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BASIC ECONOMIC VARIABLES

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When I lectured on Lonergan's economic writings at Boston College, Fordham, or Woodstock, people asked the same questions: What's the big deal about Lonergan's economics? How does it differ from mainstream economics? What's Lonergan's solution to poverty? This paper is a move towards answering those questions.

To help set the scene for an introduction to Bernard Lonergan's writings on economics it is worth quoting his views on the exchange process. He is, of course, a strong supporter of a sound exchange economy.

> An exchange economy is an attempt to give a continuously satisfactory answer to the continuously shifting question, *Who* among millions of persons, is to perform *which*, among millions of tasks, in return for *what*, among millions of possible rewards?
>
> The answer it offers is as follows.
>
> First, it distinguishes what people do or make for themselves, what they do for others expecting little or no return, and what they do for others expecting a proportionate remuneration. It decides that the first two can take care of themselves, and it concentrates its efforts on the third.
>
> Second, it directs the aggregate of goods, services, and property that are for others, yet expect a proportionate return, to a pyramid of local, regional, national, and world markets of various kinds.
>
> Third, it leaves it to the markets to control contributions and to apportion rewards.
>
> The excellence of this solution is palpable. It

leaves each one free to do as he pleases; but if what pleases him is not what others want, then demand will be zero and his reward zero. It encourages inventiveness and initiative in anticipating others' wants; for such anticipations are met with a strong demand and a high reward. It encourages each one to do his best, for excellence in performance creates favorable preferences or yields the efficiency which, when prices are uniform, produces a differential rent. It places the risks of production on producers, but it leaves control of production ultimately to the integration of consumers' decisions to exchange or not exchange. It apportions the measure of reward each is to receive by the integration of individual decisions, but it leaves the precise reward each receives to his individual choice.

The excellence of the exchange solution becomes even more evident when contrasted with the defects of a bureaucratic solution. The bureaucrat is under no pressure to anticipate precisely what people will want and to give it to them in the precise measure that they want it; he gives them what he thinks good for them, and he gives it in the measure he finds possible or convenient; nor can he do otherwise, for the brains of a bureaucracy are not equal to the task of thinking of everything; only the brains of all men together can even approximate to that. But further, even could the bureaucrat meet this issue, he could not do so continuously, for it is continuously changing; he has to work with plans, and every new demand as well as every new invention tends to upset the old plans and make a new beginning necessary; when a limited liability company has served its day, it goes to the bankruptcy court; but when bureaucrats take over power, they intend to stay. Finally, even if the bureaucrat could meet both these problems, he could not give them a human solution; men learn by experience; you can teach them to stay on one job by letting them roam about trying others; you can let

> them learn by experience that their abilities are not quite so great as they fancy; but when the pressure of terrorism is needed to oil the wheels of enterprise, then the immediate effect is hatred and the ultimate effect is either an explosion or else a servile degeneracy.[1]

It is evident from the quotation that Lonergan's focus is the exchange economy. His writings on economics are not concerned with the renovations done by do-it-yourselfers on their own homes, handy-people who repair their friends' cars for a case of beer, work done by grandparents who baby-sit or knit socks for their grandchildren, the important work performed by volunteers, unpaid housework, or goods changing hands in some sort of a barter system. Even the work done by Robinson Crusoe is not part of an exchange economy. Rather, Lonergan's concern is the exchange economy itself – *the production of goods and the performance of services that are sold and paid for with money*.

Because they also lie, strictly speaking, outside the exchange economy, Lonergan is not concerned with the reasons individuals buy and sell particular goods and services. Psychological motivations, marginal utility, opportunity costs, and the value of goods and services compared to alternatives are not elements of the exchange economy. For instance, whether a government should build a hospital or buy a missile defense system, buy food for its starving population or purchase new rifles for its army are issues that, *strictly* speaking, are not economic issues. Further, Lonergan is not attempting to construct a system for redistributing incomes from rich people to poor people. His focus is how an economy *actually* works.[2]

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[1] *CWL 21*, 34-35

[2] For more on the aims and context of Lonergan's work on economics, see Frederick Lawrence, "Editor's Introduction," Bernard Lonergan, *Macroeconomic Dynamics: An Essay in Circulation Analysis,* 15 *Collected Works of Bernard Lonergan,* ed. Frederick Lawrence, Patrick Byrne, and Charles Hefling (Toronto: University of Toronto Press, 1999); Philip McShane, "Editor's Introduction," Lonergan, *For a New Political Economy*, 21 *Collected Works of Bernard Lonergan* (Toronto: University of

It's not that Lonergan is not interested in so-called moral issues; his objective is to identify, and to understand, how the fundamental elements in an economy are related. He claims he is zeroing in on the elements that are *purely* economic, elements that can be distinguished from personal, philosophical, cultural, political, moral, or religious factors. Lonergan's focus is on the production and exchange of goods and services for money. Within the boundaries of the exchange economy the production and sale of porn films, bullets, and cocaine sit alongside ice-cream, fishing rods, and vacation packages. His objective is to keep the question *How does an economy work*? separate from questions about the worth-whileness of particular goods and activities.

The aim of this paper is to lead you to appreciate the elements that, in Lonergan's theory, are the fundamental or essential elements of an exchange economy. I begin by spelling out and illustrating the crucial distinctions Lonergan sees between basic goods and services and surplus goods and services. Then I illustrate how payments for the sale of these two different types of goods and services form distinct circulations of money. The drive of this paper is to help you appreciate how an economy works.

Lonergan's writing style – he seems to disregard what readers know and do not know – plus the breath-taking originality of his work add up to texts that are very difficult to decipher. Hence I plan to begin with simple illustrations and detailed examples in order to lead you toward some grasp of his view.

