

Reisman's Net Consumption, Net Investment Theory of Aggregate Profit

Exposition and Comparison to Mises and Rothbard

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ABSTRACT. This paper presents the essentials of George Reisman's net consumption, net investment theory of aggregate profit as discussed in *Capitalism: A Treatise on Economics*. The paper then relates Reisman's ideas to those of Austrian School economists Ludwig von Mises and Murray Rothbard. Delimiting time preference to determining the rate of net consumption, the primary determinant of aggregate profit, Reisman argues that under an invariable money, a one-time increase in the rate of saving is sufficient to stimulate an increase in the supply of capital goods indefinitely. Reisman thereby rejects the claim that capital accumulation causes a falling rate of profit.

I

Introduction

BÖHM-BAWERK (1959: 1) CONCISELY STATES THE PROBLEM OF PROFIT when he asks: "Whence and why does the capitalist receive [a seemingly] endless and effortless flow of wealth?"¹ The "effortless" part may be debated, but the "endless" part is true in the sense that at the aggregate level profits are almost always present—to the chagrin of Marx. "Whence and why," however, are the crucial questions. Nearly all economists hold, or at least have not challenged, the premise that wages are the original and primary form of income; thus profits,

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according to this “primacy-of-wages” doctrine, are a deduction from the wages of labor (cf. Smith 1976: ch. vi & viii). Many economists, both classical and contemporary, including the Austrian School economist Murray Rothbard (1962: 495–96), hold that the rate of profit (which includes the rate of interest) continually declines toward zero as the economy progresses. And many economists, including Ludwig von Mises (1966: 431, 469, 541–45), the leading Austrian School economist of the 20th century, hold that the anticipation of falling prices, even through increased production and supply, creates a negative component in the loan market rate of interest that could, by implication, render the loan market rate of interest negative.

George Reisman, in his work *Capitalism: A Treatise on Economics* (1996), disputes current and past theories of aggregate profit by turning them on their heads. He calls profits the original and primary form of income from which wages are deducted, thereby providing a powerful answer to the Marxian exploitation theory. He delimits time preference to the role of determining the rate of net consumption, which last, he argues, is the primary direct determinant of aggregate profit. He promotes net investment as a secondary determinant of aggregate profit because net investment tends to relate directly to an increasing quantity of money in the economic system. Through his “springs to profitability” he demonstrates how the elimination of profit due to a financial contraction must be temporary. And, by showing that under an invariable money, a one-time increase in the rate of saving is sufficient to stimulate an increase in the supply of capital goods indefinitely, he provides an answer to the argument for the declining rate of profit in a progressing economy.

This paper presents the essentials of Reisman’s net consumption, net investment theory of aggregate profit, an Austro-classical theory, as Reisman describes it,² and relates his ideas to those of Mises and Rothbard.

II

The Primacy of Profits

THE PRIMACY-OF-WAGES DOCTRINE, as Reisman (1996: 477) labels it, is the notion that all income earned in an economy is originally, and right-

fully, wages. The idea derives from the classical economists, particularly Adam Smith, who said that in precapitalistic times—when there are no capitalists—all productive activity is performed by laborers earning wages. States Smith ([1776] 1976: 72), “the whole produce of labour belongs to the labourer. He has neither landlord nor master to share with him.” With the rise of capitalism and capitalists, says Smith, profit comes into existence as a deduction from the wages of labor, with the capitalist taking his or her share unjustly from the laborer. Marx completely accepts this idea and incorporates it into his exploitation theory. Indeed, Reisman argues that the primacy-of-wages doctrine is the fundamental conceptual framework of the exploitation theory (476–77).³ Over the years, other economists have debated whether profit is a just or unjust deduction from wages—Böhm-Bawerk (1959: 263–71), notably, argues the former—but nearly all have accepted the basic premise.

Using concepts and principles from the classical economists, Reisman rejects the primacy-of-wages doctrine and holds that the primary form of income, even in the precapitalistic economy, is profit. As defined by the classical economists and accepted by Reisman, profit is essentially accounting profit, or sales revenues minus costs, and wages “are money paid in exchange for the performance of labor.” The capitalist is “one who buys in order subsequently to sell for a profit” (478). Thus, a sole proprietor who has no employees earns a profit, not wages, after costs have been deducted.

