Chapter VIII. The deficient-producive-spending-syndrome

This chapter draws conclusions from the economists that were reviewed in the chapter VII and uses the distinction between the wealth economy and the productive economy to push beyond their insights. It also lays down our main result about the capitalist economy: the syndrome of deficient employment-generating spending, or *the deficient-producive-spending-syndrome*.

Section 1. A merely abstract possibility of circuit closure in capitalism

The economists reviewed in Chapter VII were, as we are, preoccupied with circuit closure and the role of firms' investive spending. The general result of the chapter was *a possibility of circuit closure* – depending on how the wealth owners behaved and on whether they reinvested M'-M in the productive economy. Some authors had the intuition of different types of investment, one of which would contribute more to circuit closure than the other, and some occasionally labeled or may have internally thought of the type, which was more favorable to circuit closure, as "productive". But this notion, whether outspoken or not outspoken, remained fuzzy and was not clearly distinguished from sterile investment. Therefore, the reviewed authors were not able to examine on what the materialization of the possibility of circuit closure depended; they could neither indicate the field nor the conflict of forces, which act upon them and draw them into the one or other direction.

Quesnay had solved the problem of employment-generating spending or circuit closure in the productive economy so quickly that one could miss that he had even posed it in the first place. He neither required the idea of conflicting forces, nor of programs or of a benevolent institution. Rather, his circuits, following his axioms, closed[1] *a priori* as his *royaume agricole,* and particularly his *cl. des propriétaires,* were

1 The reader is reminded that there are two meanings of "closure" in this book, which should not be confused. If systems theoretical sociology speaks of "closure" of the economic system it means that the economy, by necessity, is always closed to its environment – as it exists

infused with a benevolent supreme spirit of a "dieu juste". They did so by spending all of their revenues in an employment-generating manner.[2] Of course, that was a pre-enlightened, if not pre-rational, style of thinking, which could help nothing to understand the working mechanisms (if they had worked). But if we spell out what Quesnay implied in the background, then we can see that his teaching was based on a strict necessity of circuit closure. This was the main lasting, yet very important contribution of Quesnay: *drawing attention to a hidden step fulfilling a hidden necessity*.

Unfortunately, the great *Adam Smith* allowed Quesnay's problem to intermittently slip out of sight again. He thought in terms of liberty and competition and worked out, with fascination, how they improve the efficiency of production and steer it towards more consumer satisfaction. But, unfortunately, Smith did not care much about the closure of productive circuits *as a problem*. Actually, his famous "invisible hand", contrary to how it is sometimes portrayed, was not meant by him to solve the problem of macroeconomic circuit closure; it was something else, less demanding and only operated at the lower level of taking care of more, better, and cheaper supplies being carried to markets, hence, the beneficial effects of competition on supply. Smith focused so much on such benevolent effects on productivity, quality, and prices and advantages for consumers and others from them that he almost forgot that enough employment-generating spending had to emerge from somewhere in order to validate the production and feed the producers and their workers.

After the Napoleonic wars, this trust of Smith in inexhaustible markets (even for colonial powers) was lost and the subject of employment-generating spending and circuit closure rose back to the top of the economic reflection agenda. It now split scholars into two camps, and the schisma lasts until today: *Sismondi* and *Malthus* denied that there would be sufficient employment-generating spending for circuit closure in principle or considered it as unlikely at least. David Ricardo tried to get the ghost back into the bottle explaining the obvious lack of employment-generating spending by temporary, sectorial, or regional frictions, largely based on the mismatch of the value-in-uses produced and esoteric demand. If a short answer was needed to coney the latter view, Ricardo, not Say, provided such a short answer in the so-called "Law of Say". Born as a bastard, it, though, remained unclear what the "law" meant exactly. Of the three interpretations we listed previously, the second interpretation of "Ricardo's Law of Say", an abstract harmonious version, became the basis for a style of economic reasoning that dominates most neoclassical economics

---

only of elementary events of payments/non-payments in time. Circuits, as we use them, however, can either close or not close. They close if they validate M-outlays by a reflux of M', thereby allowing for a proper profit M'-M. The latter use of "closure" is more widespread in the book.

