

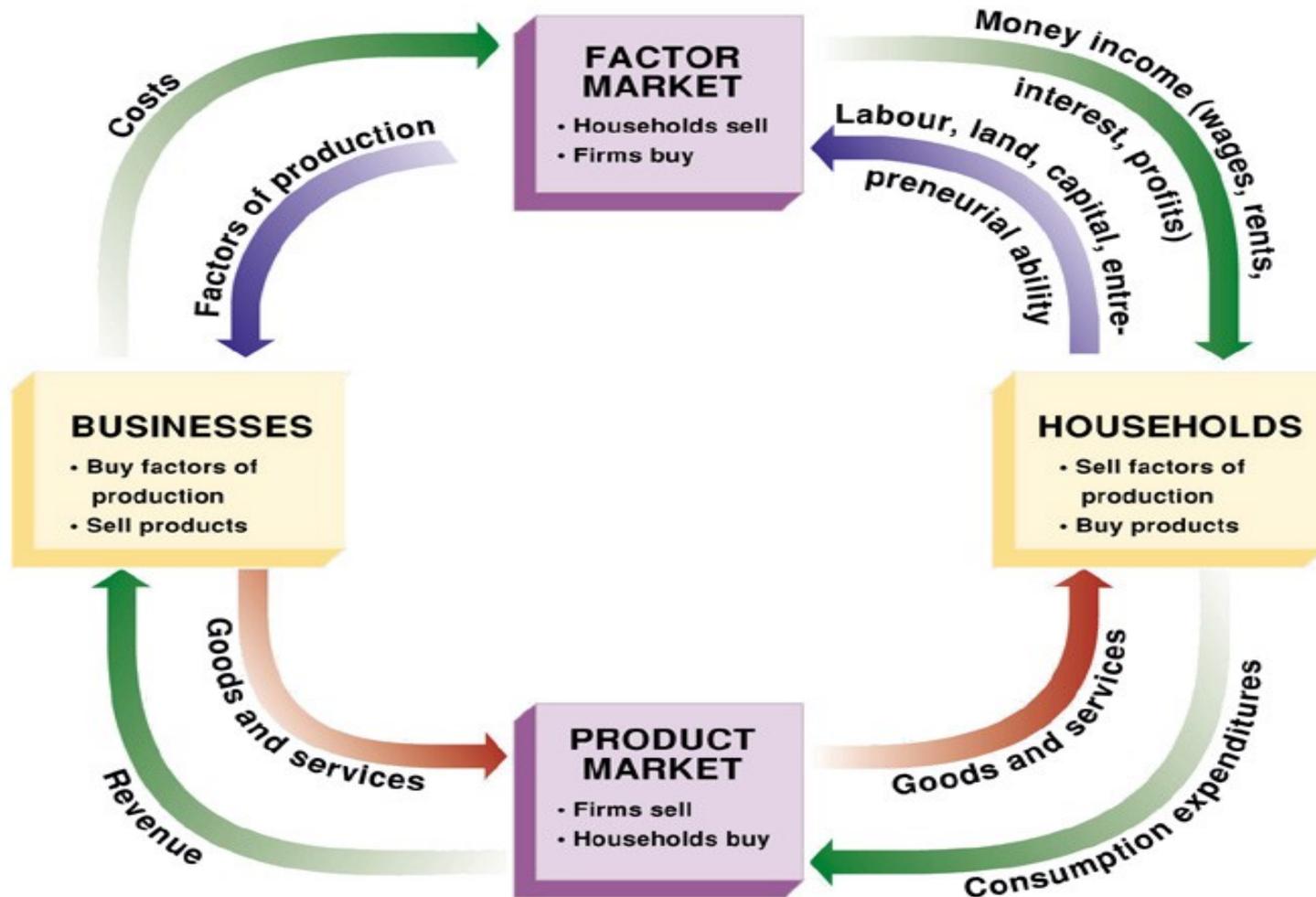
The Production, Property and Power Model

A Visual Model of the Semi-Free-Market Economy

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The Venerable Circular Flow Diagram



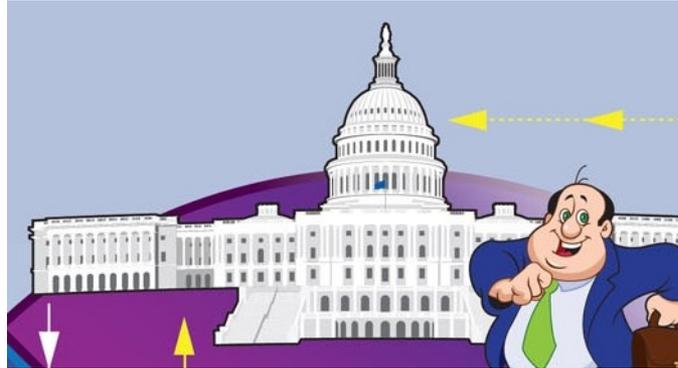
Shortcomings of the Circular Flow Diagram

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

A More Complete Teaching Model

- Retain as much simplicity as possible
- Include the essential decision makers
- Bring out the human behavior aspect of economics
- Bring out the future orientation of the economy
- Reveal the tension and balance in all aspects of the economy

Presenting:



Production,
Property,
And Power
A Model of a semi-free
market economy



The Economic Decision Makers

- Who are they?
- What factors into their decisions?
- What tensions are balanced?
- What motivates them?

