

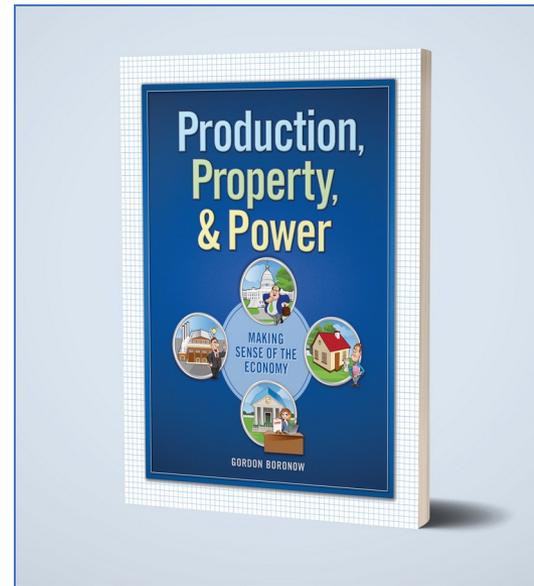
# Production, Property & Power:

## Making Sense of the Economy

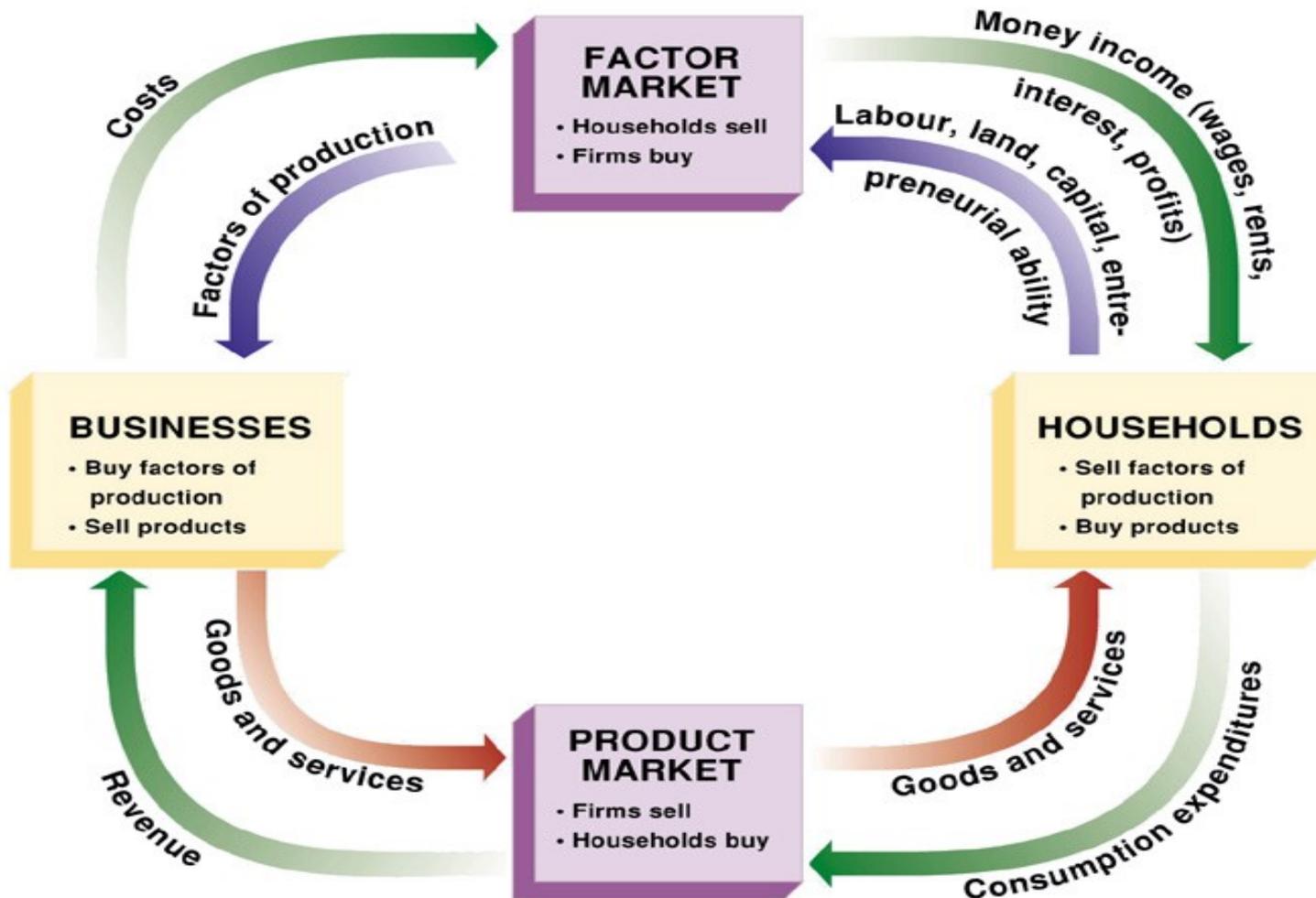
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# The Venerable Circular Flow Diagram