1 Distinguishing Between Different Types of Goods and Services

1.1 Orthodox Distinctions: Producer Goods, Consumer Goods, and Capital

Establishment economists distinguish between producer goods, consumer goods, and capital. Producer goods are distinguished from consumer goods according to how the

Toronto Press, 1998). See also Philip McShane, *Pastkeynes Pastmodern Economics*: *A Fresh Pragmatism* (Halifax: Axial Press, 2002).

goods are used. A producer good is something that is used in the production of other goods and services. For example, a pencil bought for use in a drawing-office is a producer good, but a pencil bought for a child is for entertainment and a consumer good. Sheet steel used in the production of cars would be a producer good.[3]

By contrast, a consumer good is ‘an economic good or commodity purchased by households for final consumption.’ Consumer goods include chocolate and beer consumed immediately as well as durable goods which yield a flow of services over a period of time such as a washing machine,[4] an automobile, or a television. Whether or not a good is a consumer good depends on how it is used, not the characteristics of the good itself. Electricity or a computer bought for a home is a consumer good, but the same things purchased for a factory are producer goods.[5]

The term capital is used by orthodox economists in a number of different ways. Capital is commonly defined as assets which are capable of generating income. Physical assets themselves that have been produced such as machines, plant and buildings that make production possible are called capital. (Raw materials, land, and labour are not capital strictly speaking.) The essence of capital is that it represents deferred consumption. The term capital is also used to refer to financial assets that are capable of generating income.[6] The education and skills of members of a workforce are called human capital. And the term social capital is used to refer to the particular endowments of a group.

These distinctions are not precise.

1.2 Lonergan’s Distinctions: Basic Goods and Services and Surplus Goods and Services

The key to appreciating Bernard Lonergan’s economic theory is to understand how he sharpens the orthodox

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[3] Graham Bannock, R.E. Baxter, and Evan Davis, *The Penguin Dictionary of Economics* (London: Penguin Books, 1992), 220. Producer goods are also known as intermediate goods, 342-343.

[4] *Ibid.*, 84.

[5] *Ibid.*, 84.

[6] *Ibid.*, 56.

distinctions between producer goods, consumer goods, and capital and then goes on to fully exploit the distinction he draws. The particular distinction Lonergan draws is one of the fundamental building blocks of his theory.

Lonergan does not use the terms *consumer* goods or *producer* goods. Rather, he uses the terms *basic* goods and services and *surplus* goods and services. But don't be mislead by the terms. *Basic* does not mean essential to life and *surplus* does not mean extra, superfluous, or luxurious. Lonergan's explanation of *basic* goods and services is roughly analogous to *consumer* goods and services as understood by orthodox economists, and his term *surplus* goods and services is roughly analogous to orthodox economists' description of *producer* goods and capital. But the analogy does *not* hold. There are important differences. Lonergan sharply distinguishes between basic and surplus goods and services. For him, these are fundamental elements in an economy.

To help you appreciate the distinction and its significance it is necessary to start with simple illustrations. Remember you must keep in mind that when we use the term basic goods and services or surplus goods and services we mean something different from, and more precise than, orthodox economists.

When I was a kid my parents gave me an allowance – a certain amount of spending money each week. I remember spending this money on things like chocolate bars, bus rides to the shopping mall, hockey sticks, camera film, bowling, skating. These expenditures were all made for basic goods and services. Today, I spend the money I earn on groceries, newspapers and spy novels, gas for my car so I can go sight-seeing, tickets to see the Washington Capitals play hockey, beer, movie tickets, video rentals, wood for the kitchen table I am making, my phone bill, and rent. These sorts of things are also basic goods and services. I spend money on these goods and activities in order to survive, not to make money from them.

So, in that precise way, my purchases are different from the fisherman paying to have his boat tuned up, a carpenter upgrading to the latest computer accounting program, a dentist buying a new dental chair, a bicycle courier upgrading the components on her bike, a shipping company adding a new fleet of airplanes, or a corporation building a new plant. In these situations goods are purchased and services are performed in order to maintain equipment, replace it as it wears out, or to buy new equipment. What makes these goods and services different from basic goods and services is that these goods and services are bought with the intention of using them to make other goods. These goods and services are part of the process of producing and selling other goods and services – catching fish, building an extension on a house, filling cavities in teeth, delivering packages, manufacturing new products. The engine tune-up, the accounting program, the dental chair, the bike components, the airplanes are not used just one time, but are used over and over again in the process of producing goods to be sold or in the process of performing services to be paid for. According to Lonergan's theory this distinguishes them as surplus goods and services.

Perhaps you are thinking that there does not seem to be much difference between orthodox economists' descriptions of producer and consumer goods and Lonergan's distinction between surplus and basic goods and services. On both accounts consumer goods and basic goods are consumed, used up by entering the standard of living. On both views, producer goods and surplus goods continue to be part of the process of producing other goods and services to be sold. Further, for both orthodox economists and Lonergan the criterion for distinguishing between consumer and producer goods and between basic and surplus goods is how the goods are used.

But orthodox economists think unclearly of producer goods as used in the production of consumer goods. An example is the use of sheet metal in automobiles. Sheet metal, for them, is a producer good that is used to make consumer goods, i.e., automobiles. For Lonergan, however, what determines whether a good is classified as basic or surplus is its use when it is sold as a finished product. A car used solely for leisure activities would be a basic product, but a new car purchased and used by a salesperson to sell printing presses would be a surplus good. The sport fisherman paying a mechanic for an engine tune up would be paying for a basic service, but the inshore fisherman would be paying for a surplus service. A cyclist who buys new gears so she can more easily ride around the countryside has purchased basic goods, but the bike courier who buys new gears so she can quickly deliver parcels has bought surplus goods. The home handyman who buys the same table saw as a carpenter has purchased a basic good, but the carpenter has purchased a surplus good. The recreational pilot who buys his own plane has purchased a basic good, but Air Canada has bought a surplus good. Orthodox economists don't make such clear distinctions.