Production, Property, and Power

Household Decision Maker



Concepts:

Enjoyment of Consumption

Security in Property (Savings)

Forward-looking

Cares about Future Households

Balances need for income and security against enjoyment of leisure and consumption now and in the future

Motivated by Desire for a Good Life and Avoidance of Insecurity

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Entrepreneur



Concepts:

Innovation, improvements, and growth

Risk-taking, success and failure

Forward-looking

Essential uncertainty of the future

Creative destruction

Balances the cost of money and effort against the likelihood of sufficient future profits to make the venture worthwhile

Motivated by Opportunity for Future Profits

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The Financial Intermediary



Concepts:

The Bank Aggregates Savings

The Banker Allocates Capital
(Performs Due Diligence)

“Animal Spirits”

Balances the cost of funds
against the potential for a
profitable loan transaction

Motivated to Earn Profits for the Bank

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Politicians (Government)



Concepts:

Authorized to provide security and control risk through legislation and regulation

Enforced with police power

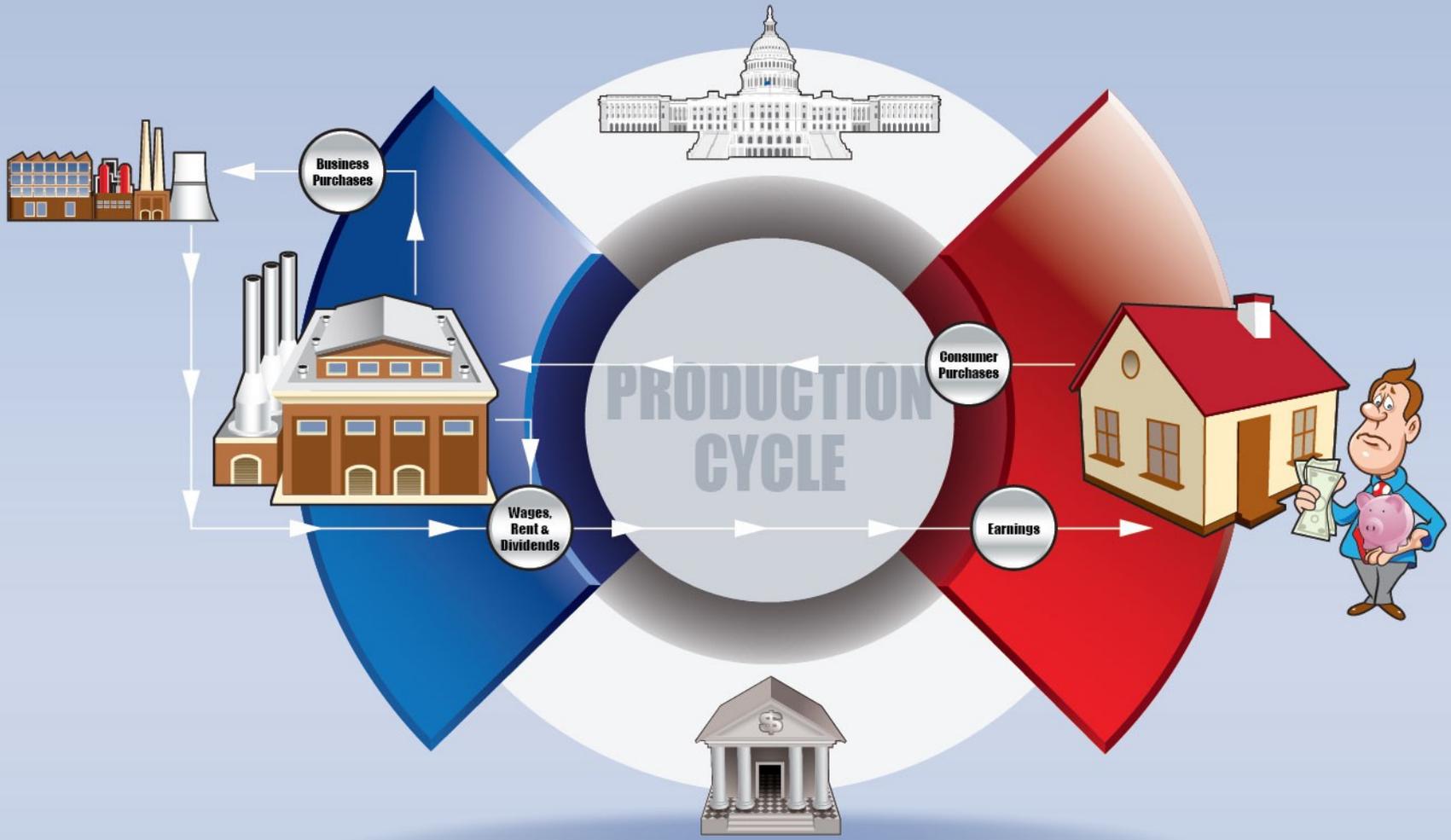
Constrained by behavioral effects on tax revenues (Laffer curve)