# Shortcomings of the Circular Flow Diagram

- Ignores Government Role in the Economy
- Cannot Explain Capital Accumulation
- Stagnant/Equilibrium
- Present Oriented
- Consumption-only Model

**A NEW TEACHING MODEL IS NEEDED!**

# Production, Property & Power

In three balanced cycles of economic activity, the Production, Property & Power model illustrates the forces which drive the economy. People in the economy respond as best they can to events which happen in life. The cycles of economic activity interact. Adjustments in one cycle affects decisions and actions in another cycle, until an elusive balance is attained.

# The People of the Economy

## Jack: The Household Decision-Maker



### **Motivations:**

Enjoyment of Consumption, Leisure

Dislikes Fear and Anxiety

Seeks Security in Property (Savings)

Cares about Future Households

### **Actions**

Chooses what to buy (or not)

Chooses to save (or not)

Chooses to work more hours (or not)

**Jack balances enjoyment of spending against anxiety of not saving enough and the enjoyment of leisure against the rewards for working longer hours.**

# The People of the Economy

## Tom: Entrepreneur and Rock Star



### **Motivation:**

Profit-seeking Innovation

Fear of Competition

Joy of Creative Activity

### **Actions:**

Implements Innovation and change

### **Concepts:**

Creative destruction

“Animal Spirits”

**Tom balances the rewards of innovation against the cost of failure.**

# The People of the Economy

## Janet: The Banker



### **Motivation:**

Profit by Making Good Loans  
Avoid Losses from Bad Loans

### **Actions:**

Aggregate Savings from Households  
Select Good Projects to Finance

### **Concepts:**

Due Diligence  
“Animal Spirits”  
Financial Intermediary

**The Bank closes the gap between the supply of funds (household savings) the demand for investable funds (entrepreneurs).**

# The People of the Economy

## Sam: The Politician (Government)



### **Motivations:**

Urge for power and to be in control

Implement his agenda to “do good”