2 See the discussion of Quesnay on page 203 et seq.

until the present day. It was mathematized as a system of simultaneous equations by *Walras* and given a graphical expression of supply and demand curves by *Marshall*. Yet, there is also a *third interpretation* of Ricardo's Law of Say. One can read it, like Quesnay, albeit more abstract and generalized, as an attempt to understand *how* the circuits of the productive economy can find enough employment-generating spending to close: All capitalists, it could suggest, at least if we bring all its possible implications to daylight, should be able to close their circuits with a profit *provided that* all capitalists also spend the profits that they expect out of a circuit and mutually purchase their products. The critical point of this third interpretation of Ricardo's Law of Say is that all capitalists must spend their full profit to buy the part of other capitalists' products that represent their profit (C'-C or M'-M or *s*). While it was likely that they would spend *c* (of the prior circuit) on each other again and *v* (of the prior circuit) on workers again, the full spending of the profit was the big challenge. This third interpretation of Ricardo's Law of Say was quite useful as it was more general and abstract than Quesnay's numeric assumptions regarding the cl. des propriétaires and the cl. stérile and because it pointed to circuit closure as a *potentiality*. It necessitated research about the preconditions, a mechanism or benevolent spirit, which could induce wealth owners to do the right thing to embrace the roles assigned to them. It also implied the lasting insight that a theory of circuit closure would largely have to be a theory of firms' investments.

Marx's notations (*c, v, s,* M–C–M') and his reproduction schemes enabled him to present the problem-exposition by the third interpretation of Ricardo's Law of Say and Sismondi's and Malthus' reasoning in a more technical and concise way (even if the labeling of these notions is influenced by his false theory of labor value and exploitation). He was able to split up M into equipment and inventories (as constant capital *c*) and into salaries (as variable capital *v*) and to identify the surplus *s* with the M'-M-margin. This also allowed Marx to set *c, v,* and *s* (M'-M) into motion and to observe how they would travel through production and circulation assuming different shapes or putting on different clothes at each stage. The problems posed by Sismondi and Malthus and the necessity stipulated by the third interpretation of Ricardo's Law of Say did not go away, but they could now be laid down more precisely: If *c*-outlays are made in a circuit, then will they also buy the *c*-part of the produce? If *v*-outlays are made, then will they also buy the *v*-part of it? And: who should buy the *s*-part of the produce? As firms had paid out M or $c + v$ in the first M–C-leg of the circuit, M or $c + v$ should, in principle, still be available in other firms and in workers' pockets to "re-purchase" the M-part (or *c*-part plus *v*-part) of the produce in the second leg. One could, thus, point fingers at the likely culprit: All firms also obviously desire to sell the C'-C-part or M'-M-part (or *s*-part) of their produce in order to realize their planned profit M'-M, and *all* firms, entrepreneurs, or capitalists just have to mutually buy these very same C'-C-parts and M'-M-parts (or *s*-parts) from each other with their profits, which they *expect* from the circuit.

All this laid out in front of the observing economists that only a *circular activity, hence, the ignition of* a new, second-generation round of M–C–M'-expeditions, would enable the closure of the prior round of circuits. Capitalists could, *as a matter of potentiality*, bring the "open" circuits to a close and could save themselves (and others) by starting such new circuits (without using value-in exchange from pre-exiting stocks of wealth or from money-creation, which will only be considered in Part 2 of Book III). But would they? What would be required to get them there? While Marx's notation (M, *c, v, s,* M') was predestined to further examine the issue of circuit closure, Marx himself, almost stubbornly, did not want to use it for this purpose. He wanted to use it for a *different purpose*, i.e., to elaborate a theory of labor value and of exploitation and let M–C–M' lie fallow as a tool to analyze problems of circuit closure. Although the issue of employment-generating spending and circuit closure gained more urgency after Marx's death and in the first third of 20th century, with imperialism, World War I, the October Revolution, and the Great Depression, his later Marxian followers, if they pursued the issue of circuit closure at all, also hardly ever used M–C–M' for the purpose. They much rather used the distinction between consumption and investment as tools. Consumption was insufficient, *Tugan-Baranovsky* believed, but capitalists, driven by their profit motive, might so fiercely invest that this could close the circuits, at least in principle. This idea offered a possible answer to the question of whether capitalists would use their (planned) M'-M to buy each other's planned M'-M.[3] Tugan-Baranovsky also used Marx's reproduction schemes. They appeared to confirm that circuit closure was possible, on the condition that the beneficial gap-filling investment observed the proportions necessary for extended reproduction. *Rosa Luxemburg* objected. Investment would *not* be sufficient, even if it observed the proportionalities of the reproduction schemes. Rather, to close circuits in extended reproduction, employment-generating spending would have to come from *external sources*, pre-capitalist markets or from foreign countries or public spending. Luxemburg mentioned armaments in particular. Even if she was not greatly elaborating on its financing, now the use of pre-existing stocks of wealth or of wealth outside of the considered circuits definitively came into view. In other words, the motive of capitalists to increase profits with more investment would *not* suffice to get capitalists to buy the produce representing C'-C or M'-M with their planned M'-M. Some kind of a *deus ex machina* was needed; circuit closure, *R. Luxemburg* pointed out, could likely only be achieved artificially, i.e., prosthetically.