It seems relatively easy to distinguish basic expenditures from surplus expenditures. But consider the lawyer who not only uses her computer to write memos and pleadings but who also uses it to surf the web for the best price on a vacation. Is the computer a surplus or a basic good? Take the stockbroker who uses his car to visit clients and also to pick up his children from school. Is the car a surplus or a basic good? Imagine the business person who wines and dines clients and also likes to take the family out for dinner. Are the dinners surplus or basic goods? For Lonergan, distinguishing between such basic and surplus goods is essential.

What about the tuition payments for a BA or an LLB degree? The purchase of university textbooks? Are these payments for basic or surplus goods and services? Is the BA degree a basic expenditure because it is considered by many people to be of no practical use? Is the LLB degree a surplus expenditure because it is training for a job? What about a side of beef purchased by a restaurant from a wholesaler? Is that a basic or a surplus expenditure? Some meals will be charged on company credit cards, but others will be purchased by vacationers. What about the purchase of sheet steel used in washing machines? Is it an expenditure for surplus goods or basic goods? Will it make a difference if the washing machines are used in laundromats or homes? Are the books purchased by university professors basic goods or surplus goods?

Will a client's payment to a lawyer for settling a personal injury case be a payment for basic or surplus services? Should a lawyer's services incorporating a company be classified as basic or surplus? Will the interest payments on a car loan be basic or surplus expenditures? Should the interest payments on a business loan be considered basic payments or surplus payments? Will government spending on new roads be classified as payments for basic or surplus goods and services? Are the payments for new navy warships basic or surplus expenditures? Can the same goods and services be both basic and surplus? It is very difficult to answer these questions. In fact, in order to answer them we must have some appreciation of the productive process. We will discover that the key to settling this issue lies in how the goods are used.

Here it is worth emphasizing that for orthodox economists the distinction between consumer goods, producer goods, and capital is not a key issue. By contrast, for Lonergan the distinction he draws between basic and surplus goods and services is fundamental to understanding how an economy works. In short, there are two types of goods and services. One type – basic – is consumed. The second type of goods and services – surplus – is involved in producing basic goods and services. Later in this paper, we'll see how Lonergan's explanation of how an economy works rests on this fundamental distinction between the two different ways goods and services are used.

2 The Productive Process

If we are to sharply distinguish between basic goods and services and surplus goods and services it makes sense to sharply distinguish between two types of production and sale: one process concerned with the production and sale of basic goods and services and the other process concerned with the production and sale of surplus goods and services. But it is difficult to find businesses that are solely involved in producing and selling either basic goods and services or surplus goods and services in light of the fact that the same goods produced by a business can be basic or surplus depending on how they are used. Goods and services do not neatly fall into one category or another. A lawyer advising a corporation on an intellectual property issue would be providing a surplus service if the product that is ultimately sold or licensed is a surplus good such as a patent used in the design of an airplane used by Federal Express. But if the same plane is sold to a person who uses it solely to take vacations the lawyer's advice would be part of the basic productive process because the airplane in this situation is a basic good. Hence it is crucial to focus on how the final products are used.

In Lonergan's analysis if the final product is used as a basic good, then the factors of production are part of the basic productive process. If the final product is used as a surplus good, then the factors of production are part of the surplus productive process. The manufacture of a table saw purchased by a home handyman would have been part of the basic productive process, but the same saw purchased by a carpenter would have been part of the surplus production process. A business lunch would be part of the surplus productive process, but the groceries used to make a meal for a friend would be elements in the basic productive process. A washing machine purchased by a hotel and used to wash tablecloths and bed sheets would be a surplus expenditure, but a washing machine purchased by a household to wash both work clothes and leisure suits would be partly a basic expenditure and partly a surplus expenditure.

I have drawn your attention to the difference between basic goods and services and surplus goods and services, but for goods and services to be part of the exchange economy they must be sold and paid for with money which, so far, we have not considered.

3 Basic Exchanges: the Flow of Money Connected to Basic Goods and Services

In the previous sections we were concerned with how goods and services were used. Basic goods were consumed and surplus goods were used to make basic goods. But in this section and the following sections our concern is with how money is being used.

Orthodox economists would have us believe that money makes the world go round. The more money you make the better. The higher a corporation's profits the better. The bigger a country's GDP per capita the better. The greater the NASDAQ Index the better. Lonergan, by contrast, holds a different view.

In his opinion, money and finance should not be considered the centre-piece of an economy. Rather, money and finance should meet the needs of production. Production should not be manipulated to meet the needs of finance.

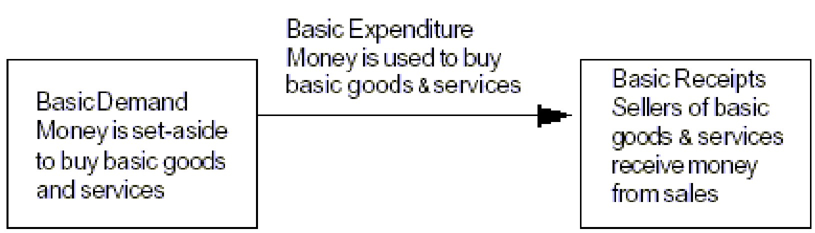
> Money is an instrument invented by man to make possible a large and intricate exchange process. While there is no simple and even perhaps no ascertainable correlation between the quantity of money and the volume of exchange activity, it remains true that variations in the volume, if not to result in inflation or deflation, postulate some variations in the quantity. Now in the long run these variations in quantity can be had only by the introduction of a money of account, but if the money of account…stands side by side with a commodity money, then not only are there the undue perturbances of the exchange process from international movements of capital and from financial crises and crashes, but the whole economy comes to be regulated not by the social good, not by the objective exigences of the economy itself, but by the money invented to serve the objective process and the social good. For when the money of account is conditioned by a relation or law connecting it with the stock of commodity money, then the money of account has to obey this law; on the other hand, the exchange process has its own objective laws, and these laws have to be subordinated to the law of money, for without money (which will be present or absent according to the law of money) exchanges cannot take place no matter how useful, how desirable, how necessary. To put the matter more vividly: the objective process has an exigence for a pure cycle, but the law of money can be satisfied only in a capitalist phase and the earlier part of a materialist phase; in consequence we have not the pure cycle but the trade cycle; as net surplus drops, the volume of credit contracts; as credit contracts, the volume of economic activity contracts; the expansion ends by reverting to a pre-expansion position or

something worse.[7]

This quotation and the idea that finance must keep pace with production raise issues that cannot be adequately dealt with unless preliminary insights are achieved.