Reisman goes on to defend the classical basis of the primacy-of-profits principle by quoting John Stuart Mill's (1987: 79) proposition that “demand for commodities is not demand for labour” and David Ricardo's (1973: 64) tenet that “profits rise as wages fall and fall as wages rise.”⁴ Concerning Mill's statement, Reisman explains: “In buying commodities, one does not pay wages, and in selling commodities, one does not receive wages. What one pays and receives in the purchase and sale of commodities is not wages but *product sales revenue*” (478; emphasis in original). Thus, in Adam Smith's “early and rude state” or in Marx's “simple circulation,” all income is entirely profit—because the producers have no costs to deduct from their sales revenue; when producers buy capital goods and hire helpers and pay them wages, the producers become capitalists and

their expenditures become costs to be deducted from their sales revenues, which were originally all profit.

Concerning Ricardo's principle, Reisman elaborates:

The wages paid in production, according to Ricardo, are paid by capitalists, out of savings and capital, not by consumers. If, as in the precapitalist economy, there are no capitalists, then there are no wages paid in production, and if there are no wages paid in production, the full income earned in Ricardo's framework must be profits.

Smith and Marx are wrong. Wages are not the primary form of income in production. Profits are. In order for wages to exist in the production of commodities for sale, it is necessary that there be capitalists. The emergence of capitalists does not bring into existence the phenomenon of profit. Profit exists prior to their emergence. The emergence of capitalists brings into existence the phenomena of productive expenditure, wages, and money costs of production. (479)

From the above, it follows that a "radical reinterpretation of 'labor's right to the whole produce'" is called for. Reisman does provide this reinterpretation (482–83) and goes on to develop his devastating critique of the Marxian exploitation theory. The purpose of this paper, however, is to present Reisman's theory of profit, not his criticism of the exploitation theory.⁵ The first point, then—the primacy of profits—has now been established.

III

Net Consumption Plus Net Investment Equals Aggregate Profit

THE TWO COMPONENTS OF REISMAN'S THEORY are net consumption and net investment, which when added together equal aggregate profit.⁶ The average rate of profit is found by dividing aggregate profit by the aggregate invested capital.⁷

A. Net Consumption

Net consumption is the consumption expenditures of business people and capitalists (725–34).⁸ This premise can be demonstrated as follows.

Aggregate profit is the difference between two demands: the

demand for the products of business minus the demand for factors of production by business. The demand for the products of business, which constitutes aggregate sales revenues in the economic system, consists of three categories: the demand for capital goods by business, labor's demand for consumer goods, and businesspeople's and capitalists' demands for consumer goods. The demand for the factors of production by business, which constitutes aggregate productive expenditure, consists of two categories: the demand for capital goods and the demand for labor.

The two demands for capital goods are identical because capital goods, by definition, are bought and sold by businesses; that is, the productive expenditure of one business *is* the sales revenue of another. The demand for labor by business is the source of labor's demand for consumer goods; and because the wages paid to labor by business are almost exclusively spent by labor on consumer goods, these two demands are virtually equal.⁹ Only one demand remains, that of the businesspeople's and capitalists' demand for consumer goods, and this constitutes an excess of sales revenues over the productive expenditures of business. Thus, aggregate sales revenue minus aggregate productive expenditure equals the consumption expenditures of businesspeople and capitalists, or net consumption, which is aggregate profit.

The primary sources of net consumption are dividends, interest payments by business, and proprietors' and partners' draws. These sources have no counterpart in productive expenditures for capital goods or labor, thereby making possible the existence of an excess of sales revenues over these productive expenditures. Units of money can be attached to the concepts in the above discussion to illustrate the source of aggregate profit. Exhibit 1 presents a simplified income statement.¹⁰ As illustrated, the only possible source of 200 profit is the consumption expenditures of business people and capitalists.

