

PROFESSOR WEINTRAUB

LECTURE II: THE ECONOMIC PROBLEM

The Production Possibilities Curve.

As it reflects the nature of the economic problem (scarce resources and the alternative uses for those resources), what the production possibilities curve reflects is the very fact that if you want more of one thing you are going to have to give up something else.

The nature of the economic problem is constantly confronting us, and if you leave this class with nothing more than an appreciation of its existence then I think you will have gained something. Once you recognize that the resources of the economy (especially in a relatively short period of time) are limited, then you must also recognize that it is impossible to do more within the economy than those resources will allow. This is particularly relevant at a time like this when we are talking about our Federal budget and the deficit.

THE BUDGET/DEFICIT ISSUE

The issue that seems to grasp the newspapers and television commentators is the issue of the deficit. But, that is the wrong issue; and, if you think about the nature of the economic problem you will understand that that is the wrong issue. The deficit, the Federal deficit, is a nonissue. Why is it a nonissue? It's a nonissue because it is not a matter of the government being in deficit. After all, the government in a real sense balances its budget every year, doesn't it? Just the way we balance our budget every year. We can't spend more than we have. We may have borrowed it from someone else, but, nonetheless, we are spending what we have, and if the Federal government is spending more than it is collecting in what we call taxes, it has to borrow to finance those expenditures over and above those taxes it collects.

EJD. ISN'T THE ISSUE NOT THE DEFICIT ITSELF BUT WHAT THE DEFICIT CAN CREATE? THE SCENARIO?

Alot of people are saying the issue is the deficit, and the repercussions of the deficit. I am saying, no,

that is not the issue. Because deficits are not consistently associated with high interest rates and inflation. Sometimes deficits are associated with high interest rates and sometimes with low interest rates. The last three years. What has been happening to interest rates and what has been happening with the deficit?

Up until the last couple of months they have been generally coming down. What has been happening to the deficit? It has been rising. So, don't tell me that deficits are going to cause high interest rates when, in fact, we see deficits at the same time that we are seeing reductions in interest rates.

We also see deficits growing; and, what has been happening to the rate of inflation? It is coming down. So, historically, there is no consistent relationship between deficits and either inflation or interest rates.

Now, what is the problem? the problem is what we have been talking about. If the government buys more goods and services -- if government expenditures grow -- private expenditures (at any moment in time the government is taking more) ... there is less left over for the private sector. Now, that creates the problem.

Before we get into that, let's take a step back, if we appreciate the nature of the economic problem -- that is scarce resources/alternative uses. Let's talk about the RESOLUTION OF THE ECONOMIC PROBLEM. There is no solution to the problem in the sense that the problem will always be here. Presumably, once the problem is solved there will be no more problem. But, there is no solution to the economic problem. There is a resolution; that is if we resolve ourselves to the existence of the problem.

The way we resolve ourselves to the existence of the economic problem is through something called COMPETITION.

What is the nature of competition? It is a situation where you have at least two people or two groups vying for an objective, the obtainment of which precludes the others getting. Only one winner will emerge.

THE DIFFERENCE BETWEEN COMPETITION AND EXCHANGE

Exchange is not competition. Exchange is cooperation. You give me something and I give you something in exchange. We are cooperating with one another. We are not competing. But, the fact that you chose me to exchange with and I chose you to exchange with means that others were not chosen. There is an implicit notion of a conflict. The person who offers me the best deal is the person with whom I will cooperate. So, that is the nature of competition -- the desire on the part of each competitor to outdo his or her rival. In so doing, the one thing competition always has is losers.

You can see the nature of the economic problem is going to elicit competition among people. Why? Because there are not enough goods to go around to satisfy all the needs that people are capable of generating. So, the question is, what kind of a competition is going to develop? What is the criteria that is going to be used to govern this competition among people for the goods that are being employed?

THE CRITERIA FOR COMPETITION

The criteria can depend on any number of things. The interesting thing is that the society is going to reflect the criteria that is used.

