The generic economic entity types. A critical analysis of basics of the Keynesian Macro-Model.

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Abstract

This below paper focuses on the economic entity concept. Difficult to find that (part of) economic literature not dealing with economic entities and issues. For the sake of better understanding ever on this our text below will start from the JM Keynes' capital paper of 1936' focusing on what was called the ‚Macro-Model', but as critical analysis of this last. There will be aimed a consistent image of basic types of economic entities. These last will be, besides the firms and households, on the 'trunk'(main part) of the macro-flow, already ‚recognized' since the ‚old classics', banks(with thier today ‚system'), the State (which is actually Government and/or the State economic sector detached) and the rest of the world, that is not only the widest economic area, but equally the appropriate expression of what is called the ‚open economy'.

Keywords: economic entity, micro- & macro-economics, firms, banks & banking system, State & Government, rest of the world, flows & stocks

JEL Classification: B12, B17, C00, D00, E00, H00

This will be first a ‚passage' from the economic thinking terms to the ones of reality around. In such a context the Keynes' ‚Macro-model' certainly reclaims what is written in our today manuals of economics, except for some additions and corrections that will be depicted and explained below each at its appropriate moment. Our aim here below will be explaining-understanding both the detail and the whole regarding economic entities[3] and so the *model* comes first as either concept and ‚quality'.

1. The time terms

These terms come up in the Keynes'[4] contribution after descerning from the 18th Century one of the Physiocrate François Quesnay rather a continuous *circular flow.* Then, Keynes makes the difference between the *short* time term – the one of the *national income* flow moving between *firms* to *households* and back to firms, together with specific effects in context coming from these entities in road – and the *long* term – i.e.

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here imagining successive short terms in the individual short term repeated context. Besides, the same *short term* might be seen and imagined both along this circular flow and beyond, and for ‚beyond' the author's *additional flows* ‚planted' on the main-orriginal circular flow.

From the *Macro-model* to the reality and practice, here the same short term might be imagined at the lenght of production process – i.e. of all productions in place – and production turning into national income flows, at the taxes' collection intervals and/or at the ones of public spending tranches etc.

The *long term* apparently has not too much more than the short term in the Macro-model view, except for repeating all the short term's content several times – i.e. there aren't all short terms for forming a long term, as real, but the successive short term ones. Operations imagined along the short term moving flow, as the circular plus its additional flows, will repeat for the long term as many times as the total flow itself. But overall, the long term will equally contain its own specific, apart from the short term's environment.

The most obvious terms' detachment between appears just ‚inside' the Macro-model – i.e. the banks' intrusion in the whole circular flow, together with the additional *savings (S) – investments(I)* flow --, but the specific time-term is here equally important and interesting. Actually, it is on the *short term* that *savings(S)* affects (reduces) *consumption(C),* and so te *aggregate demand(AD)*; it is on the *long term,* meaning beyond the short term limit, that the same savings collected turn into *investments(I)* and these last do the contrary (rising) to the same aggregate demand. Plus, the higher the savings – i.e. and their harming short term effect on the people's and other entities' welfare --, the higher the contrary long term beneficial feed-back on the economy's growth and development resources.

2. Banks, savings and investments

Just keeping on the same bank entities inducing their savings-investments specific and additional flow for here adding two important issues. On the one hand, banks form the so called *banking system,* a formula in its full development at the time of the Keynes' main paper published(1936) and this system works as coordinated by the *central bank* entity. This last either strengthens the inter-banks connections and manages the State's monetary policy.

On the ither hand, the savings-investments flow rather extends its flow (be it additional) and activity from the banks' to the *financial organizations'* zone – i.e. working for investments and crediting. And certainly these new entities skip the central bank statutory authority[4] .