The income statement in Exhibit 1 can also be used to illustrate the determination of the average rate of profit. A few points of elaboration are required first. Keeping in mind that the income statement in Exhibit 1 represents an entire economy, it also describes, for purposes of simplifying the analysis, an economy in which both the quantity of money and aggregate business sales revenues are assumed to be

Exhibit 1

Sales Revenues	
Demand for Capital Goods	500
Labor's Demand for Consumer Goods	300
Businesspeople's and Capitalists Demand for Consumer Goods	200
Total Demand for the Products of Business	<u>1,000</u>
Productive Expenditures	
Demand for Capital Goods	500
Demand for Labor	300
Total Demand for Factors of Production by Business	<u>800</u>
Profit	<u><u>200</u></u>

fixed at 1,000 units.¹¹ The 1,000 units of sales revenues are further assumed to be earned on the first day each year; the rest of the year is spent producing next year's supply of capital goods and consumer goods.

The money in the economy to buy and sell capital goods and consumer goods represents 1,000 in cash assets; even though the 1,000 units of money are used to purchase capital goods and consumer goods, the money does not disappear—it is taken in by other capital goods and consumer goods sellers. The 800 in productive expenditures represents cost value of the current year's worth of produced capital goods and consumer goods; at year end, the 800 represents capitalized inventory and net plant and equipment. Thus, total capital invested in the economy is 1,800 units of money. Net consumption, or profit, is 200. Net consumption divided by total capital invested equals a rate of profit of 11.11%. The rate of profit is the rate of net consumption.¹²

Where does time preference fit into Reisman's theory? Time preference determines the rate of net consumption by determining "the proportions in which people devote their income and wealth to

present consumption versus provision for the future" (743). A lower degree of time preference leads to a lower rate of net consumption, and therefore a lower rate of profit. A higher degree of time preference leads to opposite effects. Thus, the influence of time preference on aggregate profit and the rate of profit is indirect; net consumption is the direct determinant of profits.

B. Net Investment

Net consumption is the difference between sales revenues and productive expenditure. Net investment is the difference between productive expenditure and costs. The latter two terms are not usually equal to one another, as was assumed in the discussion above of net consumption. Many capital goods last longer than a year and the goods' costs are accounted for over a number of years. Thus, the total productive expenditure to purchase a capital good in one current year shows up on the income statement over a number of years either as small increments of depreciation or, in the case of inventory, as cost of goods sold. The gap between the current year's productive expenditure and cost, which cost results in large part from prior years' productive expenditure, is called net investment. This net investment appears in the economic system as a whole as a component of aggregate profit (744–50). For example, in Exhibit 1, if the capital goods under the heading "Productive Expenditures" are depreciated over two years, 250 of the 500 units of money that are not depreciated will show up in the bottom line as profit.

With the assumption of an invariable money, net investment tends to disappear, leaving net consumption as the only determinant of aggregate profit (758–62). If capital goods worth 500 are purchased every year and depreciated over 10 years at 50 per year, from Year 10 on there will be no more net investment. This occurs because costs catch up to productive expenditures. In Year 1, total depreciation charged against productive expenditure is 50; in Year 2, it is 100; in Year 3, it is 150; and so on, until Year 10. In Year 10, total depreciation is 500, the same as productive expenditure. In Year 10 and thereafter, current productive expenditure for durable capital goods is offset by current depreciation.

Net investment can be prolonged when the marginal productivity of capital exceeds the average rate of profit, but this process is self-limiting. The marginal productivity of capital is the rate of cost saving or sales increase per unit of capital invested.¹³ When it exceeds the average rate of profit, an incentive exists to direct new investment into more-capital-intensive lines of business. This means that productive expenditures will be depreciated over a greater number of years than the current average. When this occurs, net investment is called into existence.

For example, an economy that invests 500 units of money in capital goods yearly that are depreciated continually over two years will show no net investment after two years. A shift—brought about by a marginal productivity of capital greater than the average rate of profit—to more-capital-intensive lines of business, requiring capital goods lasting 10 years instead of two, will create net investment for at least 10 years. This process, however, is self-limiting because the new net investment increases the rate of profit, thus causing a movement toward equality with the marginal productivity of capital. As the spread between the marginal productivity of capital and the average rate of profit declines, the incentive to move into more-capital-intensive lines of business decreases.