Question: Which society would be more humane. One where the allocation of resources is based on beauty, on height or on need (defined as family size)?

Given the amount of resources available, the size of population will not be any different whether you allocate resources under each scenario, but the society will be one of large families. People with the large families will get the goods and people with the smaller families won't.

Which of these three is the most humane? The resources available are capable of supporting a certain number of people. If the largest family is 50 they will get resources; but if we run out of resources before we get to families of ten, then they will not survive. Obviously, this is a strained example. In fact, you cannot answer the question because in quantitative terms the same number of people will survive. If you

have to use some measure of humanitarianism you would use the number of people surviving.

Let me ask one more question along these lines. Suppose you now choose the criteria of PRODUCTIVITY. What do we mean by productivity? It is defined as "useful output/input". And, I say, useful output for specific reasons. There are some people who may be producing output but if the output is not useful, then from society's viewpoint they are not productive.

We talk about productivity meaning the production of goods and services that people want, they they will place a value on. And, the best measure we have of that value would be the PRICE of the output.

(We multiply the price of the output times the output, divided by the input, and you have a quantative measure of useful productivity.)

$$\frac{P/\text{unit of output} \cdot Q \text{ of output}}{Q \text{ of input}}$$

Now, price may not be the perfect measure of value, but is the the best. For instance, suppose I ask you how do you value your life? Put a price on you life. The market does it. The value of a person's life in the market can be determined in any number of ways. Let's say the average person is worth \$1 million, being determined by the amount of money that person could earn over a given lifetime. Having stated that I then go out and say to people, would you give up you life for \$1 million? And, they say no. They put a value on their lives which is greater than \$1 million. So, price is not a perfect measure of value. But, from the point of view of the society as a whole it is the best measure we have. From the point of view of the individual it may not be.

EJD. I WAS JUST THINKING THAT IN ANOTHER RESPECT WE DO GIVE UP OUR LIVES IN THAT WE WILLINGLY -- OR NOT SO WILLINGLY -- GIVE UP OUR TIME.

That is how we come up with an evaluation of life. How much is a person's time worth spread out over a lifespan.

Now, suppose we allocate resources on the basis of productivity, what kind of society will we have? A productive society. Because people who are naturally more productive would get the goods and services and people would make an effort to become more productive. Unproductive people would die.

Now, a question. Of all the possibilities we have considered, which one has the best chance of survival over time? There are incentives in all of these societies but the point is, that because of productivity criteria the rewards to people are based on what they add to the bundle of goods and services that is being provided; whereas, in the other cases, the rewards are not based on that so the bundle of goods and services is constantly being consumed and not replenished. Therefore, the bundle is likely to remain adequate for survival only under the productive society. There will be some people who are simply incapable of producing useful output and they will die.

Given a market mechanism (and the institution of money) that can function by itself. As an intelligent person I would certainly let the market do it. I would not set up a central planning commission to allocate resources because that is not efficient. I would let the market do it.

EJD. EVERYTHING YOU HAVE TALKED ABOUT IN THIS PICTURE SEEMS TO BE BASED ON SOMETHING COMING THROUGH ABOUT HUMAN NATURE. IT SOUNDS TO ME THAT YOU ARE SAYING THAT HUMAN BEINGS ARE BY NATURE PRODUCTIVE AND BY NURTURE NONPRODUCTIVE WHEN THEY ARE NOT PRODUCING. IN OTHER WORDS, IF YOU SET UP THE CRITERIA FOR DISTRIBUTION OF REWARDS BASED ON NONPRODUCTIVE GOALS, THEN YOU ARE NURTURING HUMAN BEINGS TO BE NONPRODUCTIVE. SO THAT, ECONOMICS WOULD START OUT WITH THE BASIC ASSUMPTION THAT HUMAN BEINGS ARE BY NATURE PRODUCTIVE.

No. They are capable of being productive.

Getting back to where I started, suppose you have an economy that uses nonproductivity criteria for allocating resources. That redistributes goods and services from the productive to the nonproductive. You can see from the discussion we just had why that economy can be expected to confront problems, economic

problems.