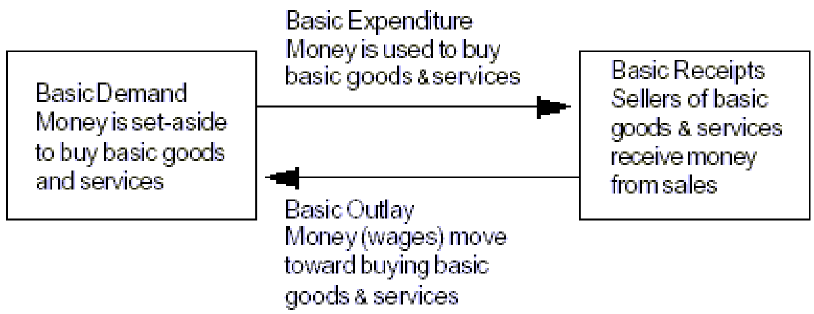
Let's begin by focusing on the payments corresponding to the purchase and sale of basic goods and services. Consider the wages you receive at the end of the week or month. What is the money used for or spent on? You have living expenses to pay – your mortgage payments, phone bill, heating, gas for your car, entertainment, groceries, restaurant meals, the carpenter's bill for materials and the work done to build a new addition to your house. Payments for these goods and services represent expenditures for basic goods and services. From the point of view of the suppliers of such basic goods and services they are receipts for the sale of basic goods and services.

But let's back up for a moment. When you set-aside the amount needed to spend on basic goods and services, before you actually pay your bills, we can say that a particular amount of money is *set-aside*, *poised for*, or *devoted to* basic expenditures. The money might be set aside only momentarily, the moment it is deposited in your bank account by electronic transfer and just before it is withdrawn by direct debit to pay a particular bill. The use of the money you receive is that it is simply *held in readiness* for consumer expenditures. You might say the money is first used to demand basic goods and services. The second use of the money is as an expenditure to pay for basic goods and services. The third use of the money is as receipts of the businesses who supplied you with your basic goods and services. A diagram can capture the uses of your money.



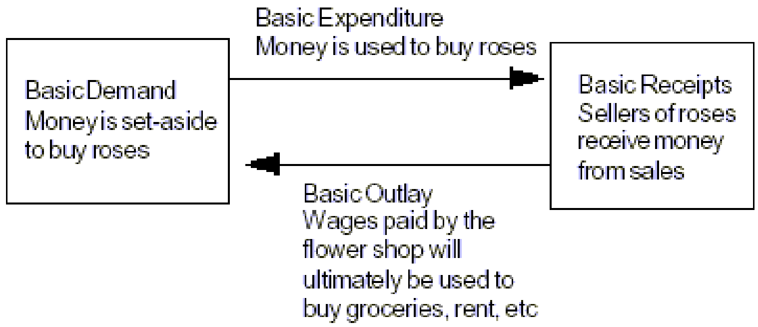
[7] *CWL* 21, 104-105

Say you paid the carpenter for work done on your house. How does this money move? Let's trace the flow of payments: (1) You *set-aside* money for the renovation. (2) Your payment to him is a basic *expenditure*. (3) From his point of view it is a *receipt* for basic goods and services. But the carpenter also has to live. How does he use the money he receives? From his receipts he has to pay his own mortgage, phone bill, electric bill, groceries, entertainment, restaurant meals, flowers for the garden. (4) Hence he directs a portion of his own receipts toward purchasing consumer goods. In this way, the carpenter's payments are set-aside or held for the purchase of basic goods and services thereby joining the flow of money used to buy and sell basic goods and services. The more complete diagram looks like this.



It is apparent from the diagram that your own expenditures on basic goods and services are involved in a circulation of payments for basic goods and services. We started with the basic payments of an individual consumer and followed those payments to a supplier of basic goods and services who in turn sets-aside money for basic expenditures and who also spends money on basic goods and services.

Let's take another example of the flow of money connected to the purchase and sale of basic goods. Suppose you decide to buy a dozen roses for your Valentine. In your mind you set-aside $25 for roses. Money is poised or ready for a basic expenditure. Another way to say it is that there is a demand for basic goods, the roses. You make a basic expenditure when you pay for the roses. Your expenditure is part of the basic receipts of the flower shop who supplied you with the roses. The flower shop, in turn, has basic outlays. For example, it pays wages to employees who will, in turn, purchase basic goods and services. The various uses of money consist in (1) your money being set-aside for, or demanding, basic goods – roses, (2) your basic expenditure – paying for the roses, (3) the basic receipt of the flower shop – receiving money for the roses, (4) the basic outlay of the flower shop – wages of employees who will demand, or set money aside for, basic goods and services. This circulation of money can be captured by this diagram.