Modern economies, however, do not have an invariable money. Even a money system based on precious metals will experience an increase in the quantity of money, caused by the continued and increased mining of gold and silver. When this occurs, costs never catch up with productive expenditures, leaving a permanent component of profits caused by net investment. Costs fail to catch up with productive expenditures because year after year productive expenditures become larger and larger, due to the increasing quantity of money. Costs, however, reflect past purchases of capital goods, made at a lower level of productive expenditure. Hence, a permanent gap occurs between productive expenditures and costs in an economy with an increasing quantity of money (762–73).

Indeed, concludes Reisman, the rate of net investment tends to equal the rate of increase in the quantity of money, thus providing a permanent component of aggregate profits caused by the increase in the quantity of money.

IV

The Springs to Profitability

FROM THE ABOVE DISCUSSION of net consumption and net investment, it follows that aggregate profit can never disappear for any length of time, nor can the rate of profit permanently fall to zero. (The elimination of profit, say, due to a major depression will be temporary.) For example, net consumption, as the consumption expenditures of businesspeople and capitalists, is likely always to exist. And net investment, as a product of the increase in the quantity of commodity money, in a precious metals economy, will always exist under conditions of capital accumulation. The potentially most powerful spring to profitability, however, is the tendency for a plunge in the rate of profit to stimulate investment in more-capital-intensive lines of business, thus generating net investment and restoring profitability (778–84). This governor-like mechanism operates as follows.

As the average rate of profit falls, more-capital-intensive lines of business become attractive. This occurs because, as discussed above in the exposition of net investment and the marginal productivity of capital, more-capital-intensive investments produce lower costs than less-capital-intensive investments. As the average rate of profit declines, the rate of profit of the more-capital-intensive lines of business becomes more attractive (higher) relative to that of the less-capital-intensive lines of business. A capital improvement, for example, that generates a 10% return will be undertaken when the average rate of profit falls below 10%.

Also, the rate of profit requires more-capital-intensive investments to carry a greater premium on prices and sales revenues than that of less-capital-intensive investments; as the average rate of profit falls, more-capital-intensive investments once again become more attractive because of the lower premium required by the lower rate of profit relative to less-capital-intensive investments. In the condition of a depression in which the rate of profit plunges and may be wiped out altogether, the operation of this “spring” is capable of bringing about a restoration of profitability.

No Falling Rate of Profit Due to Capital Accumulation

THUS, THE RATE OF PROFIT IN A MARKET ECONOMY can never decline to zero for any length of time. What remains to be demonstrated is that such declines as may occur are largely independent of capital accumulation (809–17). Exhibit 2 provides the means for this demonstration.

Exhibit 2 reproduces the income statement of Exhibit 1 plus three additional years of data; it also introduces a one-year lag between productive expenditures and costs.¹⁴ Year 1 represents the economy of Exhibit 1, in which production is equally divided between capital goods and consumer goods and represents a stationary economy. Years 2, 3, and 4 represent a progressing economy, in which 60% of production is devoted to capital goods and 40% to consumer goods. For Year 1, the quantity of capital goods produced is 1K and the quantity of consumer goods is 1C. For Years 2 through 4, the quantity of capital goods increases at the rate of 20% per year. The quantity of consumer goods declines 20% during Year 2, due the change in the mix of capital goods and consumer goods from Year 1 to Year 2, then increases at the rate of 20% per year for Years 3 and 4. The quantity of labor used in production remains fixed throughout at 1L. Financial data, indicating the average rate of profit for each year, are displayed in the last three lines of the exhibit.