If you take from the most productive and give to the least productive you are going to discourage the least productive from trying to be more productive and discourage the most productive to be even more productive. Why put out a dollar's worth of effort to get 50 cents back? Some may and some may not. You see, when you have a system which allocated resources be nonproductivity criteria you threaten the survival of the system. Or, let's say that the more you use nonproductivity criteria the greater is the threat. It is difficult to say just how much nonproductivity criteria are used before the system collapses.

Look around and examine economies that use various degrees of nonproductivity criteria. We see that a very high correlation exists between the successful economies that use productivity criteria and the unsuccessful economies that do not use productivity criteria very much. And, we also see within those unsuccessful economies productivity criteria being employed in clandestine ways, yielding greater benefits to the people who are employing them.

Here in the United States we have government programs which provide goods and services to the people if they are unemployed. And, we have farm price support programs that provide goods and services to farmers if they don't produce. How blatant can you apply nonproductivity criteria. You provide subsidies to people who happen to be over 65 if they choose not to work.

STUDENT. WHAT ABOUT THOSE WHO CANNOT PRODUCE?

That depends on the reaction of people to the deprivation that does exist in society. The fact is that during the late 19th century in the United States, what is referred to as the heyday of capitalism -- of greed -- what happened is this. The period of time when the percentage of national income that went into charity was the highest it has ever been in American history. What I am suggesting to you is that just because productivity is the official criteria doesn't stop people from employing their own individual criteria through private charitable organizations, etc. And, it existed even before the income tax laws made it attractive to give money to charity.

EJD. I HAVE HEARD THAT SAME ARGUMENT FROM MILTON FRIEDMAN. AND, THE ONLY PROBLEM I HAVE IS THAT OF A DIFFERENT VIEW OF THAT PERIOD OF HISTORY, BECAUSE, IF YOU LOOK CLOSER AT THOSE INDIVIDUALS THEY WERE MONOPOLISTS. THE POLITICAL SYSTEM PERMITTED ...

You are talking about particular individuals, but I am talking about the tremendous burgeoning of activities around hospitals, free libraries and churches that we nongovernment funded, but simply the result of people getting together.

EJD. I GRANT THAT THAT OCCURRED. MY POINT IS THAT IT WOULD HAVE OCCURRED ANYWAY IF THERE HAD BEEN A POLITICAL SYSTEM WHICH LET PRODUCERS KEEP THAT WHICH THEY PRODUCED, IF THE WORKERS WERE ABLE TO KEEP THAT ...

Are you suggesting that in your mind Carnegie and Rockefeller and J.P. Morgan kept what they produced or did they keep ... what did they do with what they produced?

EJD. I AM SUGGESTING THAT THEIR EFFORTS WERE SUCCESSFUL BECAUSE THEY WERE ABLE TO CAPTURE THE PRODUCTION OF OTHER INDIVIDUALS BY GOVERNMENT SANCTIONED MONOPOLY; AND, THEREFORE, ...

In some sense they were and in some senses they weren't. In the case of some of the railroads that may have been true, but I don't know that that was true in the case of oil or steel. People were creating empires in spite of what the government did.

EJD. IN MY VIEW OF HISTORY, THERE WAS NO EFFECTIVE POLITICAL SYSTEM IN PLACE THAT REPRESENTED THE INTERESTS OF THE PEOPLE OF THE COUNTRY AND, THEREFORE, THESE INDUSTRIALISTS WERE ABLE TO COMBINE AND GATHER NOT ONLY GREAT FINANCIAL RESOURCES ...

How did they do this?

EJD. THEY TOOK ADVANTAGE OF A SYSTEM THAT HAD STRUCTURAL FLAWS.

What were the structural flaws?

EJD. THE STRUCTURAL FLAWS WERE THAT THE STATE DID NOT

HAVE A GOVERNMENT EMPOWERED TO PROTECT THE INTERESTS OF
THE PEOPLE BY ELIMINATING MONOPOLY.