Lord Keynes may or may not have known about this discussion within what he called the "underworld" of Marxists and other leftists when he wrote the *General Theory*, but he too put the consumption/investment-distinction in the center of his reasoning. He gave an explicit alternative theory of why consumption was deficient – because of the falling propensity to consume with increased income – and then also

3 Again: M'-M is always equal with C'-C or *s*.

looked to investment to close the gap. His reasoning was more sophisticated than Tugan-Baranovsky's and in his result he was more skeptical; in fact, he took almost the opposite view of the latter. Keynes outrightly *denied* that investment would *automatically* come forth in the volumes required to substitute missing consumption (which he did not relate to M'-M or *s* etc.). Investment was rather conditional. To understand it better, he drafted a novel theory about *when* firms would make investments. This theory exceeded Marx and foreshadowed today's state-of-the-art business valuation. He did so, in particular, with the idea that an "inducement to invest" does not solely depend on the *expected rentability of a considered investment*, but that it also depends on the *lack of reasonably better alternatives*. In the *General Theory* he benchmarked a considered investment with a certain marginal efficiency of capital (m.e.c.) only against interest on loaned out money or on bonds, in the *Viner-rebuttal*, he made an adjustment and saw the bad effect of high or rising interest rates as *mainly operating indirectly* via *falling values of old, pre-existing assets*. If these fallen values come close to or drop lower than the production costs of similar newly to-be-produced assets, then that will stop investment. (Whether an investment to produce a new asset is made requires that the values of old, similar assets remained significantly higher than the production cost or replacement costs for new assets).

Ultimately, Keynes' theory of deficient aggregate employment-generating spending closure came down, first, to explaining deficient consumptive employment-generating spending by a falling propensity to consume and, second, to showing how substitutive investive spending would encounter problems *as there were systematic reasons for it to run out of good motives*. That could be taken as an answer to our question, again phrased in Marx's M–C–M'-notation, about whether capitalists would mutually spend their expected profits M'-M to buy each other's surplus produce C'-C for investment reasons. Keynes' result was similar to Rosa Luxemburg's: They would probably not! From this point onwards Keynes' analysis does not progress much further; instead, he turned to prosthetic recipes such as deficit spending, public works, etc.

Kalecki admitted that nobody (which expressly included himself and ought to have included Keynes as well) possessed a valid theory of investment at the time. Investment theory was rather a "central *pièce de résistance* of economics." *Minsky*, when he arrived on the scene, worked out the evolution of Keynes' theory of investment in the Viner-Rebuttal. He elaborated that investment decisions are not only affected in the negative by poor relations of the m.e.c. to interest rates (Keynes before the Viner-Rebuttal), but also by asset prices having fallen so low that there was no point in producing similar assets at higher costs (Keynes after the Viner-Rebuttal). While Keynes was more interested than Marx in whether entrepreneurs would make the original outlay M–C, Minsky was interested in a moment that occurred even prior to M–C. This moment was not even captured by Marx's notation M–C–M'. It lay before there was M, so it could only be expressed as "…M". He asked: "Where does the

money for investment come from?", "when does it come?" and "in what form does it come?". Or: "Are there knots and twists that are connected to its origination?". He found that credit has a substantial impact upon investment and buttressed much more than Keynes that the decision about productive investment is not made in a "neutral" space of an interplay of esoteric demand, available employment-generating spending, and profit expectations. Rather, *finance is always already there – in the absolute center of investment and employment decisions.* So, in Minsky, the theory of circuit closure, which Keynes evolved into a theory of investment, extends into a *behavioral science of finance*. All investments, very plausible and sound investments, like very unplausible and unreasonable ones, owe their existence to the same, healthy or unhealthy, financially driven dynamics. And there are *cyclical moments* and *conjunctures* in finance… Whether its dynamics push towards circuit closure or not depends on the stage of the business cycle. Circuit closure is time-determined, given that it is cycle-determined. In Minsky, *everything* comes out of the discretionary and uncontrolled dynamics of finance, which almost wags the dog of the productive economy and plays havoc with it – for the good and for the bad. That is a huge difference to Quesnay's view where a boringly reliable cl. des propriétaires always will, year after year, unaffected by any conjunctures whatsoever, consistently spent the social surplus, which had been transferred to it previously, in the productive economy. Quesnay's productive economy is stomach-governed, Minsky's economy is Non-Quesnayian, erratically finance-governed.