The change from a stationary to a progressing economy comes about because of a decline in net consumption, from 200 in Year 1 to 100 in Years 2 through 4. Under Sales Revenue, this decline in net consumption results in an increase of 100 in the Demand for Capital Goods in Years 2 through 4 (compared with Year 1) and a decline of 100 of Demand for Consumers' Goods (compared with Year 1). Profits in Year 2 remain at 200 because the increase in Demand for Capital Goods to 600 results in net investment of 100. In Year 3, net investment disappears because costs rise to equality with the higher productive expenditures. Profit then falls to 100 and continues at that level for Year 4 and additional years, provided no further change occurs in net consumption.¹⁵

Exhibit 2

	Year 1	Year 2	Year 3	Year 4
Sales Revenues	<u>500</u>	<u>600</u>	<u>600</u>	<u>600</u>
Demand for Capital Goods	300	300	300	300
Labor's Demand for Consumer Goods	<u>200</u>	<u>100</u>	<u>100</u>	<u>100</u>
Businesspeople's and Capitalists' Demand for Consumer Goods	1,000	1,000	1,000	1,000
Total Demand for the Products of Business (i.e., Sales Revenues)				
Productive Expenditures				
Demand for Capital Goods	<u>500</u>	<u>600</u>	<u>600</u>	<u>600</u>
Demand for Labor	<u>300</u>	<u>300</u>	<u>300</u>	<u>300</u>
Total Demand for Factors of Production by Business	<u>800</u>	<u>900</u>	<u>900</u>	<u>900</u>
Costs*	<u>800</u>	<u>800</u>	<u>900</u>	<u>900</u>
Profit	<u>200</u>	<u>200</u>	<u>100</u>	<u>100</u>

Exhibit 2 Continued

Profit Due to Net Consumption	200	100	100	100	100	100
Profit Due to Net Investment	0	100	100	0	0	0
Quantity of Capital Goods Produced	1K	1.2K	1.44K	1.728K	1.728K	1.728K
Quantity of Consumer Goods Produced	1C	.8C	.96C	1.152C	1.152C	1.152C
Amount of Labor Used in Production	1L	1L	1L	1L	1L	1L
Cash to Finance Transactions	1,000	1,000	1,000	1,000	1,000	1,000
Capital Invested	1,800	1,800	1,800	1,900	1,900	1,900
Rate of Profit	11.11%	11.11%	11.11%	5.26%	5.26%	5.26%

*A one-year lag occurs between Productive Expenditures and Costs; thus, the Total Demand for Factors of Production by Business in one year becomes the Costs of the next. The arrows illustrate this lag.

Exhibit 2 demonstrates that capital accumulation from Years 1 through 4 results only in a one-time decline in the rate of profit, from Years 2 to 3. Thereafter, the rate of profit is constant, as the quantity of capital goods continues to accumulate at the rate of 20% per year, as does the quantity of consumer goods.¹⁶ Any further fall in the rate of profit would have to be due to a further fall in the rate of net consumption. In an economy with an invariable money, as Exhibit 2 assumes, it is prices and costs that decline steadily as capital accumulates. Indeed, as the quantity of capital goods and consumer goods accumulate at the rate of 20% (in Years 2 through 4), prices and costs decline at the rate of $16\frac{2}{3}\%$. This occurs as follows. If, as exists in Exhibit 2, the quantity of capital goods and consumers' goods goes up from one year to the next by $\frac{6}{5}$ and the monetary demand is constant, then prices and costs must decline to $\frac{5}{6}$ of what they were previously or, in other words, fall by $\frac{1}{6}$ or $16\frac{2}{3}\%$ (815).

The reason that aggregate profit does not decline is that, in the aggregate, total sales revenues and total productive expenditures, or costs, remain the same. When decline and increase rates are the inverse of one another, as they are here, falling unit prices multiplied by an increasing quantity of goods produced equals the same sales revenues as before. Similarly, falling unit costs times an increasing quantity of materials equals the same cost of materials as before. The quantity of labor used to produce the increasing quantity of capital goods and consumer goods is held constant throughout Exhibit 2 at 1L and the cost of labor remains the same throughout at 300. This implies an increasing productivity of labor as the economy progresses—and lower unit costs, but the lower unit costs are offset by an increasing quantity of goods produced.¹⁷ The result is that aggregate sales revenues and aggregate costs are not affected by capital accumulation and declining prices. Thus, aggregate profit does not change.