3. State and Government

Besides powers of the State since always – e.g. defense, public order, healthcare and education – master Keynes sees the *economic entity* status at the same. His precision here made is that the same State acts as the economic entity, the same as for the rest of its status – i.e. *defending the other entities' interests, no proper interest against them!*

[4] *[5], [6].*

Actually, States do support dictators and even gangster gangs – i.e. but such facts never contradict such an enounced principle, either. On the contrary, any State supports its society governed around, as this is – i.e. when State and its society shape together democratic and rule of law foundations the State will govern as these.

As an economic entity the same State will act in context – i.e. all over differently than all the rest of economic entity known types. State does collect its income through taxation – e.g. it is not only a reality, but equally expected that the taxes amount isn't the same with quantity and quality of services provided. In reality the State's income comes from other sources as well, but taxation here lasts as a strong majority income source of all time and in all today world States – i.e. and the Macro-model reduces its State income sources to *taxation*.

Taxation could actually be found among the old(est) economic activities of both State and the other economic entities, plus as pretty immutable everysince. Or, we might here face the economic entities' portraying in the Adam Smith's first treaty of economics ever, in 1776[5], much different from what we see today around, whilst the same classic author equally enounced some ‚taxation principles' that stay currently valid. And this is once more accountable for the State's specific, as economic entity, against the other ones.

The *Macro-model* does simplify taxation (at least) twice: (1) firms do not here appear as taxpayors; (2) taxation is seen as reduced to the direct taxes – i.e. current (national) income related. But on the ‚correct' Macromodel thinking side, there though remain the essential taxation aspects.

First, but actually once more the *economic entity* quality of the State isn't the same and even has nothing to do with its economic leadership and policy issuing ones. Then, let us see back Diagram 3, in which goverment spending (G) adds to private investments (I) in the common aim of forming aggregate demand (AD) and then national income (Y) of the new year-cycle, so in the economic growth environment.

The idea that government spending(G) yields growth and welfare, and that in direct market competition with private investments(I), then equally attracts other ideas of interest. Let us see first how economic *performance* in the State economic entity case evolves differently than for the other such entities – e.g. the last entities expend priory of there expecting corresponding revenues and so profit, that is basing their welfare, part of the whole welfare in the area (i.e. national income), i.e. the same last entities' welfare comes directly from (current) national income (Y) and indirectly from the (previous) State's expense(G).

Then, besides this specific economic welfare's relation to *government spending,* plus government revenu not quite being the Government's/State's performance's repayment – i.e. it just couldn't be as such this way --, there comes the third aspect here induced – the *budget deficit* condition: **G>T**

Or, actualy it is to be just here emphasised what is coming up on the other side or beyond the inflationary effect of this – i.e. that we hear about all over and everyday.

[5] *The Wealth of Nation, that also was the single book ever written by the Scottish Adam Smith that was called the 'parent of economics' . Actually, in its evolution economics had started with just ideas, theses and phrases inserted in other papers, e.g. philosophical or literary. The so-called 'Treaty Era' of economics started with this treaty of Adam Smith and continued with treaties written by David Ricardo, Karl Marx and Alfred Marshall during the next following 19th century.*

Together with government spending, budget deficit basically feeds the next forward national income and its afferent welfare, as, let us say, the ‚State's generosity'.

That is also because and very together with the opposite State *budget surplus* – i.e. of course, equally opposite to any welfare feeding, but moreover, with not too much sense of existence for the same State, as economic entity. It is only the extreme circumstance of chronic inflation-hyperinflation encountering that budget surplus means really something for. Just look back at the other economic entities – i.e. in their zone of profit maximising ever – to see what is once more different for the State economic entity – i.e. since no State's interest off its relations with citizens and entities, what would ever be its revenu surplus for?

Another significant aspect and the last one to be here depicted relates to the State's revenu and expense levels off the budget disequilibria light. Actually, when State's revenu is high, its expense is always similarly high – i.e. even face to a whole scale of budget deficit levels -- and this roughly means a high State's weight in the whole economy. Or, here there are at least two zones of thinking about. For the one of them, when picking of all world national economies the ones of high national incomes and other macroeconomic indicators per capita and good resource allocations and transforming, it will be likely to find both high and low State sector's weights in the whole economy amongst. Shortly, this zone of thinking equally relates to *political thinking*.