### **Actions:**

Provides justice and security

Taxes the economy to get funds to carry out agenda

Enforce regulations and laws with police power

### **Concepts:**

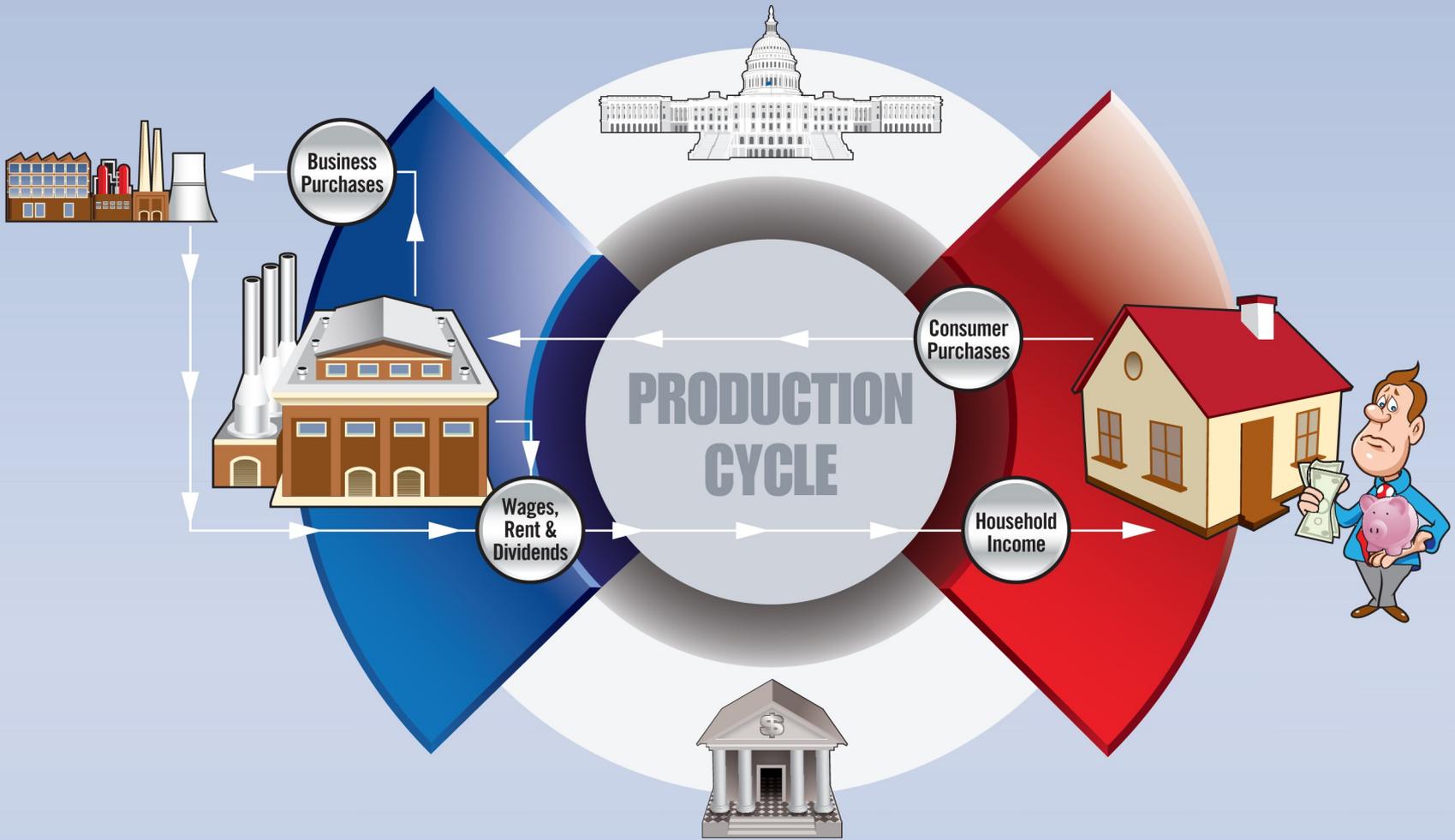
Constrained by the Laffer curve

Short-sighted (next election)

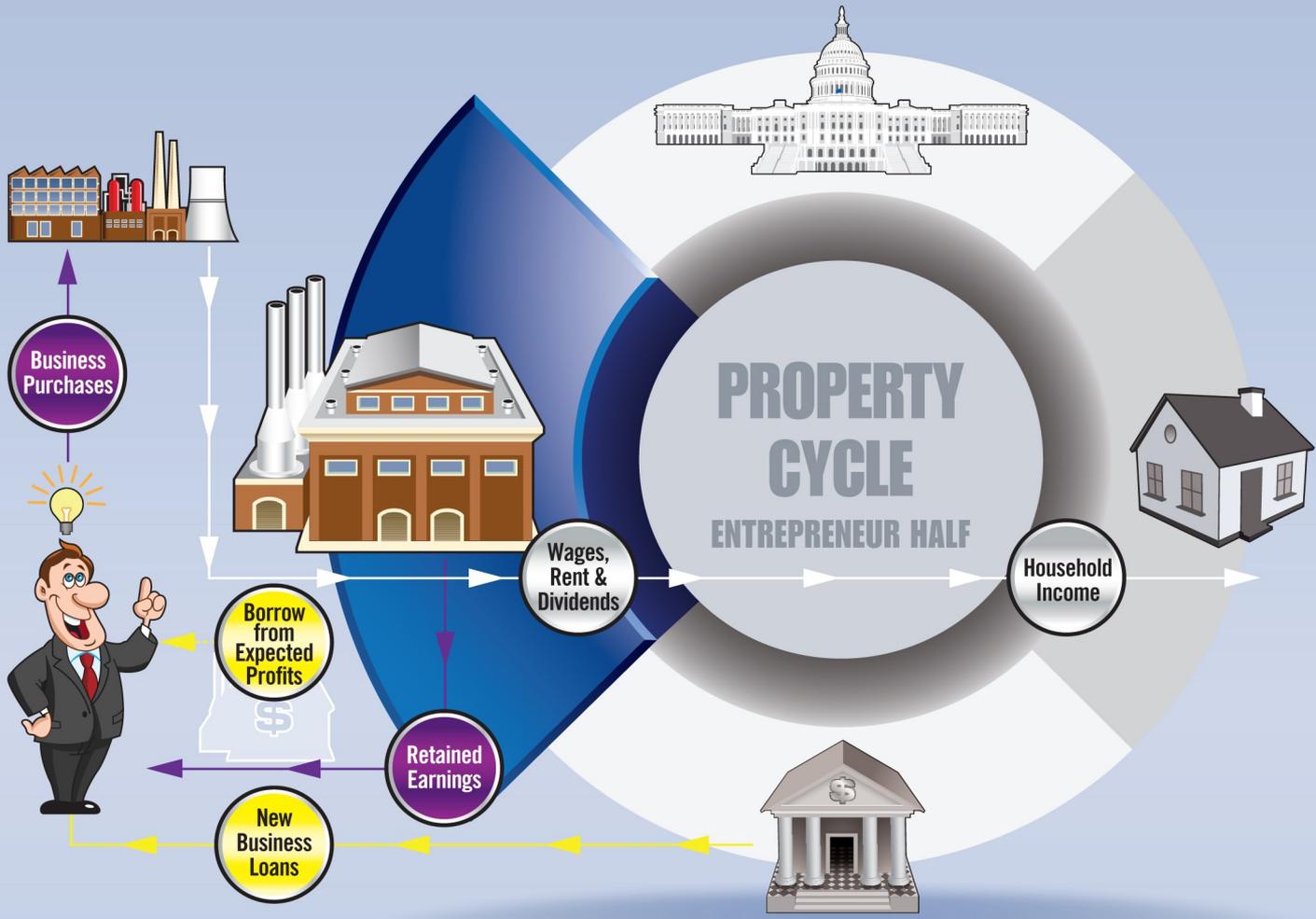
Self-interested (and possibly public-minded)