Reisman points out that most economists see only the one-time decline in the rate of profit from Year 2 to Year 3 and thus conclude that this is the continuing pattern of capital accumulation. They see repeated saving—repeated cycles of Year 1 to Year 3—as the essential requirement for capital accumulation. They see the savings rate

increasing year after year, as well as the proportion of investment devoted to capital goods over consumer goods. As a result, they see the rate of profit continually declining in a progressing economy. Reisman, on the other hand, holds that the one-time increase in saving—the decrease in net consumption—and the corresponding one-time shift in the proportion of investment devoted to capital goods over consumer goods are sufficient to stimulate an increase in the supply of capital goods indefinitely. And this last occurs without any further effect on the rate of profit.

“Each act of saving . . .,” concludes Reisman, “stands in the same relation to capital accumulation as does force to the acceleration of mass in the world of physics” (814). Other economists see the relationship as one of repeated force necessary to maintain motion.

Fundamentally, what enables capital to accumulate indefinitely is technological progress, for innovation is required to offset the effects of the law of diminishing returns. Without technological progress, the productive ability of the economic system would eventually fail to keep up with the growing supply of capital goods. And, sooner or later, the growth in the supply of capital goods would stop, regardless of how much saving is devoted to capital goods production. Thus, saving, according to Reisman, is not the sole source of capital accumulation, as other economists maintain, nor is technological progress the means of providing outlets to the expanding supply of capital goods or of propping up the falling rate of profit (556–58, 629–31). Indeed, saving determines the production of capital goods relative to consumer goods, but it is technological progress that maintains the rise in the productivity of labor in the process of capital accumulation; technological progress and capital accumulation, then, reciprocally reinforce one other (631–32).

A further implication of Reisman’s theory is that the long-run nominal rate of saving (or net saving in terms of money in the economy as a whole) is mainly a function of increases in the quantity of money. As such, nominal saving adds a permanent component to the rate of profit as net investment. Contrary to the prevailing view of other economists, Reisman sees nominal saving as the accompaniment of a higher rate of profit, not the cause of a lower rate (834–38). Thus, “[i]n the system as a whole [under an invariable

money], there is no net saving in terms of money. Capital accumulation and economic progress in such circumstances take place exclusively in the form of falling prices" (835).

One variant of the declining-profits doctrine holds that anticipations of falling prices due to rapid increases in production and supply produce a negative component in the rate of interest that potentially could eliminate the rate of profit. Such activity would increase the desire to hold money, thereby leading to a depression. Capital accumulation, in other words, is said to be a potential cause of depressions. This "negative price premium" argument, however, is mistaken, because falling prices, as Reisman has shown, caused by capital accumulation (assuming an invariable money) have no effect on the rate of profit. And no effect on the rate of profit means no effect on the demand for or supply of loanable funds. Hence, no effect on the interest rate. The cause of falling prices as may occur in a depression, states Reisman, and the accompanying falling aggregate profit and loan market rate of interest, is a reduction in the quantity of money and volume of spending in the economy. Price premiums, positive or negative, are strictly a monetary phenomenon (825–26).

In fact, falling prices caused by increased production may actually be accompanied by increases in the rate of profit and interest, if there is an increase in the quantity of money that is less than the increase in production and supply. The latter causes the fall in prices, the former the rise in the rate of profit and interest. Similarly, rising prices caused by decreased production may be accompanied by decreases in the rate of profit and interest, if there is a reduction in the quantity of money that is less than the decrease in production. When relating prices to the rate of profit and interest, states Reisman, "[p]rice changes are altogether nonessential. . . . Changes in the price level are related to changes in the rate of profit and interest merely by a process of association" (825).

VI

Comparison to Mises and Rothbard

ONE OF THE MOST SIGNIFICANT DIFFERENCES between Reisman and the Austrian School economists Ludwig von Mises and Murray Rothbard

occurs over the time preference doctrine. Both Mises and Rothbard accept the traditional time preference theory of aggregate profit, with Rothbard's discussion being essentially an elaboration of Mises.