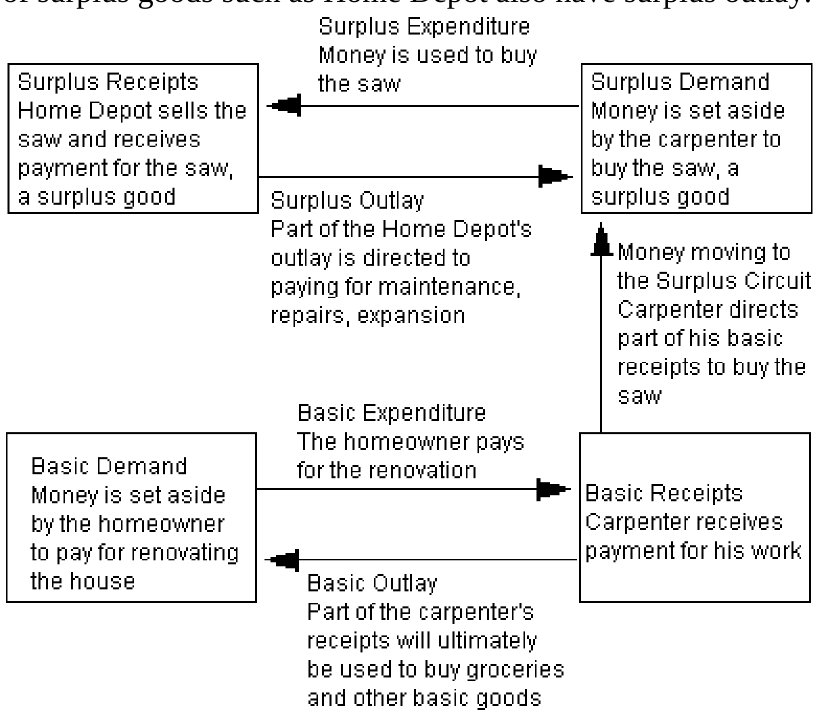
In the discussion above of how money is used in relation to basic goods and services I have not been concerned with the actual amounts of payments or the time intervals during which they take place. Of course, these are important dimensions and it is essential to know how much money and how it is actually being used in particular time intervals. But for now I am content to stress how the use of money with respect to basic goods and services shifts. In other words, what I want to communicate is that the purchases and sales of basic goods and services constitute a circulation or flow of payments.

And this flow of payments is comprised of: (1) money is set-aside for purchasing basic goods and services; (2) money is spent on purchasing basic goods and services; (3) sellers of basic goods and services receive money from sales; (4) sellers of basic goods and services direct their money toward purchasing basic goods and services for themselves. And so on.

4 Money Leaving the Basic Circulation of Payments and Joining the Surplus Circulation of Payments

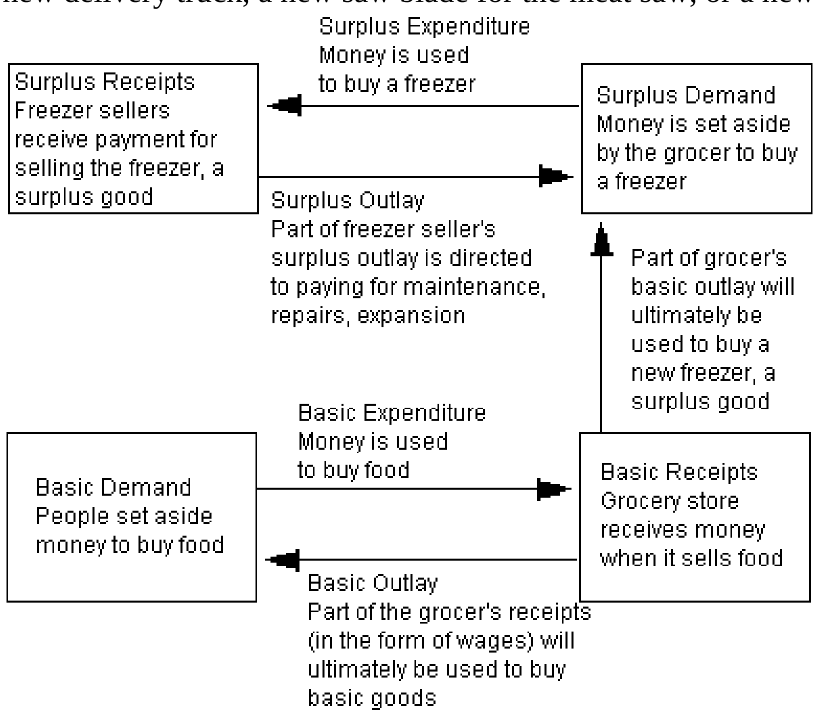
From time to time a carpenter needs to buy a new circular saw. These saws wear out after using them day in and day out. Is this purchase a basic or a surplus expenditure? Purchasing this new saw will *not* be a basic expenditure because the saw will be used on any number of jobs. It will be a surplus expenditure. Presuming that the carpenter specializes in renovating houses, his receipts are for supplying basic services. But the money the carpenter spends on the circular saw is a surplus expenditure. Hence money must leave the basic circuit and enter the surplus monetary circuit.

From the carpenter's receipts, that is, the money he receives for doing home renovations, the carpenter has outlays. He pays his expenses. Not only does his money – in the form of his wages – move toward purchasing basic goods, but a portion of his money is also set aside to be used for purchasing surplus goods like the new circular saw. Thus we can say that a portion of the carpenter's money is used to demand surplus goods. When he buys the saw at Home Depot he has made a surplus expenditure. The supplier or seller of the saw – Home Depot – treats this payment as a surplus receipt. But suppliers of surplus goods such as Home Depot also have surplus outlay.



They use their receipts from the sale of surplus goods and services to pay their expenses. Home Depot may buy a new boom truck, replace its paint mixer, or change the oil in its delivery trucks. In other words, a portion of the surplus goods supplier's money is ultimately spent on buying surplus goods. This flow or circulation of money is captured by the diagram above.