I think there is a basic problem here, in that they
didn't do it with armies. They didn't do it with
guns. They didn't force anybody.

EJD. BUT THEY DID.

How. How did they force the workers to work?

EJD. THE EXISTENCE OF A STATE, ANY STATE, SUPPORTED BY
A GOVERNMENT THAT HAS POLICE POWERS EXERCISES COERSION
AGAINST CITIZENS. THAT COERSIION MAY BE VOLUNTARY OR
INVOLUNTARY BUT THE FACT THAT THE ...

How?

EJD. WELL. IF YOU WORKED FOR CARNEGIE AND YOU SAID,
CARNEGIE I AM GOING TO KEEP WHAT I PRODUCE AND YOU TRY
TO TAKE AWAY THE STEEL YOU PRODUCE, THAT DAY CARNEGIE
IS GOING TO CALL UP THE POLICE AND SAY COME GET THIS
GUY AND PUT HIM AWAY.

The point I would make is, when it comes to producing
steel let's say, would the workers be able to do it be
themselves without the capital that Carnegie supplied.
And what portion of the steel produced is the result of
the capital and what portion produced is the result of
the labor?

EJD. THE MACHINES BEING USED FOR STEEL ARE CONSTANTLY
DEPRECIATING. IF YOU TAKE THE LABOR FORCE AWAY THEN THE
MACHINES ARE GOING TO DETERIORATE AND NOTHING WILL BE
PRODUCED.

They are not going to deteriorate. Nothing will be
produced by the machines, that's all.

EJD. BE THE FACT THAT THEY ARE NOT BEING USED THEY WILL
DETERIORATE.

But who is forcing these workers to work on these
machines? Except their own interests.

EJD. SO, THE QUESTION IS ONE OF ALTERNATIVE
OPPORTUNITIES TO EMPLOY YOUR LABOR.

And there were plenty of opportunities to employ their

labor. They could have gone out and farmed.

(Discussion on employment of young females in New England textile mills). When girls went to work in the textile mills in Lowell, Massachusetts, for example, they were very very carefully supervised. They lived in boarding houses, etc. ...

EJD. AND, YOU WOULD SAY THATR THAT WAS CONSISTENT WITH THE TREATMENT OF LABOR IN THE 19TH CENTURY BY THOSE INSTITUTIONS RUN BY THE LARGE CAPITALISTS?

I am simply saying that with the exception of the antebellum South -- the Blacks in the United States -- the United States economic development did not depend upon slavery. That people were free to choose where they wanted to work and they did.

EJD. YOU AND I HAVE A PROBLEM IN THAT WE DISAGREE WITH THE HISTORICAL INTERPRETATION OF EVENTS.

Unless you can demonstrate that these capitalists were pointing guns to the heads of these people and telling them you have no choice, I don't see how you have a leg to stand on.

... The first part of our discussion here is to get an understanding of how markets work and what are some good examples of competitive markets. And, we can talk about it in this historical context ... I rather enjoy going off on tangents and I enjoy a good discussion which has something to teach of value.

EJD. THEN, I WILL OFFER MY INTERPRETATION OF HISTORY. I THINK IT'S APPROPRIATE TO START WITH HOW THIS COUNTRY WAS FOUNDED. IT WAS FOUNDED BY A PROCESS WHERE APPROXIMATELY ONE-HALF DOZEN EUROPEAN MONARCHS SAID THEY OWNED -- THEY CONTROLLED -- NORTH AMERICA. AND, TO THE EXTENT THAT THEY HAD THE MILIARY ABILITY TO SUPPORT THAT CLAIM THEY STAKED A CLAIM, TO THE EXCLUSION OF ALL THE REST OF HUMANITY. SO, THEY FIGHT IT OUT AND ENGLAND WINS AND YOU HAVE 13 COLONIES FOR ENGLAND. THEN, WE FIGHT IT OUT WITH ENGLAND AND WE STAKE OUR CLAIM. THE REST OF THE CONTINENT IS EMPTY. NOW, THE EASTERN PORTION OF THE CONTINENT IS TOTALLY STAKED OUT. THERE ARE ONLY A FEW MILLION PEOPLE HERE. THE LAND IS BASICALLY EMPTY BUT OUR FRIENDS -- THE FOUNDING FATHERS -- ALL STAKE OUT THEIR CLAIMS TO MILLIONS OF ACRES OF GROUND AND ALL THE RESOURCES -- TO THE EXCLUSION OF ALL

THEIR FELLOW CITIZENS.