Mises states his theory as follows (using "originary interest" for aggregate profit): "Originary interest is the ratio of the value assigned to want-satisfaction in the immediate future and the value assigned to want-satisfaction in remote periods of the future. It manifests itself in the market economy in the discount of future goods as against present goods" (Mises 1966: 526). Thus, the difference between the valuation of factors of production in the present to produce an automobile and the valuation of a finished automobile in the future is the source of profit. As Rothbard puts it, profits are a premium earned by capitalists for advancing capital over time, from the time of initial outlay for factors of production to the time the finished goods are finally sold (Rothbard 1962: 322).

Reisman, however, criticizes the time preference theory in its traditional form for not demonstrating what it claims to demonstrate, namely, the determination of the rate of profit (792–94). The theory assumes that prices remain the same in the future as they are in the present but, as shown above in an economy with an invariable money, prices decline over time as production increases. If, for example, 1C of consumer goods with a monetary value of 500 are produced by .8C factors of production valued at 400, then the rate of profit would be 25%. If production were to double from one year to the next, caused, say, by technological progress, and 2C of consumer goods were produced by .8C factors of production, the time preference theory would imply a rate of profit of 150% ($2C/.8C = 2.5$ or a 150% increase). Under an invariable money, however, where the value of 2C consumer goods would remain at 500 and .8C factors of production would remain at 400, the true rate of profit would still be 25%.

The time preference theory in its traditional form, Reisman points out, confuses "ratios in terms of physical goods, with ratios of monetary value." The former, states Reisman, is "simply irrelevant" in the determination of the rate of profit (794). Thus, Reisman delimits time preference to the determination of the rate of net consumption, as presented above in the discussion of net consumption.

Mises and Reisman do agree in other areas of the theory of aggregate profit. "Originary interest," states Mises, "is a category of human action. It is operative in any valuation of external things and can never disappear" (1966: 527). And: "The disappearance of originary interest would be tantamount to the disappearance of consumption" (1966: 533). However, Mises endorses the purchasing-power-price premiums argument by stating: "The expectation of rising prices thus has the tendency to make the gross rate of interest rise, while the expectation of dropping prices makes it drop" (1966: 543). Much of Mises's discussion of price premiums occurs in the context of rapid inflation, where a positive premium in the interest rate is likely to be caused by increases in the quantity of money, but Mises nevertheless seems to make a more direct connection between prices and the rate of profit and interest than does Reisman. Thus, a noteworthy disagreement between the two economists.

Rothbard and Reisman decidedly disagree over the declining rate of profit under capital accumulation. Rothbard states: "It is clear that a feature of the progressing economy must necessarily be a fall in the pure rate of interest . . . Hence, for the economy to keep advancing, time preferences and the pure rate of interest must continue to fall" (Rothbard 1962: 495–96). As discussed in the preceding section of this paper, Reisman demonstrates that the premise of the declining rate of profit is false.

VII

Conclusion

"THE TRUTH OF TODAY IS THE SPECIAL CASE OF TOMORROW." This quotation is attributed to the biologist Otto Koehler in Konrad Lorenz's preface to a book by Darwin (1965: ix). The discovery of a new principle often leads to overgeneralization and application in areas that are not ultimately justified. In later years, scholars delimit the principle to its proper context. This is precisely what Reisman has done in his net consumption, net investment theory of aggregate profit. Time preference has been delimited to its proper role in the determination of the rate of profit.

In addition, Reisman has elevated net investment to its proper place

in the theory of aggregate profit, his primacy-of-profits principle has provided the basis for a powerful answer to the Marxian exploitation theory, his “springs to profitability” have answered concerns about the disappearance of profit due to a major depression, and he has demonstrated how the rate of profit is largely independent of capital accumulation. In the process of developing this theory, Reisman has amply answered Böhm-Bawerk’s question, “Whence and why does the capitalist receive an endless . . . flow of wealth?”

Notes

1. The entire sentence is italicized in the original. For ease of reading, italics here are omitted.

2. More precisely, Reisman states that all of his views on economics can be described as Austro-classical, rather than specifically Austrian (Reisman 1996: 11, n. 2).

3. All subsequent freestanding page references are to Reisman (1996).

4. Ricardo’s statement has been badly misunderstood. See Reisman’s discussion of what Ricardo meant by a fall in wages (495–96).