Let's consider another example of money leaving the basic circulation of payments and entering the surplus flow of payments – a grocery store that wants to buy a new freezer. The grocery store is a supplier of basic goods to the extent it sells food to people who eat it and have no intention of using it to make and sell power-breakfasts or business lunches. Not only does the grocery store use its receipts as basic outlay – in the form of wages that ultimately will wind up being spent on consumer goods and services such as food, rent, entertainment – but if the grocery store needs a new freezer a portion of its outlay will be set-aside for a surplus expenditure. Buying a new freezer is a surplus expenditure. If the grocer bought a new delivery truck, a new saw blade for the meat saw, or a new



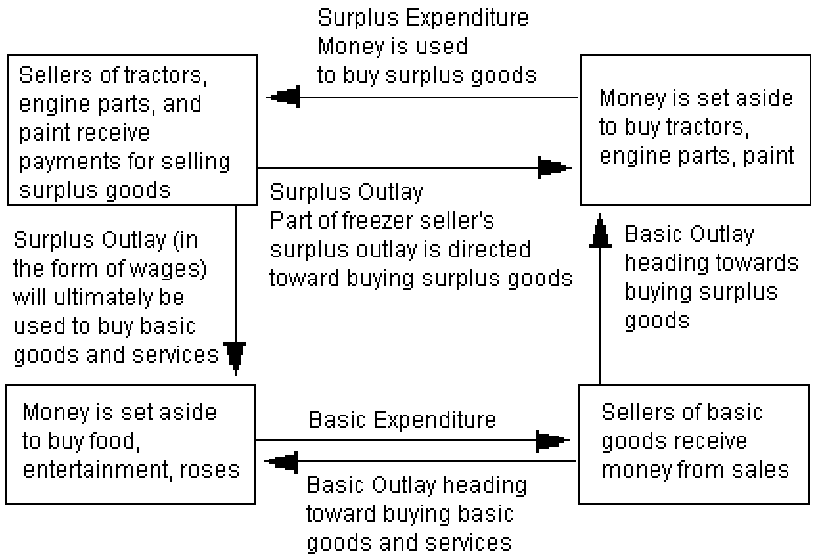
cash register they would also be surplus expenditures. The above diagram indicates how the money would circulate in this situation.

5 Surplus Exchanges and the Flow of Payments Connected to Surplus Goods and Services

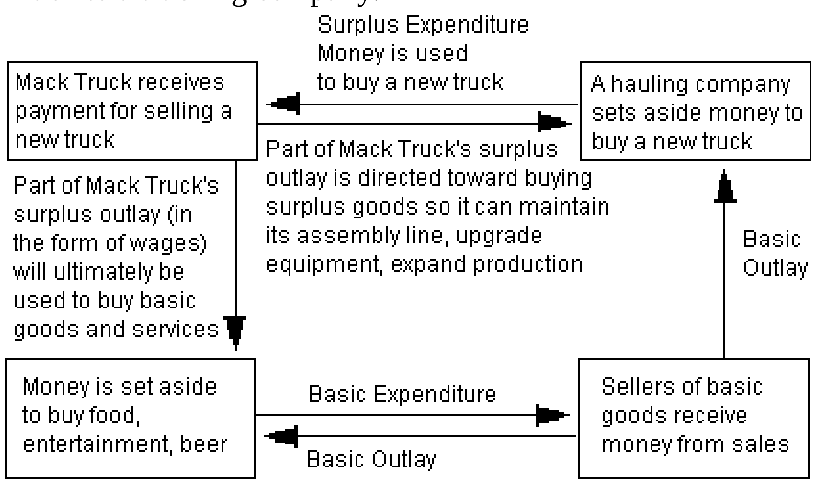
Let's begin by examining a selection of payments made by the owner of a cargo ship. The owner is paid for transporting goods around the world. If the ship owner transported tractors that will be used in a farm business then the payments made to the ship owner for transporting the tractors will be surplus expenditures. For the ship owner, these payments represent receipts for surplus goods. These are surplus receipts because the final goods sold – the tractors – are surplus goods. The ship owner is a supplier of a surplus service. A portion of the ship owner's money will ultimately be spent on painting the ship, buying new engine parts as they wear out, up-grading the navigational equipment from time to time. These will be outlays for surplus goods and services.

When the ship owner *sets-aside* a portion of his receipts to purchase maintenance for the ship we can say that the money demands surplus goods or is poised or ready to buy surplus goods. Paying for the maintenance is a *surplus expenditure*, an expenditure on surplus goods and services. From the point of view of the paint seller, the engine parts supplier, and the navigational equipment suppliers, such payments are *surplus receipts.* These businesses in turn have *surplus outlays*. They also pay to maintain and repair their own machines and buildings and sometimes expand their businesses.

But a portion of the ship owner's outlay is also spent on wages – the captain and crew must be paid. Assuming that these people spend all their wages on basic goods – groceries, rent, entertainment, heat, phone, electricity, car payments – a portion of the ship owner's outlay moves toward and into the basic monetary circuit. In this way money leaves the surplus circulation of payments and enters the basic circulation of payments. The diagram on the next page captures this movement.

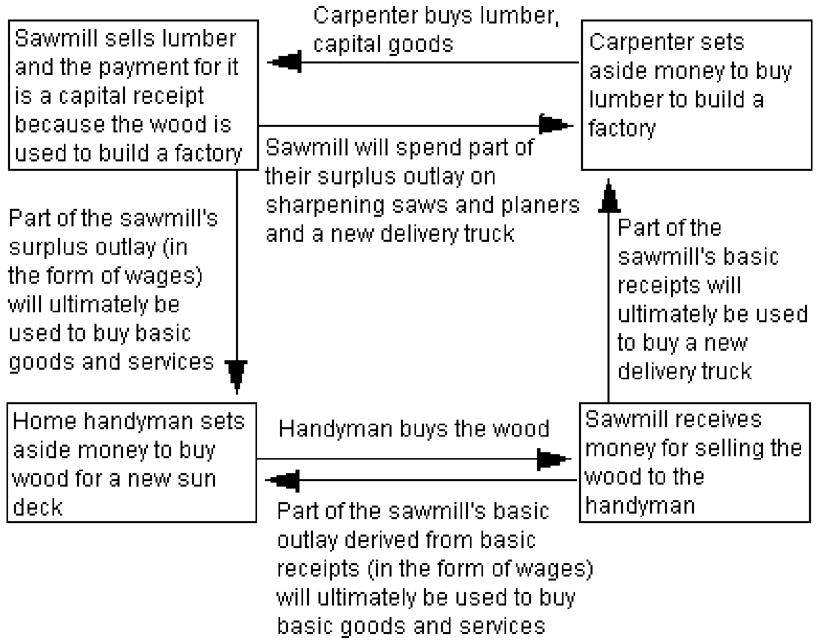


We can also diagram the flow of payments connected to the sale of a transport truck from a manufacturer like Mack Truck to a trucking company.