Minsky, accordingly rendered things more complicated. If we confront his results with our central question of whether firms will spend their expected profit M'-M or *s* to buy each other's produce (thereby enabling circuit closure in the productive economy, rewarding investment and employment), then Minsky will tell us that there is no hard macro transmission to ascertain this benevolent outcome. The capitalist economy is a self-reflective world in which profit depends on anticipated future profit opportunities, investment depends on anticipated future investment opportunities, and the benchmark for profit on finance. The present not only comes out of anticipating the future, but also through a weird circular reflective business and financial psychology. What firms observe in mirrored mirrors calls the shots in this world of observations of the second and higher orders. Firms observe other firms, whether they anticipate future profits and will, via investments, create opportunities for other firms to invest too. Firms' investments depend on financing and on whether bankers (and later the state and central bank) join or exit the auto-reflective fever of productive firms. By easing or restricting the supply of money, bankers doubly improve or worsen the conditions for new investment. They raise or depress the values of the annuities of old capital assets, against which the quasi-rents or profits from new investments are checked, and the render the production of new assets cheaper or more expensive. Doing so, bankers have no better insights into the future than the employment-generating firms but err through the same mirror-cab-

inet. What they and firms do, which undoubtedly has hard effects on the economy, results from ghostly speculations. The only available means to observe what others will do in the future is to try to guess what their intentions are, by which they react to the expected intentions of others. But even those intentions are hard to read – they stick in human heads. Thus, one can only try to study external behavior to spot signals of intentions. What information do others possess? What information do they consider important? How carefully do they look at this information? What changes of public opinion do they expect? We have a highly complex process originating out of multi-level reflective observations and only utterly meager, ambiguous, and often deceptive facts. Trendwatchers watch trendwatchers betting on nebulous trifles and bagatelles.

Three moments aggravate the situation: *First*, while firms who observe firms and banks will possess some decision-making algorithms, these algorithms will not only often be unknown, non-linear, complex, reflective, or even chaotic, but they may also change over time. Thus, even if we could process the vague information from the mirror-cabinet into usable data and we had learned to work with the algorithms that other firms used previously, we would still not know which algorithms they will use in the future. What is pivotal today may no longer be relevant tomorrow, including at the level of algorithms used for reflection and action. Neuronic networks change all of the time. Gimbal frames, upon which other gimbal frames are hinged, are substituted quickly and suddenly.

Second, whatever data we may be able to get out of the mirror-cabinet, our own strong emotions, greed, and fear, animal spirits always sit on the side-lines ready to pounce. They do just the opposite of furthering rationality in the interpretation of the poor data. We need to distrust both ourselves and others.

Third, typically, decisions have to be made very quickly – time pressure increases the likelihood of unsound results in this environment of scarce information, uncertain algorithms, emotionality, and irrationality.

In the aggregate, all of this surrenders the steering centers of capitalism – on which the issue of whether capitalists will mutually validate their M'-M-expectations and close circuits ultimately depends – to circuses, which, while they hunger for facts, are actually, mostly only feverishly dependent upon themselves. They suffer so much from the instability they perceive that they are grateful if *any* direction is offered to them and throw themselves as quickly into exuberance as they do into crisis, panic, or depression, which may ultimately almost come as a relief.[4]

To this house of madness, Minsky even added a further "hard" macro-transmission, which only operated downwards. Not only could the (generally shrinking) investment and lack of easy credit disenable and dis-encourage firms from investing,

4 See *Kindleberger* (1978). Thus, crises become a factor in the theory of circuit closure. See also *Kiehling* (1991) page 24, et seq., *Mackay* (1841) and *de la Vega* (1688).