THEY ARE THEN ABLE TO CONTROL THE MARKET BECAUSE THEY HAVE INSTITUTED EXCLUDING ALL THEIR FELLOW CITIZENS FROM THE USE OF RESOURCES BY THE ARTIFICIALLY IMPOSED POLITICAL SYSTEM OF PRIVATE PROPERTY IN LAND.

Now we are getting at it. Do you have a problem with private property?

EJD. NO.

That is all I wanted to know, because the basis of all the discussions that we will have here includes the concept of private property.

EJD. I HAVE A PROBLEM WITH THE DEFINITION OF PRIVATE PROPERTY.

What is your definition of private property?

EJD. ANYTHING PRODUCED BY HUMAN BEINGS IS PRIVATE PROPERTY.

No. I disagree 100 percent. Because the education that you are getting here ... the steel that is produced by a steel worker is not the property of the steel worker.

EJD. AGREED. THE CONTRIBUTION THAT THE INDIVIDUAL WORKER MAKES TO THE PRODUCTION IS HIS WAGES. THE VALUE OF HIS CONTRIBUTION COMES BACK TO HIM IN THE FORM OF MONEY WAGES BECAUSE HE CANNOT TAKE SMALL PIECES OF STEEL AND GO OUT AND BUY FOOD WITH IT. THE CONTRIBUTION OF THE CAPITALIST IS THE EXTRA BENEFIT ON TOP OF WHAT THE LABORER CAN PRODUCE WITHOUT THE CAPITAL. IF THE CAPITALIST ONLY TAKES THAT EXTRA CONTRIBUTION IN THE FORM OF PROFITS OR INTEREST, THEN THAT IS EACH GETTING WHAT HE PRODUCED. BUT, I DON'T BELIEVE THAT IS THE CASE WITH CARNEGIE AND ROCKEFELLER. THEY NOT ONLY TOOK WHAT THE CONTRIBUTED BUT THEY TOOK HALF OF WHAT THE LABORER CONTRIBUTED AS WELL.

But, how do you evaluate what the laborer contributed? You see the problem is you are talking about evaluating contribution, and evaluating Carnegie's contribution. Carnegie's contribution had to do with his ability to amass capital -- to put these things to work. The quintessential entrepreneur. I think he was one.

Workers did not have the ability that Carnegie had. If there were more workers who had the ability that Carnegie had there would be more Carnegies. But, he was one in more than a million.

EJD. TO THE EXTENT THAT HE WAS ABLE TO AMASS CAPITAL AND EARN OFF OF HIS CAPITAL, PLUS HIS OWN LABOR, I HAVE NO PROBLEM WITH HIM.

What criteria can you employ to demonstrate that the workers were paid less that they deserved.

EJD. THE RELATIONSHIP IN THE SOCIETY BETWEEN THE NUMBER OF EMPLOYMENT OPPORTUNITIES AVAILABLE TO THE WORKER AND THE NUMBER OF WORKERS LOOKING FOR WORK.

There was no pressure in that regard. In fact, the economy was growing so rapidly that we were pulling in immigrants from all over the place. And, they were getting jobs as soon as they came here and jobs that paid them better than what they could earn in the country from which they came.

EJD. AGREED.

So, what's the problem? In this course we don't get into issues of monopoly versus population.