5. Reisman’s critique of the exploitation theory can be found in two places: 473–98 and 603–72.

6. Reisman provides an algebraic derivation of this formula, based on his interpretation of national income accounting (699–707, 723).

7. The average rate of profit, as Reisman uses the term, is roughly equivalent to ordinary interest, as Mises (1966: 526–32) labels it, and the pure rate of interest, as Rothbard (1962: 297–301) describes it. See below for the three economists’ different interpretations of time preference. Above average profit, for Reisman, is roughly equivalent to entrepreneurial profit, as Mises and Rothbard use the terms.

8. Consumption expenditures of businesspeople and capitalists are the main, enduring source of net consumption, according to Reisman. Other possible sources include net extensions of consumer credit (734–35). Fundamentally, net consumption for Reisman is the consumption of sellers of products, which embraces both businesspeople and capitalists in an advanced economy as well as manual workers in Adam Smith’s “early and rude state.”

9. This is Reisman’s initial assumption, which he demonstrates is an equilibrium condition. His analysis subsequently incorporates the case in which the demand for labor by business exceeds the demand for consumer goods by wage earners (750–54).

10. This is adapted from Tables 16-1 and 16-2 in Reisman (726–727).

11. Reisman frequently assumes an invariable money to facilitate analy-

sis. This enables him to analyze changes in the economy without interference from changes in the money relation. Thus, he achieves a dynamic equilibrium (see 537–40). The notion of “invariable money” means “the assumption that the quantity of money and [the] aggregate volume of spending in the economic system for the goods and services of business are fixed” (538). This concept differs considerably from Ricardo’s. See pp. 536–40 for Reisman’s discussion of invariable money, of his concept in relation to Ricardo’s, and of the significance of the concept for economic analysis.

12. The foregoing is a highly simplified presentation of Reisman’s discussion of the determination of the rate of profit (see 731–34). Throughout Part 3 of his book Reisman uses a series of ingenious graphical figures, which cannot be reproduced or discussed in this short paper, to demonstrate numerous points about the economy as a whole. For example, they are used to demonstrate the differences between stationary and progressing economies (710–11), the determination of aggregate profit and the average rate of profit (729, 732), the effects of an increasing quantity of money on production and profits (765), the effects of an invariable money on profits in a progressing economy (811), the average period of production in a progressing economy (823), and the effects of falling supply in a retrogressing economy (900). An essential theme running throughout these analytical figures is that prices and costs decline as production and supply increase, and that such declines must be clearly separated from price and cost declines caused by decreases in the quantity of money. See especially 573–76.

13. Reisman’s usage here differs from the marginal net physical product concept of the productivity theory of profit and should not be confused with it (787–92).

14. Exhibit 2 is a highly simplified adaptation of Figure 17-1 in Reisman (811). Reisman refers to Figure 17-1 as “a virtual laboratory in which one captures the essential pattern of economic progress in a monetary economy in an intellectually manageable size, and [in which one] is then able to look at it from every possible angle and, as it were, poke and prod it and see exactly how it responds” (812). Cf. note 12 above.

15. Under Productive Expenditures, Demand for Capital Goods, the proportions devoted to capital goods and consumer goods production will change. In Year 1, the mix will be equal at 250 each. In Year 2, however, the mix will change to 300 for capital goods and 200 for consumer goods, reflecting the changing proportion of 60% of total production devoted to capital goods and 40% to consumer goods. In Years 3 and 4, the mix changes to 360 and 240, respectively, for capital goods and consumer goods, reflecting the 60/40 division of the additional 100 of Demand for Capital Goods. Similarly, the mix of labor devoted to each category of production will change: from 150 each for Year 1 to 180 for capital goods and 120 for consumer goods in each of Years 2, 3, and 4.

16. One unstated variable in Exhibit 2 essential to the increase in the quantity of capital goods and consumer goods is technological progress. See subsequent discussion of technological progress.

17. For a thorough analysis and defense of the closely related productivity theory of wages, see Chapter 14 in Reisman (603–72).

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