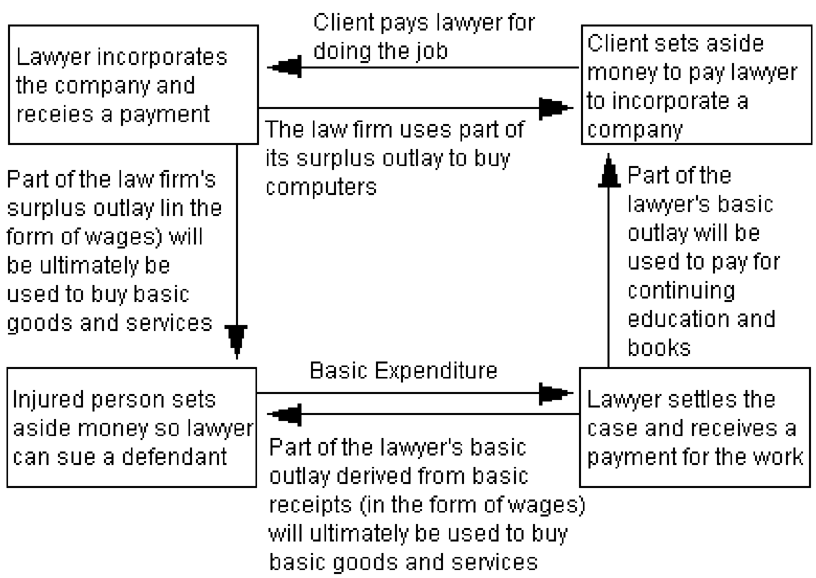


6 Enterprises Selling Both Basic and Surplus Goods and Services

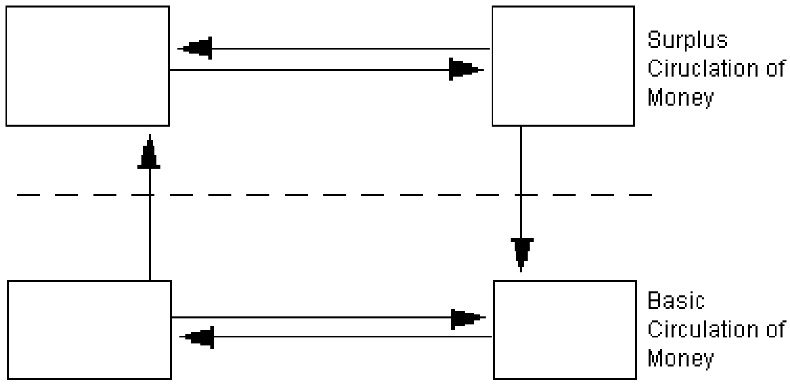
In an effort to draw together the circulation of payments for basic and surplus goods and services consider a sawmill that sells lumber to do-it-yourselfers and also to carpenters who construct buildings to be used by businesses. Can we map out the circulation of payments?



Let's analyze the flow of payments involving a lawyer who incorporated a company for one client – a surplus service – and who also settled a personal injury claim for another client – a basic service.



Take a store like CompUSA which sells computer accounting programs to businesses and games to people who just want to have some fun. See if you can map out the flow of payments.



7 Redistributive Exchanges: Exchanges That Do Not Involve Goods and Services

Our concern up to this point has been with the production and sale of new goods. We have focused on payments for goods that cover the costs of production and payments for services that cover the costs of performing those services. When they are purchased, goods leave the productive process. If those same goods are resold later it would be a mistake to include those payments in the monetary circuits we analysed above. To include payments for second-hand goods such as used clothing and used carpentry tools would amount to counting the payments for those goods twice.

Consider a house. A couple hire a contractor to build their dream home. When it is completed they pay the contractor. The house is no longer part of the productive process when it is paid for. We could say our basic good, the house, leaves the productive process when it is purchased. Two years later, however, the couple decide to sell their house. After being on the market for a few months they close the sale. This sale is different from the original purchase of the house. The original owners of the house do not use the money they receive when they sell their house to pay the contractor. The contractor has already been paid for his services and has paid his expenses. In this second sale money is transferred from the buyer to the couple. But the transfer of money is simply given to the couple in exchange for owning the house. This payment is not connected to the productive process in the sense that here the money is not an expenditure for building the house. The transfer of money is not a payment to the contractor or anyone else for his services in building the house. The cost of building the house has already been paid by the original owners. In other words, the second sale is not used to take a product out of the productive process. The house was taken out of the productive process when the original owners paid the contractor. To classify the resale price of the house as a basic payment would mean counting the cost of the house twice.