EJD. IN THE WESTERN EXPANSION WHEN THE EARLY TOWNS WERE FOUNDED THERE WAS NO UNEMPLOYMENT AND VERY HIGH WAGES. SINCE GOVERNMENT CAME IN AND ESTABLISHED A SYSTEM THAT ALLOCATED ... GAVE LEGAL TITLE TO ALL THE AREA'S RESOURCES, THE MINES, THE REAL ESTATE, FORESTS, WHATEVER ...

Government came in to enforce the concept of private property which had been in existence but which was being enforced by the gun not by the government.

EJD. WELL, IN THAT CONTEXT, GUN OR GOVERNMENT IS THE SAME THING.

From the point of view of individuals in a more anarchistic situation, or the gun from the point of view of the government wielding the gun in a less anarchistic situation?

EJD. WELL, IT DEPENDS ON HOW THEY ARE USING THE GUNS

...

I don't mean guns in the literal sense of shooting up the place. I mean the power of a Federal authority versus the dispersed power of individuals who are acting as their own policemen.

EJD. THE POINT FROM THE STANDPOINT OF THE CONDITION OF THE ECONOMY AND HOW WEALTH AND PRODUCTION IS DISTRIBUTED, IS SIMPLY THAT YOU ARE SAYING THAT WAGES WERE HIGHER HERE IN THE UNITED STATES IN THE PERIOD OF TIME THAN IN EUROPE. AND, I GRANT THAT. BECAUSE EUROPE HAD A THOUSAND YEARS TO DEVELOP A VERY ENTRENCHED SYSTEM OF MONOPOLY.

Called the guild system.

EJD. YES. AND, HERE WE JSUT WERE BEGINNING. BUT, SINCE THE COUNTRY BECAME FULLY SETTLED AND GOVERNMENT CAME INTO PLAY TO ENFORCE INDIVIDUAL CLAIMS TO LAND AND RESOURCES, YOU STARTED TO SEE A REDUCTION IN WAGE LEVELS ACROSS THE BOARD.

I have to disagree with you. You don't see a reduction in wage levels. You saw a steady increase in real wage levels over the course of economic development in the United States up until recent years.

EJD. I DISAGREE. BUT, WHAT I AM GETTING AT IS THAT ... IF I BECOME KIND OF UTAH AND I BUILD A FENCE AROUND UTAH, I CAN EXCLUDE EVERYONE FROM COMING IN AND TO GROW FOOD, TO MINE MINERALS, TO DO ANYTHING.

As long as you are willing to accept the consequences of a nonproductive Utah.

EJD. BUT I CAN PRODUCE AS MUCH AS I NEED AND MORE.

Not if you don't have the people to do it.

EJD. I CAN LET IN AS MANY PEOPLE AS I WANT TO TO PRODUCE WHAT I NEED.

And how are you going to let them in? Only if they are willing to work for you.

EJD. AS LONG AS THERE IS OTHER TERRITORY THEY CAN GO TO WORK IN THAT IS FINE. BUT, WHEN THE WORLD BECOMES FULLY SETTLED AND OCCUPIED ... IF THERE ARE FIFTY KINGS OF

UTAH AND EACH HAVE A STATE OF THEIR OWN IN THIS CONTINENT, THEN YOU HAVE FIFTY PEOPLE CONTROLLING THE DESTINY OF THE ENTIRE POPULATION. BECAUSE PEOPLE NEED A PLACE TO LIVE.

I don't know what you are boiling up here. We don't have that kind of system. We have a free market economy where people are free to move. Mobility here in the United States is extremely high compared to most European countries.

EJD. I AM NOT BUILDING AN ABSOLUTE. I AM BUILDING A TENDENCY. I AM SAYING THAT I THINK THERE IS ENOUGH HISTORICAL EVIDENCE AVAILABLE THAT THERE IS A CASE TO BE MADE THAT WE ARE HEADED IN A DOWNWARD TREND. BECAUSE OF THE BASIC STRUCTURAL FLAW.

When you make a general statement like that, you can't disagree except that I think we are heading in the direction we are heading because there isn't enough respect for private property. And because the government is trying to impose too much of its will on the free economy. You seem to be suggesting the opposite.