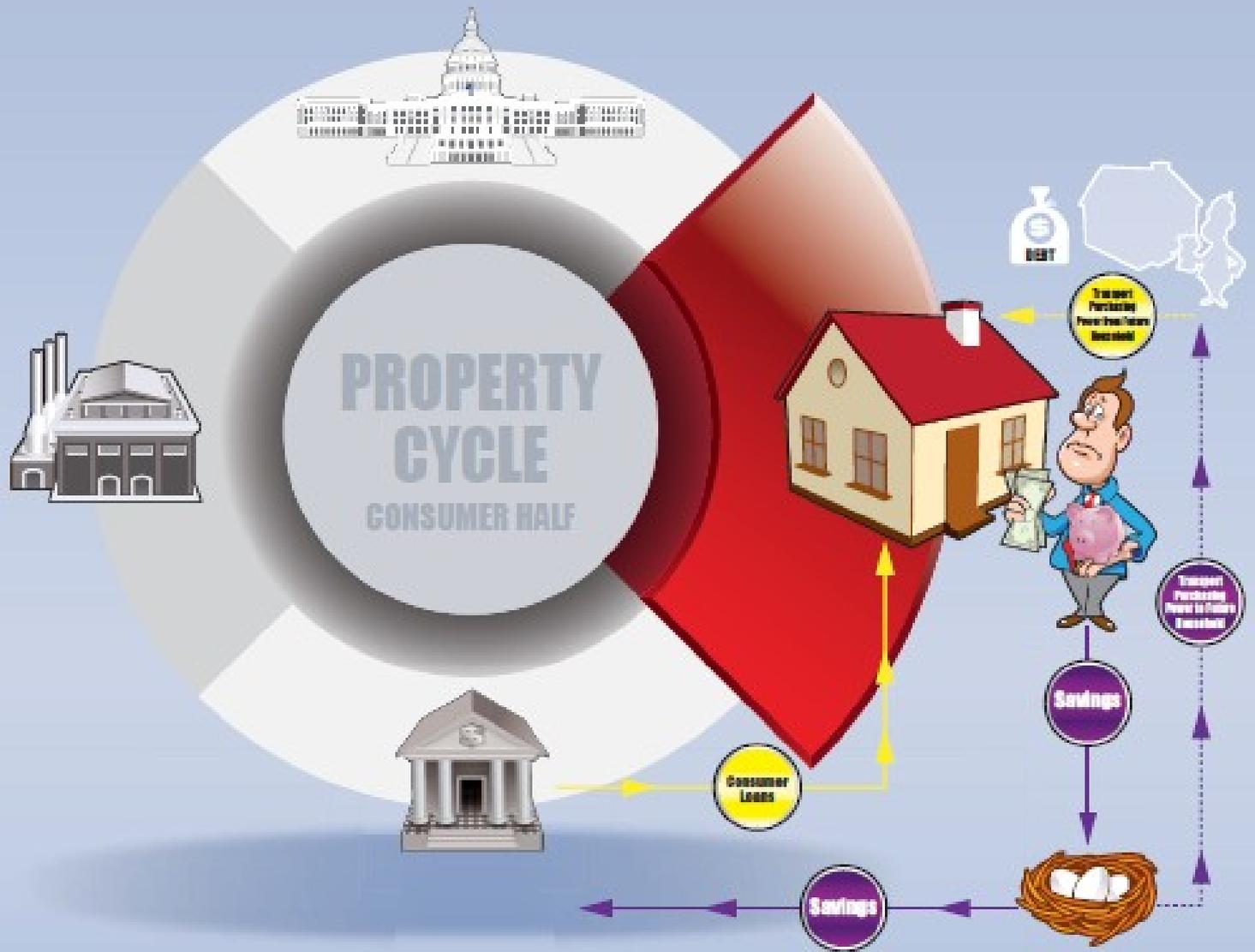
Short-sighted (next election)

“Public Servants” (with Self Interests)