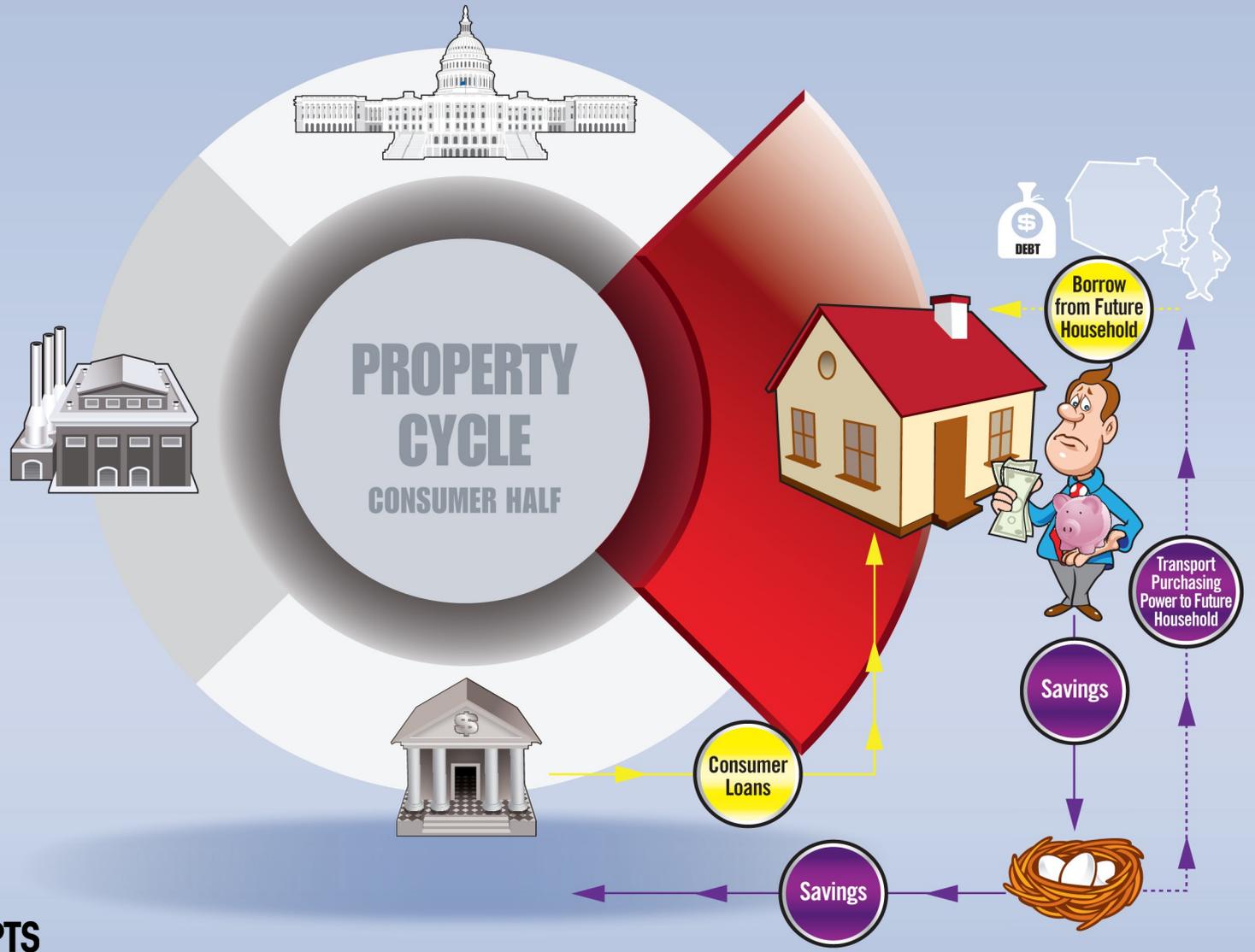
**Sam balances the need for tax revenues to power his agenda against the likely actions of the people.**