Other sales that simply involve a change in ownership are purchases of second-hand cars. Purchases of all the weird and wonderful things found at garage sales and flea markets are simply changes in ownership too. Buying or selling shares in Microsoft or Royal Bank simply represent changes in the ownership of shares. When you get a bank loan the principal is a transfer of money. Taking out a loan or paying back the principal is not payment for surplus or basic goods. An insurance company reimbursing you when your car is stolen is simply transferring the ownership of money from it to you. A defendant ordered by a judge to pay a plaintiff a sum of money as compensation for personal injuries is not connected to the productive process either. Perhaps it is obvious that the sale of stolen goods simply represents a change in possession. Perhaps it is easier to see that gifts, inheritances, government transfer payments, tax payments, and charitable donations do not move goods and services through the productive process. Lonergan calls these types of exchanges *redistributive exchanges*.[8]

However, we cannot forget that most of these exchanges come at a price. The second-hand car dealer takes a percentage of the sale price, the stockbroker charges a fee, insurance companies have their deductibles, interest must be paid on

[8] Don't be misled by the term *redistribution*. Lonergan does not use the term to mean redistributive justice or the redistribution of incomes. He uses it to stress exchanges that are not directly connected to the process of producing basic or surplus goods and services.

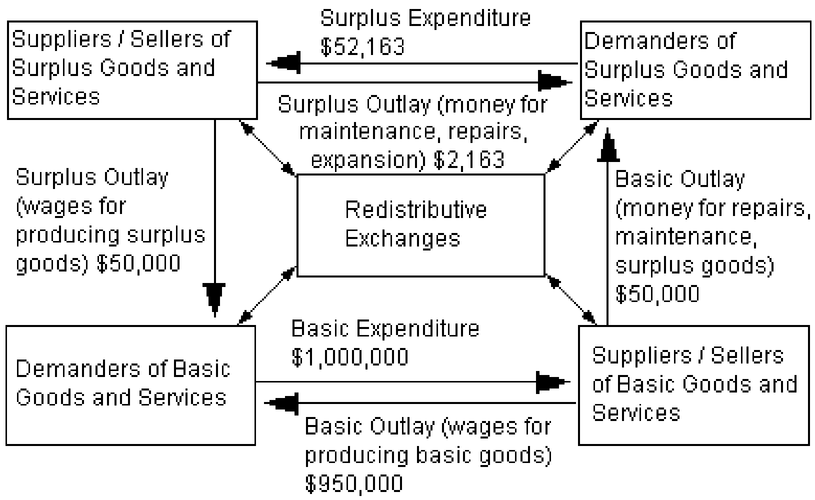
bank loans, and lawyers don't like to work for free. These charges and fees are part of the productive process. They are payments for services rendered. Whether the payments are for the performance of basic services or surplus services depends on the nature of the service and the goods. The percentage collected by the second-hand car dealer would be a receipt for the performance of a basic service if the car is used for sightseeing. A fee paid to an insurance broker who looks after the insurance of a company engaged in producing surplus goods should be classified as a receipt for performing a surplus service.

8 The Circulation of Payments for all Goods and Services in a Closed Economy

I have focused on payments for circular saws, groceries, freezers, trucks, lawyers' advice, paint, home renovations in order to indicate how payments for basic goods and services and how payments for surplus goods and services circulate in an economy. Lonergan's idea is that *all* the payments connected to the sale of basic goods and services and *all* the payments connected to surplus goods and services in a particular time interval in an economy should be kept track of. This means that it is crucial to accurately measure how much money is moving or flowing in each circuit of payments – the basic circuit of payments and the surplus circuit of payments – and to measure how much money is leaving or entering each circuit during particular time intervals. Measuring the movement or flow of money in an economy is the key to understanding what is going on. The diagram on the next page integrates the analysis above by indicating how money would flow in an economy.

9 Concluding Pointers

We have arrived now at a fundamental diagram of economic activity. What the diagram means to you depends, of course, on the amount of work and economic experience you bring to it. What the diagram does is help you hold together and develop your economic understanding. I have identified



the essential elements, the significant variables in an economy. More work will help you read that diagram in a fuller fashion.[9]

In summary, I sharply distinguished between basic goods and services and surplus goods and services and went on to identify two main types of exchanges: *basic exchanges* involving the sale of goods and services that are consumed and *surplus exchanges* involving the sale of goods used in the process of producing other goods to be sold.

The connection between the production and sale of basic goods and services was portrayed as a flow or circuit of payments in which: (1) money is set-aside to buy basic goods and services, (2) money was spent on purchasing basic goods and services, (3) sellers of basic goods and services received money (receipts) which they treated as income, and (4) sellers of basic goods and services paid their employees and bought surplus goods and services. I portrayed the connection between the production and sale of surplus goods and services as a flow or circuit of payments in which: (1) money is set-aside to buy surplus goods and services, (2) money was spent on purchasing

[9] For example, you will find it worthwhile to examine the relations among the economic variables when an economy is experiencing a static phase, a surplus expansion, and a basic expansion, when a government collects taxes and spends money, and when an economy is involved in international trade.

surplus goods and services, (3) sellers of surplus goods and services received money (receipts) which they treated as income, and (4) sellers of surplus goods and services bought surplus goods and services and paid their employees.

Lonergan's concern is the exchange economy, with the goods and services that are produced and sold for money. Gifts and barter lie outside his interest. Further, it doesn't matter whether the goods and services sold are cocaine or coconuts, guns or greens, sex or spaghetti. As long as these goods and services are sold at market value they are part of the exchange economy. Prescribing solutions to complex issues such as poverty has not been part of my immediate agenda. Before tackling such problems we must first *understand* as best we can how an economy works. An analogy may help. In order to properly treat a person with kidney failure a doctor has to know how kidneys work. Similarly, in order to know how to properly treat a sick economy we must first identify the significant variables and understand how they are related.

What particular goods we produce and sell, whether or not we should devote our efforts to selling popcorn or porn, building armies or fighting AIDS, paying off the national debt or building hospitals, drilling for oil or saving energy, buying stocks or donating to charity, are important questions. But they are not the questions I raised in this paper. Rather, my point is that issues having an economic dimension can only be adequately tackled after getting to grips with the economic dimension itself. To be blunt, there are two main sets or flows of payments in an economy – basic and surplus – and without making that distinction you are in the field of guess-work. Hence I have been concerned with matters that are *strictly* economic. And the starting point is Lonergan's key diagram.

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