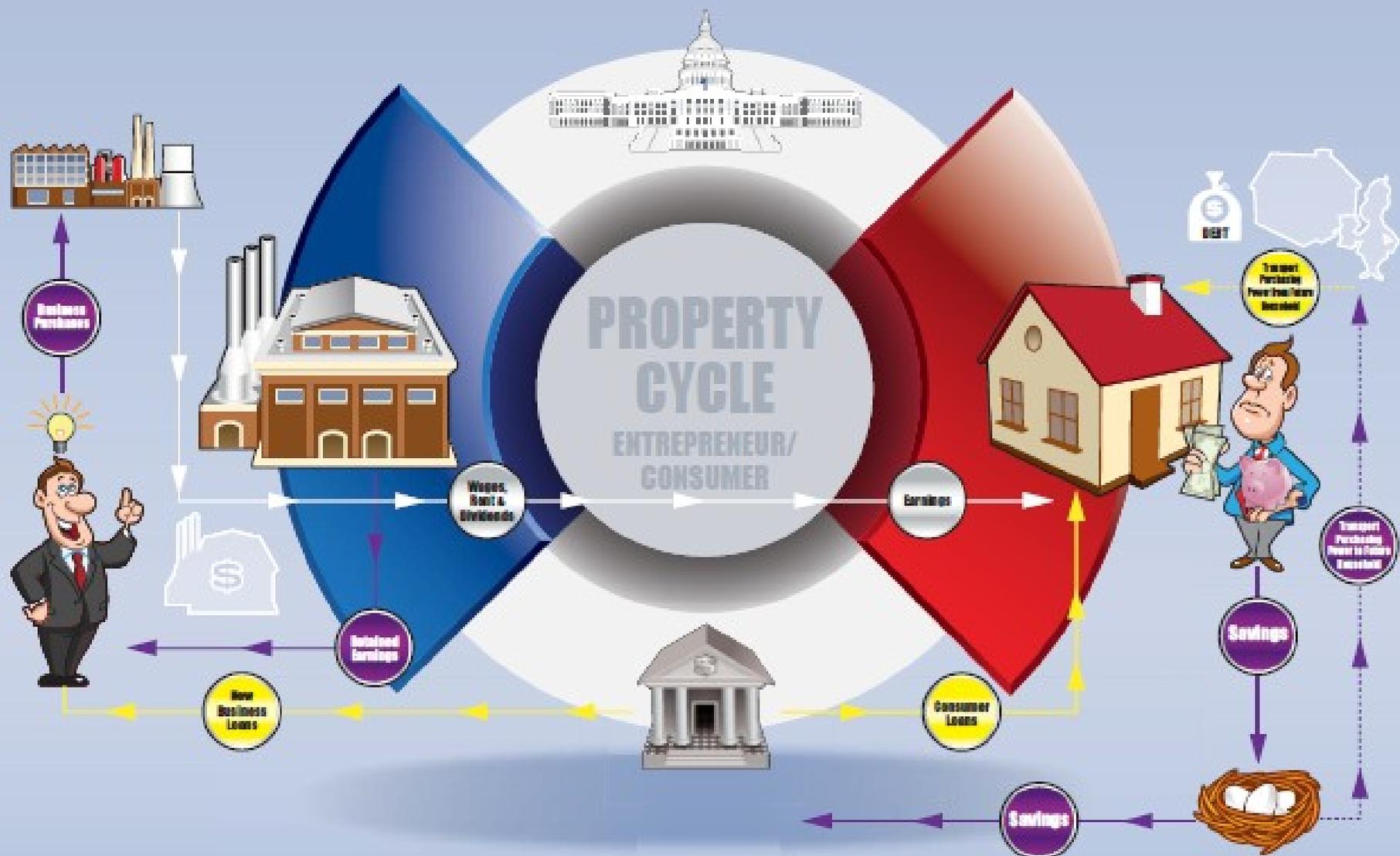
Balances the urge to control against the discontent and tax avoidance of taxpayers

Motivated by an Urge to Control and to Use Power to “do good” (i.e., to implement their “Vision”)