# The Production Cycle



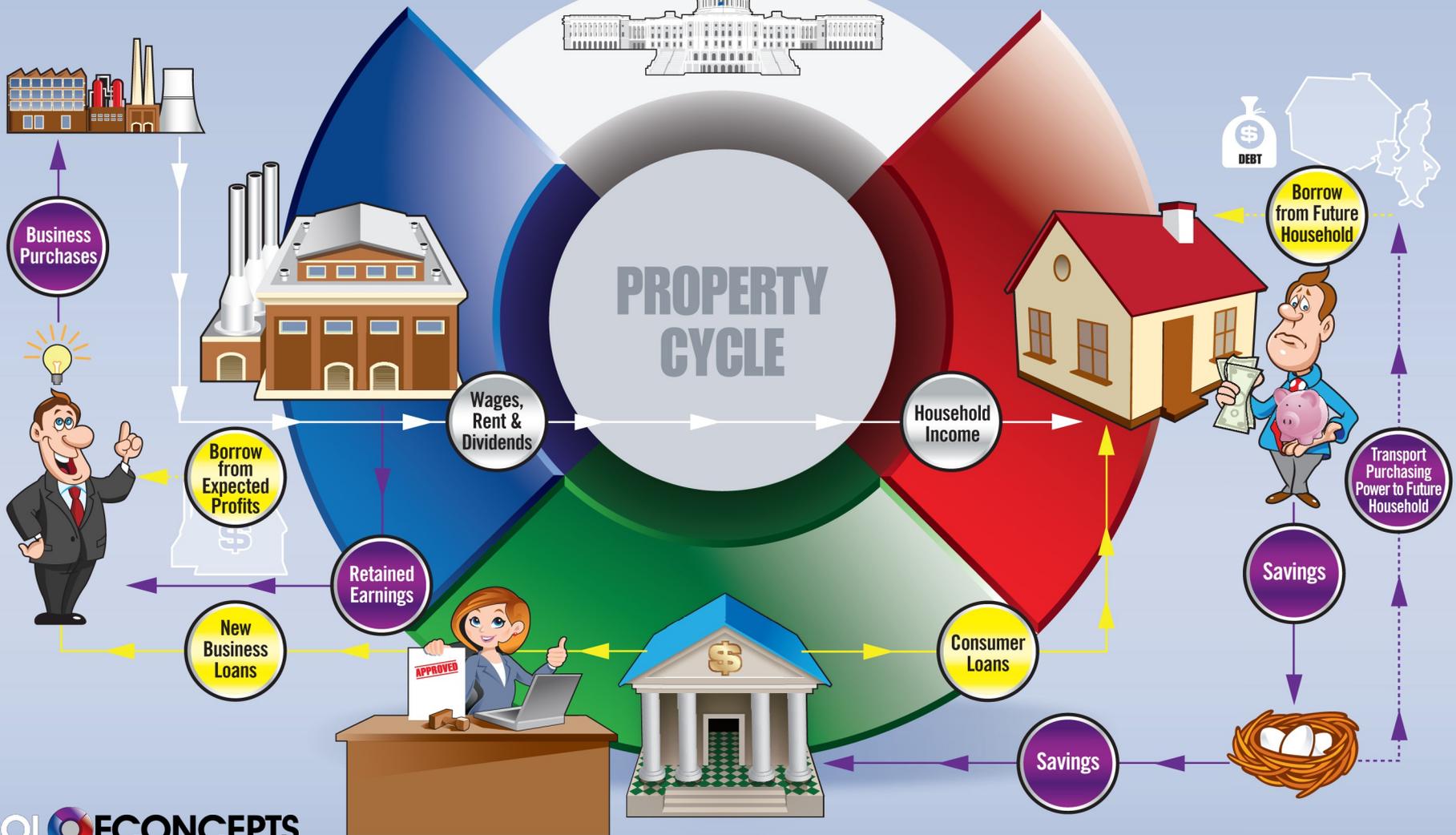
# The Property Cycle



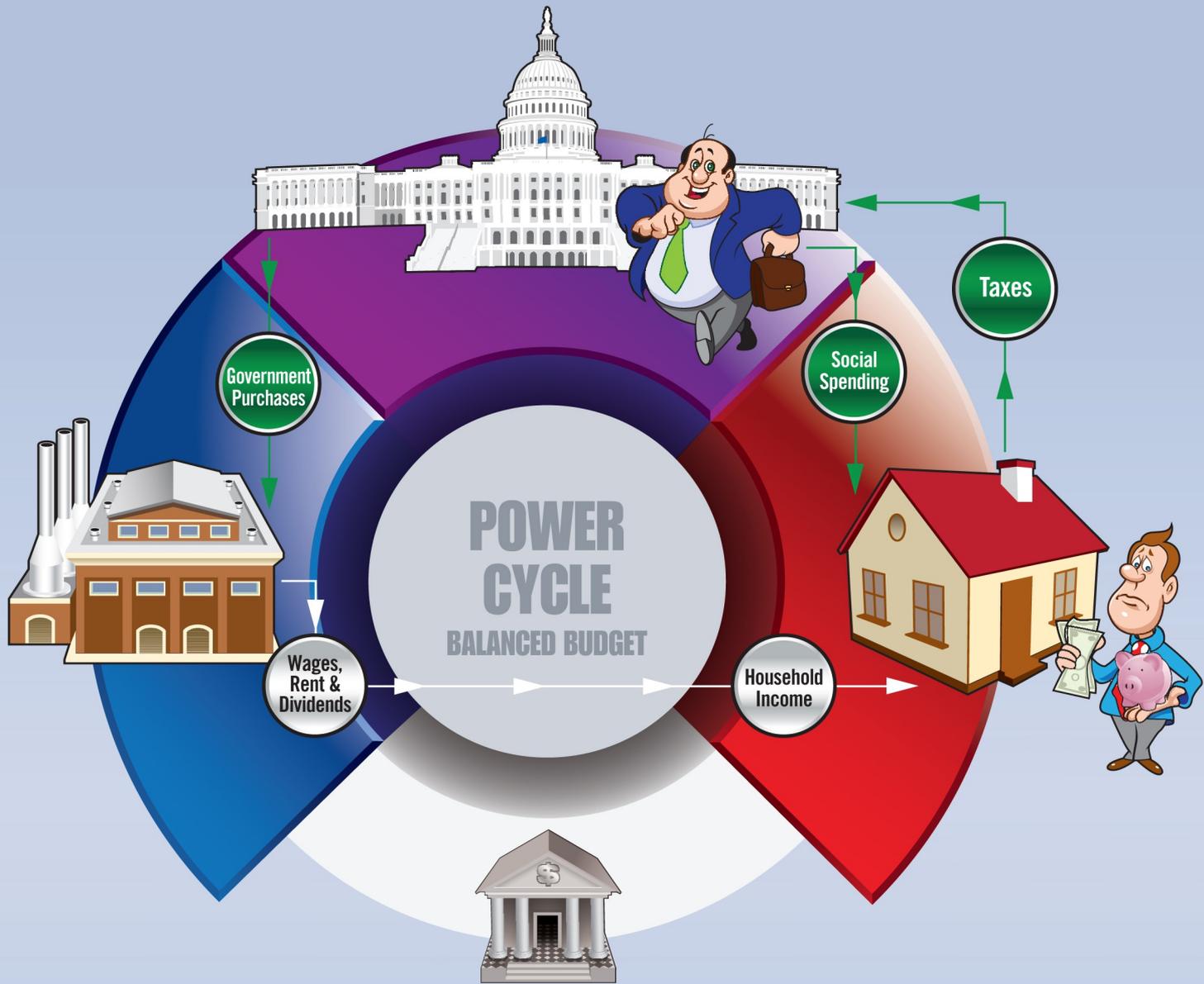


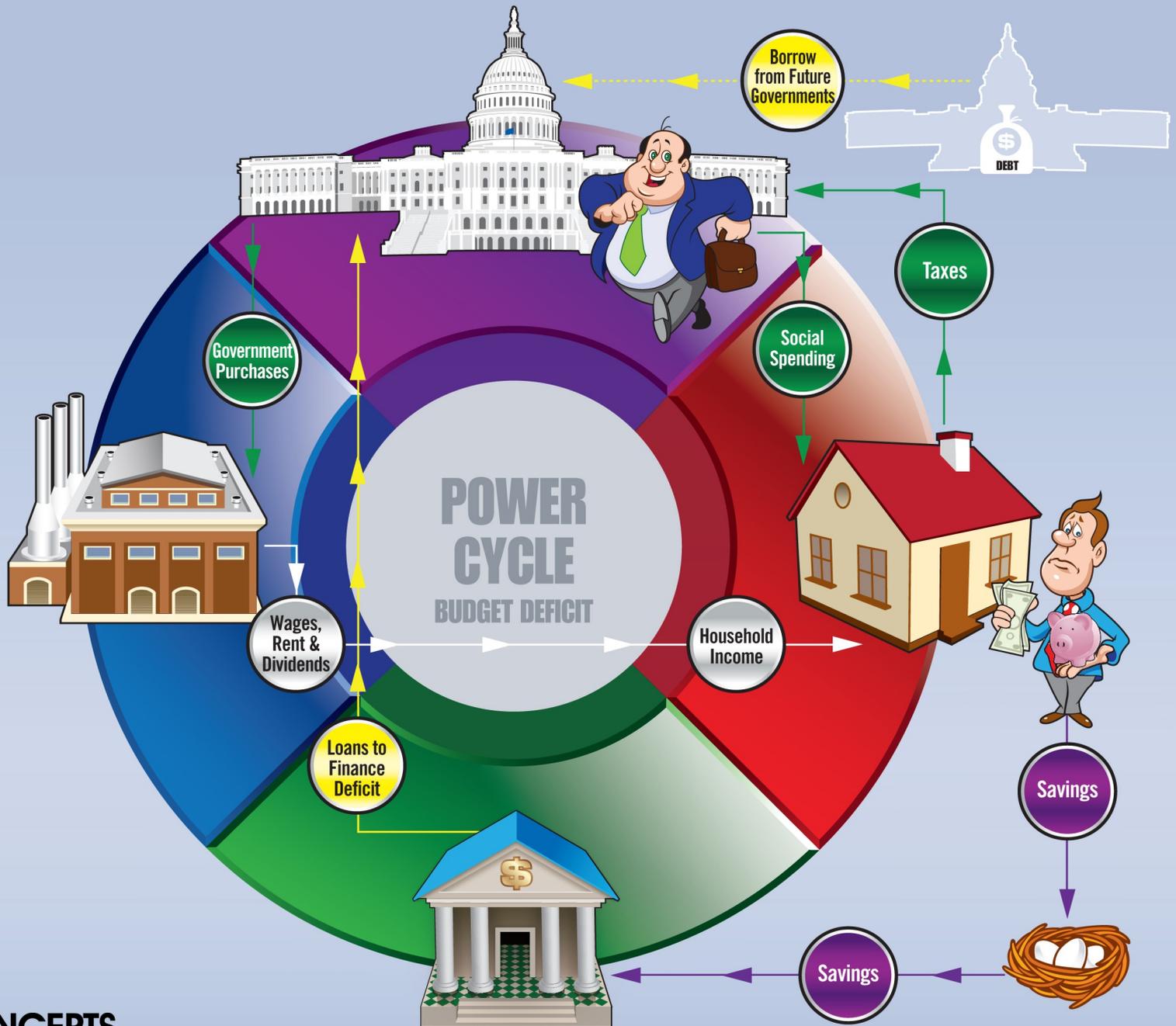


# PROPERTY CYCLE



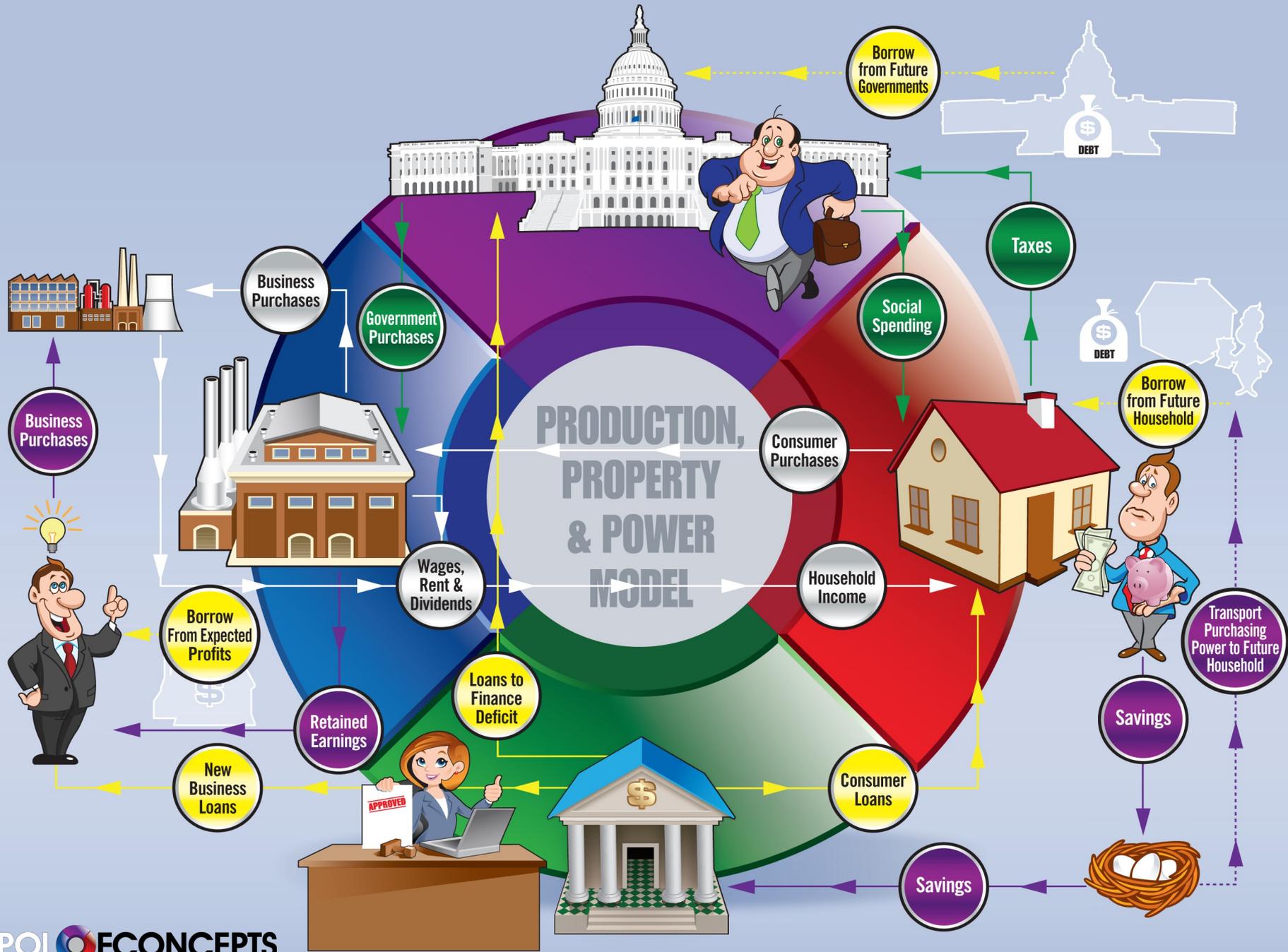
# The Power Cycle





# The Production, Property and Power Model

All three cycles of economic activity are interconnected and act upon each other.



# Market, Psychological and Political Forces

- Multiple Forces at Work at the Same Time which Creates Tension within the System
- Without Tension, there is Slack in the Economy
- System Tends to a Balance of Forces
- That Unstable Stability is “Equilibrium”

# Equilibrium: Negatively Defined

- Firms are unable to further increase profits
- Households are unwilling to work more, or spend more or save more
- Banks are unwilling to lend more at the current interest rate
- Entrepreneurs do not want borrow more at the current interest rate
- Government is unwilling increase tax rates
- Government is unwilling to increase debt

# Equilibrium: Positively Defined

- Firms have maximized profits
- Households have maximized the pleasure of consumption and enjoyment of security
- Banks can lend all they want at current interest rates
- Entrepreneurs can finance all the projects they want at current interest rates
- Politicians expect to be re-elected

# The PP&P Model

- A “tree-top” view of the whole economy.
- Illustrates the many connections in the economy.
- Allows public policy proposals to be evaluated with a comprehensive view.
- Helps business, financial managers and politicians plan for adjustments to specific events or actions.

