannot explain the existence of an addition to the aggregate profits of the economic system, because equivalent losses on the part of other firms are implied." Discuss.
6. "If all firms in the economic system employ more productive methods of production based on the use of more capital, no addition to aggregate profits or the average rate of profit is implied." Explain and illustrate in terms of everyone adopting the more productive boats and nets in the conditions of an invariable money.
7. Describe the two *indirect* connections that can exist between the adoption of more productive methods of production and a positive contribution to the rate of profit/interest via (a) the effect on the rate of increase in the quantity of commodity money, (b) the effect on net investment.
8. Describe the two reasons why the general marginal net productivity of physical capital goods conceived of in terms of abstract units of wealth, such as the productive consumption of each unit K of capital goods resulting in an output equivalent to $2K$ of capital goods, is far higher than the average rate of profit/interest.

9. Describe the explanation of the rate of profit/interest that is provided by the time preference theory in its traditional form.
10. "According to the time preference theory, profit/interest exists because factors of production are future goods, which are purchased at a "discounted value" in comparison to present goods of the same kind and number, and then mature or ripen into present goods, which shake off that discount and sell at the full value appropriate to present goods." Discuss.
11. "Rothbard's exposition shows that the time-preference theory in its traditional form shares with Böhm-Bawerk's critique of the exploitation theory the error of regarding the wage earners as the real producers of the products, rather than, as is in fact the case, the businessmen and capitalists." Discuss.
12. "The basic formula of the time-preference theory in its traditional form does not demonstrate what it is supposed to demonstrate. Starting with 9 present apples and ending with 10, 20, or 5 present apples a year later simply does not tell us the rate of return that is actually earned in production." Discuss.
13. What assumption does the time-preference theory make about the prices of present goods? Explain why this assumption does not hold up in the conditions of an invariable money accompanied by changes on the side of production and supply. Use Figure 162 as the basis of examples showing why not.
14. What error does the time-preference theory share with the productivity theory in connection with the relationship between a greater or smaller physical product and sales revenues?
15. "The supporters of the time-preference theory in its traditional form are led into the contradiction of regarding increases in production as the cause both of an increase and a decrease in the rate of profit." Explain.
16. Explain and illustrate why it is an error to take the value of consumers' goods as a fixed starting point and to assume that changes in the rate of profit/interest affect only the value of the factors of production used to produce them.
17. "The prices of factors of production are determined by supply and demand no less than the prices of consumers' goods; the rate of discount (viz., profit) then emerges as the result of *differences* between the demand/supply situation in the market for products and the demand/supply situation in the market for factors of production." Discuss, being sure to relate demand and supply differences to net consumption and net investment.
18. Describe the result of Böhm-Bawerk's recognition that whoever has savings of any kind thereby demonstrates that he values the last unit of wealth that he devotes to the future above an additional unit of wealth that he might devote to enjoyment in the present, and thus, to this extent, has *a preference for future goods over present goods*.
19. Explain why the role of time preference in determining the rate of profit/interest is not eliminated by the fact that at the margin individuals may value units of future goods above units of present goods.
20. Describe what is required to view Ricardo's proposition that "profits rise as wages fall and fall as wages rise" as implying the net consumption theory.
21. Explain how the above interpretation is reinforced by John Stuart Mill's proposition that "demand for commodities is not demand for labor," which Ricardo accepted.