but the fall of asset prices and the rise of interest could also, brutally, irresistibly, and directly cut down on investment if the ongoing debt service absorbs the financial means, which firms could otherwise use for new investment (or if firms even went bankrupt). This is where Minsky's "survival constraint" pushes to the fore. If its time comes, this "check" totally overrules all normal investment-decision-making. The calculus of anticipating annuities from investments, calculating a m.e.c. and benchmarking it against interest rates or whatever, is displaced by the new simple rule: maintain liquidity at all costs! This rushes firms to sell or pledge assets, which precipitates further drops in assets prices. In this stampede, firms' contributions to investment and to other firms' circuit closure will die, even if the firms manage to save themselves. What Minsky exposed here is, unfortunately, *another bad thing for circuit closure*. If things get bad, that will automatically make things even worse. It will put firms' normal operation on hold and will establish an emergency regime that cares only for liquidity and about its own survival.[5]

Both, Keynes and Minsky supported the recipes on which states were operating for the longest time: Try to induce productive firms – by monetary or fiscal stimulus – to invest more and try to convince, manipulate or force firms into productive investments. Also guide and help banks to finance such investments. One problem is that a lot of the money that is poured-out will still go into the sterile economy and will, in both economies, cause booms and, ultimately, busts, which will often outweigh the previous benevolent prosthetic effects. Therefore, most recently, particularly after the financial crisis of 2008, states have raised the level of control over firms and banks and have introduced new legal means, compliance requests and supervision in order to moderate the bad "animal spirits" of firms, at least with regard to the money coming out of the prosthetic monetary and fiscal policies. Social control over top agents in firms and banks becomes a means of macroeconomics (as it occasionally had been in Quesnay, but much more stringently implemented today). This novel type of social control extends to not only to significantly policing and penalizing banks and firms,[6] but even to therapeutics (e.g., by setting limits to top-management salaries and bonus structures) and to outright moral re-education. Top managers and owners are, in fact, expected to bring about circuit closure in the productive economy by socially-minded, not profit-minded, investment de-

5 Minsky still saw one "hard" positive macro-transmission; he confirmed that workers will reliably re-spend salary outlays to them on consumption goods. Biological necessities and their being non-owners, with no means to obtain consumption goods from elsewhere, guarantees this. Like Kalecki, Marx, and others, Minsky also assumes that they will spend their whole salaries, but that is not enough, of course.

6 "US banks", reports *Wolf*, "have paid more than $200bn in fines". "But", he adds somewhat disappointed, "… almost nobody has gone to prison" (*Wolf*, How to defeat rightwing populism, in: Financial Times of 25 May 2016).

cisions. While socialism is off the table, at least for the time being, the organs of capitalists are often expected to act almost like socialists.[7]

In summary, most authors dealt with in chapter VII were looking into the direction also pursued by this book, but neither of them achieved a satisfactory grip on the problem. The capitalist wealth economy has a broader and deeper negative impact on investment in the productive economy than disturbances, cycles and bubbles. The problem is not just the role of finance in decisions on productive investment, the nature of the prevailing finance or the existence of a survival constraint, but *the problem is the capitalist wealth economy as such*. It persistently sucks away value-in-exchange before this value can enter the productive economy and flow into employment-generating uses. That is the main reason for deficient circuit closure in the productive economy. We shall now take up the distinction between the productive and sterile economy again and develop it further.

Section 2. The drain of wealth out of the productive economy

Producive/sterile and investive/consumptive further elaborated

Ultimately, from authors reviewed in chapter VII, Quesnay believed that the *classe des propriétaires* would clear the markets by its luxury consumption and Ricardo was confident that this result would at least somehow be achieved. The other authors looked at productive firms investments, but remained unconvinced. Nobody arrived at a usable conclusion as to why employment-generating spending was deficient and why circuit closure in the productive economy failed – if it failed. Consumption appeared to be good, they were aware, but perhaps some felt that consumption of wealth owners might include spending, which was not really generating employment. They hoped that investment would fill the gap, but some were also aware that investments in the stock, bond, or real estate market were mostly not useful either. They got stuck here and remained unable to elevate the intuitive difference between a "good" sector and a "bad" sector in consumption *and* in investment to a usable notional macroeconomic distinction.

We shall now try to make progress right here. For this purpose, we take up the distinctions between the wealth economy and the productive economy or sterile

7 These policies cannot nearly work, obviously. They are only attempts to find non-existent subtleties between having one foot on the accelerator and one foot on the brake. The prescriptions come from mass-democratic politicians who mostly do not remotely understand what they are doing, but know very well that, even if they understood, they could not even act on better knowledge. Their main effect will, thus, be an additional layer of hypocrisy. We are about to lose one of the true beauties of capitalism – its openly admitted rationality of profit-making.