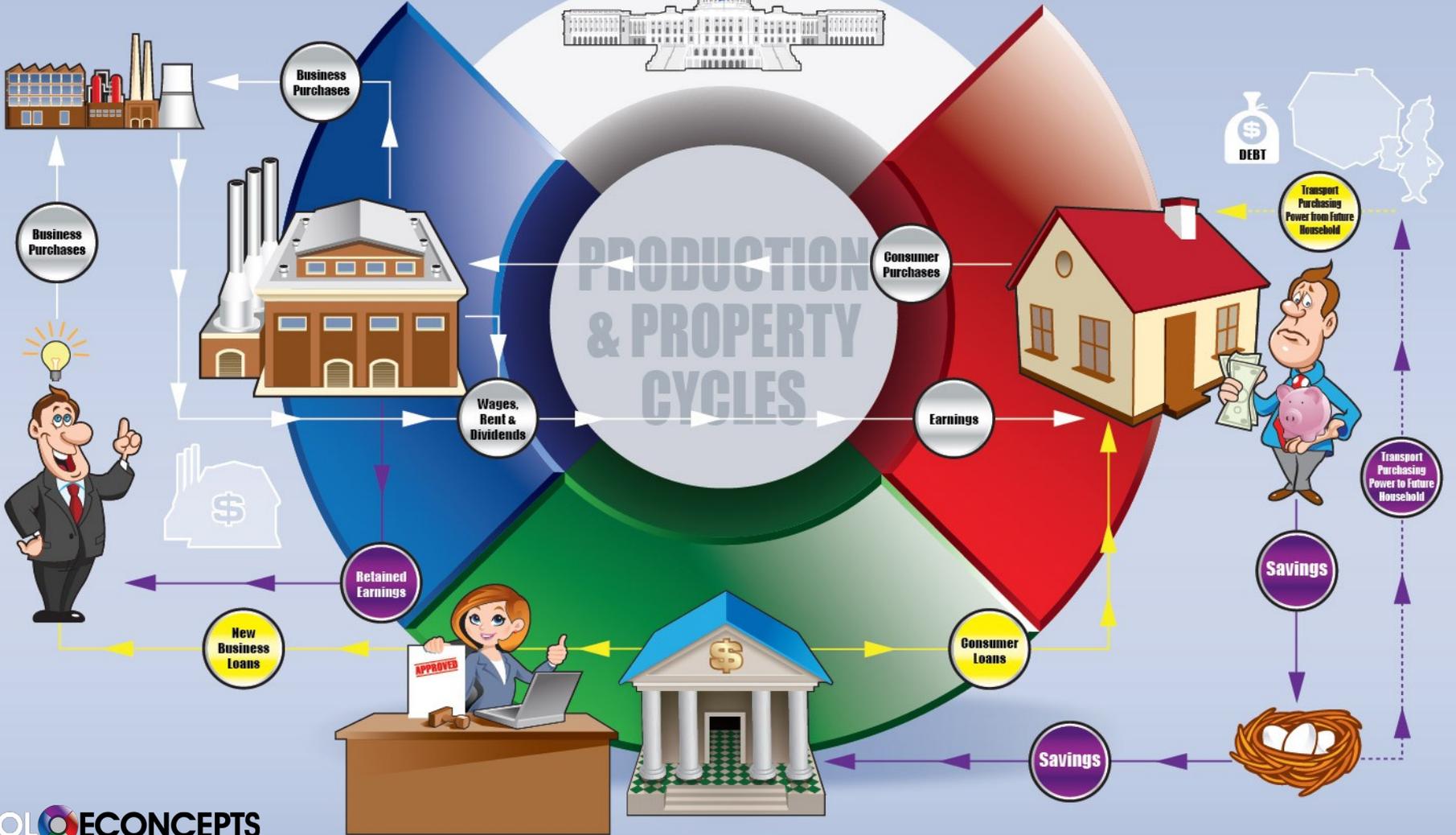


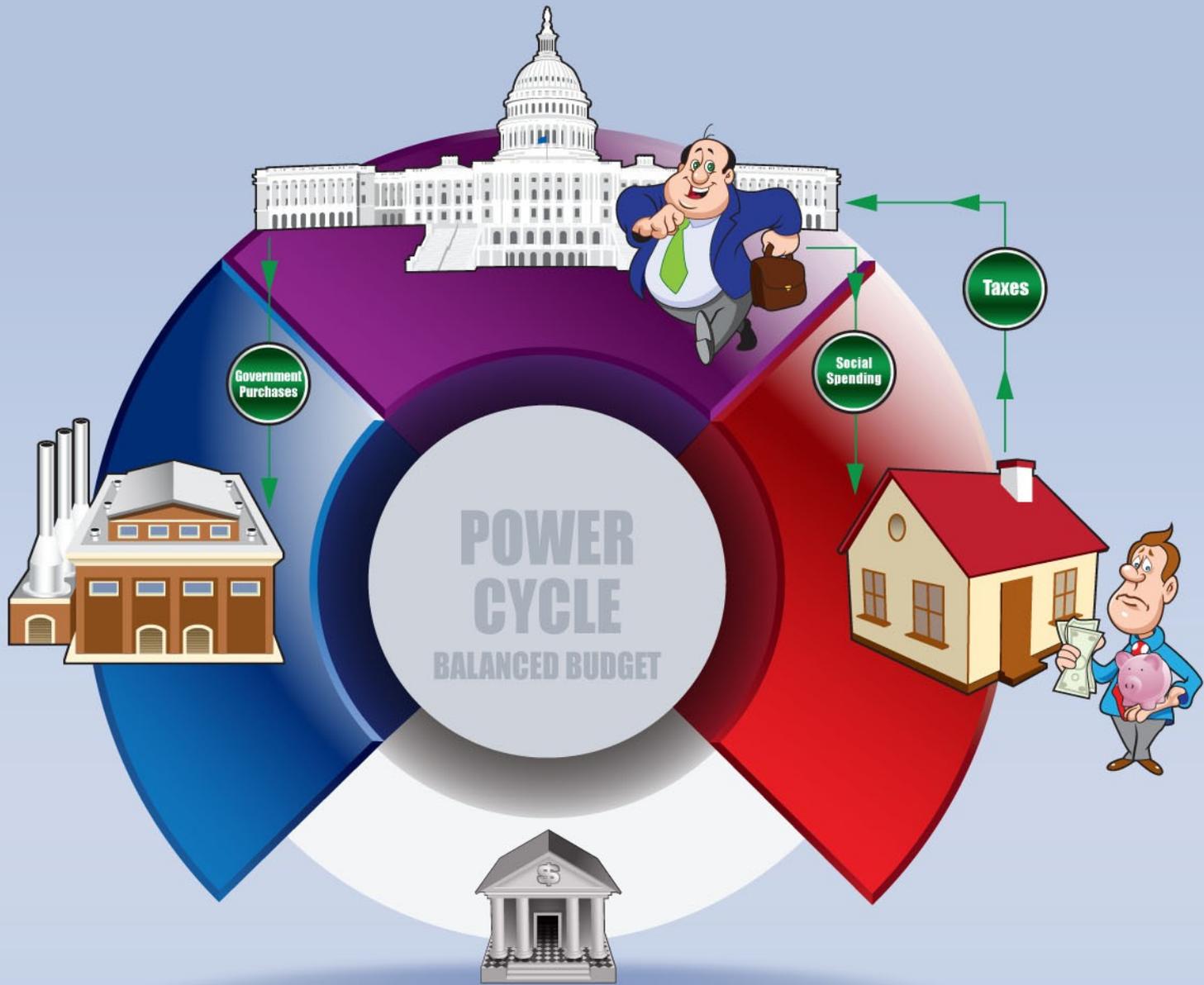


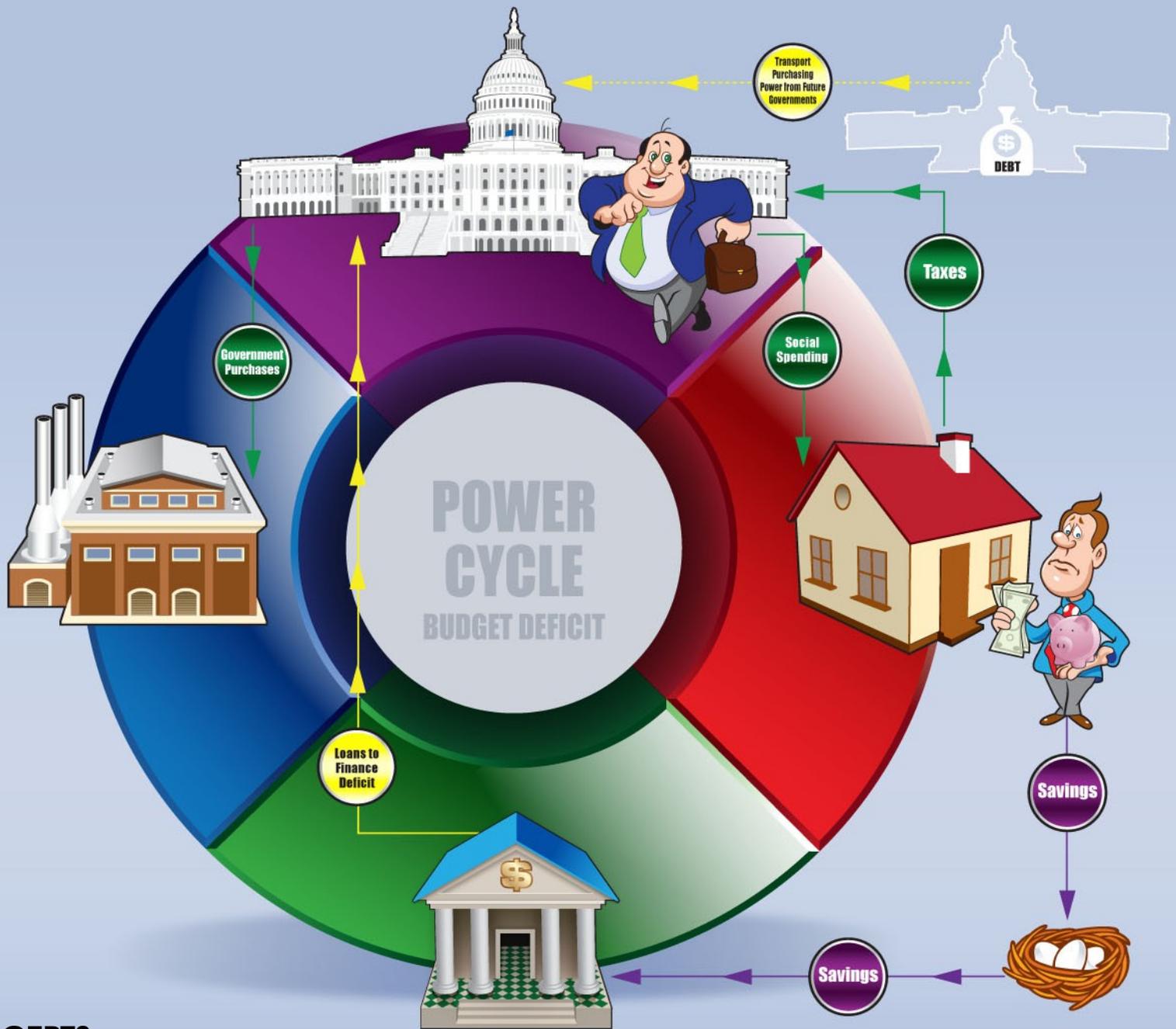


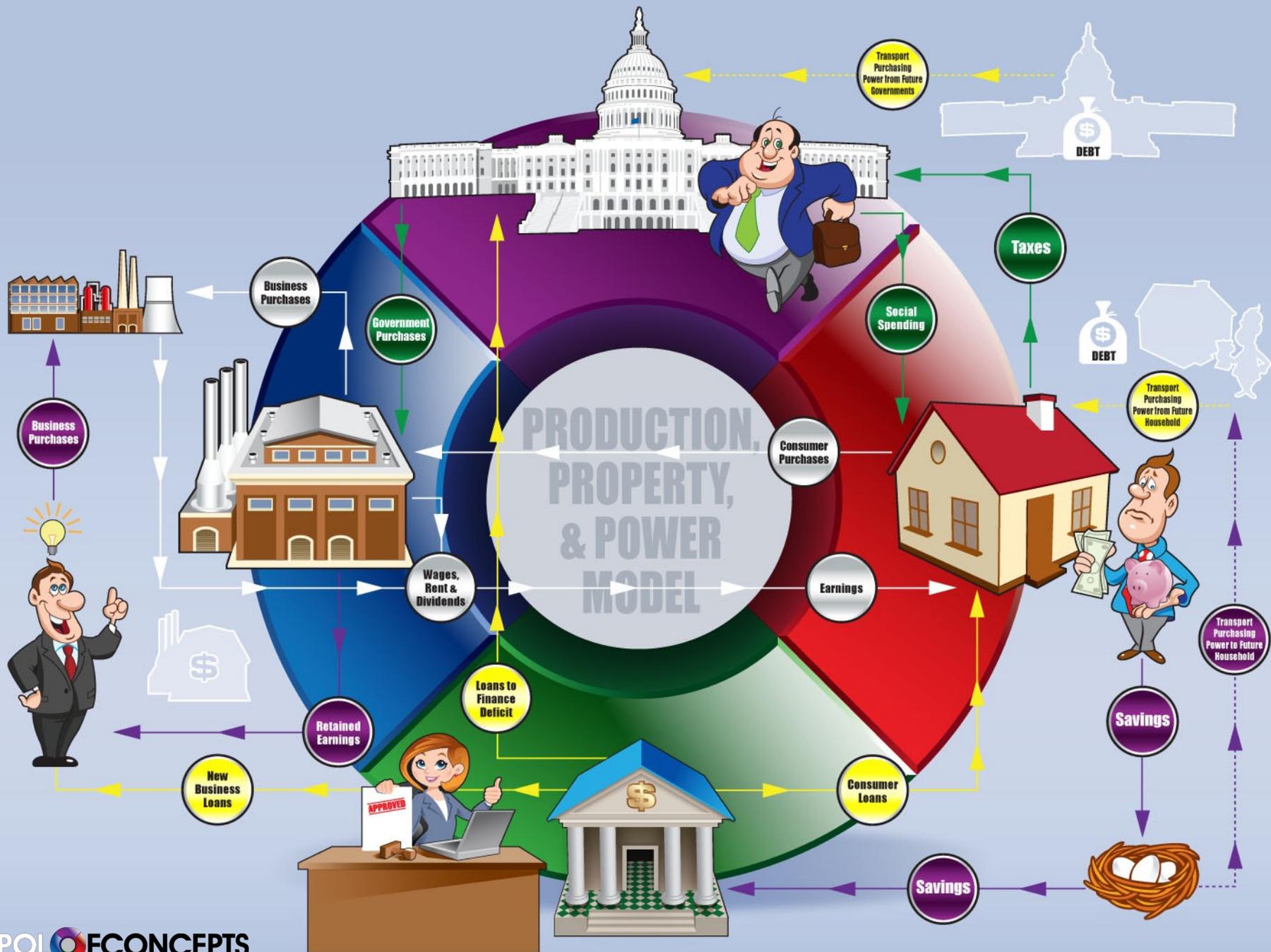


PRODUCTION & PROPERTY CYCLES







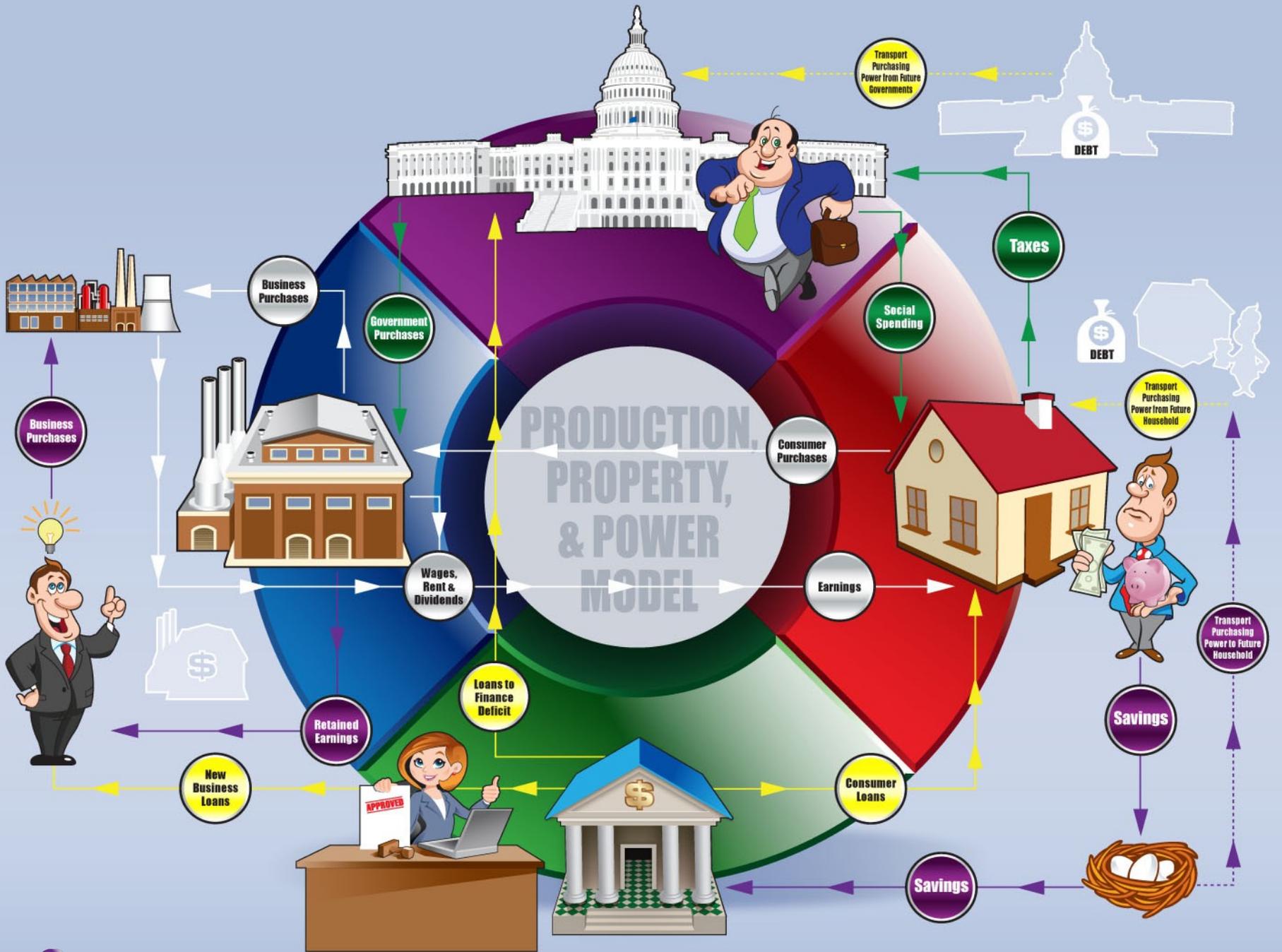


Equilibrium: Negatively Defined

- Firms are unable to further increase profits
- Households are unwilling to work longer hours at the going wages
- Households are unwilling to spend or save more at current prices and interest rates
- Entrepreneurs do not want to make investments at the current cost of capital
- Government is unwilling to increase taxes
- Government is unwilling to increase debt

Equilibrium: Positively Defined

- Firms have maximized profits
- Households have optimized the pleasure of consumption with a feeling of security.
- Entrepreneurs can finance all the projects they want to implement at the current cost of capital
- Government Controllers have provided the maximum degree of security possible given the resources at their disposal



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The End.