EJD. ONLY, AGAIN, BECAUSE I DEFINE PRIVATE PROPERTY DIFFERENTLY. BECAUSE I DO NOT INCLUDE LAND AND NATURAL RESOURCES IN MY DEFINITION OF PRIVATE PROPERTY. I ONLY INCLUDE LABOR PRODUCED PRODUCTS.

I disagree.

SUMMARY OF POINTS ON COMPETITION

Are there any other questions about this process of competition and how the society develops so as to reflect the criteria used for governing competition? Do you understand the implications associated with redistributing income from productive to unproductive people? That is not to say, and I don't mean to suggest, that we must take a very cold hearted view of the situation and not be humanitarian. It is simply to recognize that when we do redistribute from the productive to the unproductive that there is a cost. You are giving up something. It is not what the productive are giving up that is the cost, it is the output that won't be produced when the redistribution takes place. That is the cost. That is never seen.

You are aware of the fact that marginal tax rates were reduced from 70 percent to 50 percent in the first year of the Reagan tax cut. In fact, it was the reduction from 70 to 50 percent that made people accuse the Reagan administration of favoring the rich in the tax cut because people making more than \$43,000 would have paid 70 cents out of every additional dollar earned. So, the marginal tax rate (we have in the United States a graduated tax rate so that the higher tax rate is paid on any additional income) when you reach \$43,000 you are in the highest marginal tax rate. Any additional money you earn was taxed at 70 percent. So, the argument has been raised by politicians that the reduction benefits the rich.

Now, what will happen to the amount of tax collected from the highest income earners? Will it (a) increase, (b) decrease; or (c) stay the same? It increased. There was an effort to earn more money and people got out of tax shelters.

There is a lot of talk about a flat rate tax. Reduce the exclusions and deductions and government would collect just as much money. But, out of every dollar you earn you will keep 80 percent. Who is against a program like that?

EJD. SPECIAL INTERESTS.

The accountants and the lawyers and the tax shelters, who would lose under a system like that because there would no longer be an incentive to be in a tax shelter. The public employees working for the IRS. All the investment counsellors.

The point I am making is, if you confiscate less of the output of the more productive sector, you encourage that sector to earn more income and the only way they can earn more income is to be more productive.

We will be talking about a market economy where private property exists as it is -- not as you would like to see it -- but as it is. Where people own land. Land is not public property. Where people own capital. Where all of the resources are owned privately. Of course, in the United States that is not completely true ...

EJD. I AM NOT OPPOSED TO PRIVATE TITLE TO LAND. WHAT I

AM OPPOSED TO IS PRIVATE CONFISCATION OF ITS VALUE.

I don't see the distinction. Maybe we will cover some of these issues. I thought I could dispose of you quickly. Obviously I can't.

HOUSEHOLDS AND FIRMS

So, we are talking about a system where property itself is private, where the market functions as the device for allocating goods and services. There are basically two types of economic units in this society. There are households (HH) and there are firms.

A household has as its primary function the conversion of goods into resources. The firm has as its primary function the conversion of resources into goods. They complement one another.

Household Resources.

Everything that exists in the private sector of the economy is owned ultimately by a household. It may be owned by a corporation but the stock of the corporation is owned by a household. Simply because we live in a private property economy. It is the goods that service you that give you strength to do your work. So, you are converting those goods into resources.

The resources are the things that are capable of producing the output, whatever that output may be. Ultimately, resources are reduced to land, labor and capital. But, the ownership of all that rests with the household which is recognized by law as a basic unit ownership.

A person's ability or skill is a resource. They are owned by the household, but are often put to use by the firm. Any entity that combines resources for the production of output is a firm. Goods and services can be output. That is not to say, of course, that the output of some firms won't be used for the input of another firm. For example, one firm has as output chemicals and another uses those chemicals to produce something else. Thus, within this collection of entities we call firms, there is a lot of interaction as well.

