Wealth and Capital

Precise understanding requires precise terminology and clear meaning

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There has been some discussion in Internet groups about the meanings and economics of wealth and capital, so perhaps the following analysis can help sort out the distinctions.

Wealth is property with economic value. Economic wealth consists of produced goods with a market value, while financial wealth includes economic wealth and also financial assets such as money, bonds, and land.

Economic wealth excludes labor, as human beings are indeed produced, but are not “goods,” since they are regarded in economics as self-owners. Slaves are persons involuntarily controlled by other persons and illegitimately treated as the economic wealth of the slave owner. Land, meaning natural resources, is also excluded from economic wealth, as it is not produced by human action.

Some economists in the past thought there was a significant distinction between services and tangible goods. They thought goods were wealth, but services were not a form of wealth. Economic theory today properly recognizes that for production, there is no significant difference between services and tangible goods. Consider a haircut. It can be considered a service, but one could also look at is as a tangible good, the reshaping of your physical hairs. Cooking can be considered a service, but one is also manufacturing a tangible good, namely food.

Indeed, the value of wealth is in the services it provides. A car provides the service of transportation. A house provides dwelling services. Services can be considered wealth that is immediately consumed. Consider a concert where an orchestra is playing a symphony. The service, music, is consumed by the audience at the same time as it is produced. The music is wealth because the audience paid to hear it, so it has economic value, even if at the end of the concert it has been consumed, although actually personal value can remain from the memory of the performance. Thus the term “goods” includes services, although it can also refer to tangible goods, as when one says “goods and services” to emphasize that services are included.

Economic production is the creation of economic value. Consumption is the using up of economic value. Goods are used up when they wear out, when they become transformed like food after you eat it, when they become obsolete, or by the use of a time-slot such as a parking space, as time is continuously consumed.

The word “capital” has several meanings in economics. Capital goods consists of goods which have not yet been consumed. For example, when you buy a car, and a year later it is still running, it remains a capital good. But it has less market value than a year ago, so the depreciation is the consumption of the capital good. All tangible wealth is therefore also capital goods. But wealth and capital goods can be intangible. For example, a good reputation of a firm enables it to sell more goods than otherwise, so it has reputation capital, which is a capital good. Accountants call it “good will,” and it has market value, since the firm has a higher value than that based only on its physical stock of goods and land.

Financial capital means assets such as money or bonds. A bond is a certificate of debt, so it is a financial asset but not economic wealth. Money has exchange value, but the value of a paper money note is not in the paper but in the ability to exchange it for economic wealth. The term “human capital” means the knowledge and skills that workers have, and this is part of labor rather than a capital good.

Capital goods have also been defined as wealth that is used to produce more wealth. This is consistent with capital goods as wealth not yet consumed, since the production of wealth includes the services provided by capital goods. If you rent out a house, the house produces housing services to the tenant, and if the same house becomes owner-occupied, the house provides the same services to the owner who now happens to be the tenant also, so it remains a capital good.

During the 1800s, economists confusingly referred to financial assets or funds as “capital” and also to capital goods as “capital.” So if one means capital goods as a factor of production, it is clearer to say “capital goods.” Precise understanding requires precise terminology and clear meaning.

Wealth in the hands of the final user plays the same economic role as wealth in the hands of a firm which sells or rents it out to the final user. A tenant who leases an apartment from a landlord is the final user, and the apartment rental include paying wages for the management labor services, paying land rent for the use of the space, and paying for the services provided by the capital goods, the physical structures of the building as well as possibly for furniture and appliances.

If the building is converted to condominiums and the tenant also becomes the owner of the dwelling unit, there is no change in the services provided by the unit. The owner-occupied apartment still has space and capital goods. The resident plays two roles, landlord and tenant, and as tenant in effect pays an implicit rental to his role as owner. The same concept applies to a self-employed person who has the role of the owner of a firm and also a role as a worker employee, so he as owner pays to his worker role an implicit wage.

Many students of economics, and unfortunately some teachers, have not grasped the purpose of learning economics. They continue to think like accountants rather than like economists. The main value of learning economics is to understand the implicit reality that exists beneath the superficial appearances of financial transactions. The factors of production (land, labor and capital goods) and their incomes (rent, wages, and the yield of capital goods) are implicit realities independent of the superficial appearances. Economists refer to the “economic way of thinking,” which applies economic theory to explain the reality that can be quite different from the visible transactions.

Antiquated doctrines say that consumption is a separate field from production, but in the economic way of thinking, consumption is inherently integrated with production, as capital goods become consumed in the process of producing goods. Capital goods have a turnover which depends on how fast they depreciate.

When you learn the economic way of thinking, you will realize that we cannot develop land, that all our valuable stuff is capital goods, and that when you wash dishes, you have performed labor. The economic way of thinking will make you realize that a vacant plot of land still provides land services and rent which becomes wasted consumption if there is no tenant to make productive use of that land.

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FRED E. FOLDVARY, Ph.D., (May 11, 1946 — June 5, 2021) was an economist who wrote weekly editorials for Progress.org

Foldvary's commentaries are well respected for their currency, sound logic, wit, and consistent devotion to human freedom. He received his B.A. in economics from the University of California at Berkeley, and his M.A. and Ph.D. in economics from George Mason University. He taught economics at Virginia Tech, John F. Kennedy University, Santa Clara University, and San Jose State University.

Foldvary is the author of *The Soul of Liberty*, *Public Goods and Private Communities*, and *Dictionary of Free Market Economics*. He edited and contributed to *Beyond Neoclassical Economics* and, with Dan Klein, *The Half-Life of Policy Rationales*. Foldvary's areas of research included public finance, governance, ethical philosophy, and land economics.

Foldvary is notably known for going on record in the *American Journal of Economics and Sociology* in 1997 to predict the exact timing of the 2008 economic depression—eleven years before the event occurred. He was able to do so due to his extensive knowledge of the real-estate cycle.