We are starting with an absolute picture of the

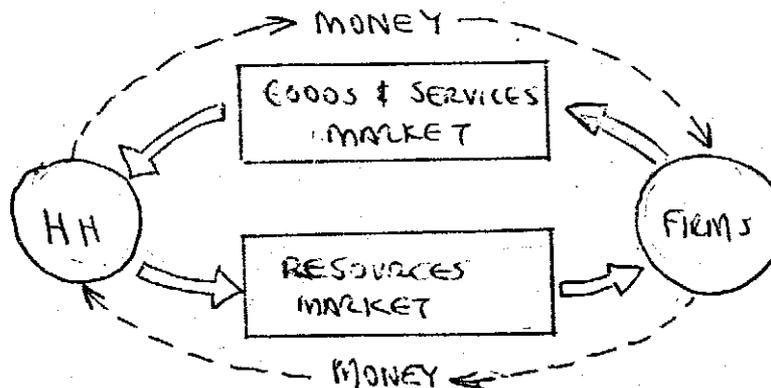
economy, drawing a relationship between firms and households, ignoring that there is a relationship among firms. Of course, there is also a relationship among households. But, what I am concerned about now is the relationship between firms and households.

What I am trying to demonstrate is a very general relationship which is in such an abstract level that when you try to make a concrete example it is almost impossible. Thus, I can't say that an individual produces goods within the framework of the firm and then consumes those goods. The goods that keep you going are the goods produced by other people.

EJD. WOULD IT BE WRONG TO JUST SAY THAT THE FIRMS ARE PRODUCERS AND HOUSEHOLDS ARE CONSUMERS.

Yes. The households are producers and consumers and the firms are producers and consumers. The households consume goods and produce resources. The firms produce goods and consume resources.

These economic units operate in different kinds of markets. They operate in the market for goods and services and in the market for resources. What happens is that the resources that are coming out of the household are supplied to the resource market and as a result of the demand placed by the firms in these resource markets, these resources go to the firms. The firm converts these resources into goods and services supplying the market with goods and services where the households buy those goods and services and consume them.



Consuming those goods and services, they have the wherewithal to survive -- to go on to live, to work, to provide resources to the market. Is there any problem

with that so far?

MONEY

What moves in the opposite direction of this flow? Spending, in the form of money. When you buy something the money goes one way and the goods the other way. What is money?

EJD. IT MAKES EXCHANGE EASIER. BECAUSE IT IS GENERALLY ACCEPTED BY EVERYONE IN SOCIETY.

It is a medium of exchange. Why does it make exchange easier?

EJD. IN THE CASE OF THE PERSON WORKING IN THE PHARMACEUTICAL FIRM, SHE WORKS PRODUCING PHARMACEUTICALS. IF SHE WANTED TO GET FOOD SHE WOULD HAVE TO FIND SOMEONE WHO BOTH HAS FOOD AND WANTS DRUGS. SHE HAS TO FIND SOMETHING ELSE THAT EVERYONE WOULD ACCEPT IN THAT PROCESS.

In other words, the use of money allows individuals to separate the act of buying from the act of selling. When you trade in the barter sense you are both buying and selling at the same time, are you not? The use of money denies the need for a mutual coincidence of wants between traders, so you can sell today and buy tomorrow or buy today and sell tomorrow. These are all possibilities when you introduce money.

THE CIRCULAR FLOW CHART

The real things are moving in one direction and the money has to be moving in the opposite direction.

Our first concern is to talk about how the markets work. Before we can do that we must talk about the market. What is the market? It is a meeting or an agreement between buyers and sellers. It need not be a physical place (it can be your telephone or your computer).

How many buyers and sellers must there be for a market to be competitive? At least two of each. If you have one buyer and two sellers there is no competition on the buyer's side; and if you have only one seller and two buyers, there is no competition on the seller's side. So, you need at least two. That is necessary

for competition to take place. but is sufficient?

The more you have competing with one another the more likely competition will continue. So, when we talk about a competitive market, we talk about a market where there are many buyers and sellers, none of which has any influence over the price. In other words, the absence of one of those buyers or sellers from the market will not affect the price. That is the nature of the competitive market.