In such a context, liberals – i.e. despite all their thinking related disturbances in the aftermath of the Big Crisis (1929-1933) – stand against economic interventionism, or in favour of harshly limitting it. The State woud be supposed to limit its acting to its basic (i.e. non-economic) functions: defense, public order, healthcare and education. As regarding the economy, intervention admitted by liberals would be limitted to its so called *negative* approaches: e.g. ensuring an appropriate environment for all economic entities acting. Liberals eversince work for free initiative and taxes reduction – i.e. in favour of working economic entities all over. Plus, since recently they do claim about the State's intervention that, instead of the expected boosting production and business hand in hand with the private sector working, on the contrary, ‚infects' or pushes the last away from this scene.

Liberalism is finally blamed for social inequality and poverty problems induced equally in the industrialized economies. And that together with business success restricted to and differenciated among the most powerful and highly endowed ones.

On the contrary, *socialists* and *social-democrats* roughly enjoy Keynesian theses – i.e. while, on his position the author of ‚The General Theory...' keeps far from such a political ideology and no ‚social-democrat economics' comes instead, as much as its opposite *liberal economy* keeps really valid issue[6]. Social-democrats are likely to wish to the natioinal economy a strong and influent government economic sector with high skill specialits in all areas able to take good care of economic infrastructure and management. Social-democrats see the ‚shadows of the free economy' when rather taking care of spreading-generalizing welfare and dealing with equity and non-discriminating criteria of welfare distribution. In the vicinity of the ‚old 19th century socialism' today social-democrats yet keep finding ‚imoral' all economic performance not then translated into

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[6] *i.e. classics and neoclassic remain the dominant economic current of thinking since the first treaty of economics of Adam Smith – 'The Wealth of Nations' (1777).*

social welfare and life standard rised. Or, this is really why State is required to be(come), stay and stand strong – e.g. for welfare (re)distribution ensured and poverty fought, but certainly not only --, here including as economic entity.

Social-democracy is blamed, in its turn, for wealth *distribution* prioring against wealth producing, which naturally comes first; for claiming equal wealth on the ‚not performing side' of the economic society and to the ones rather found of material rights freely offered by the authorities and that in spite of forcing the others, those who ever work for economic growth and development, to pay taxes according to their performance done; for ever rising government spending in favour of the same for taxation – i.e. while the higher the State's revenu from taxation, the closer the taxing to its *progressive* system also according to individual income and fortune levels[7].

Actually, this same (i.e. pro-political) zone of thinking does find radicalism – i.e. together with economic thinking related to the political one – on both sides and it is this explaining how policies and governments' attitude become rather moderate on the ground – e.g. social-democrat governments sometimes taking liberal political measures, like tax reducing, as well as liberal governments sometimes increasing pensions and other incomes from the authority and public administration.

The other economic thinking zone – i.e. the one finally breaking up with political ideologies, but then with their splitted views on welfare producing & distribution, as well – deals, in its alternative, with a presumable *optimal size of the public sector* in the whole economy – i.e. see Diagram 4 [7][8].

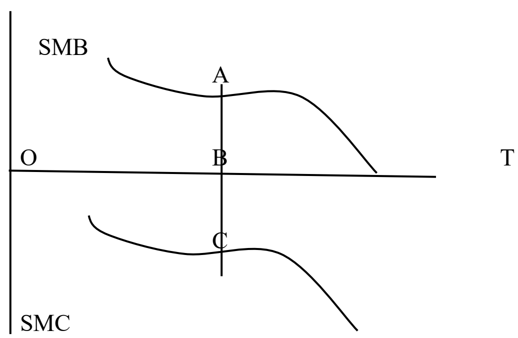

Diagram 4

See in this Graph the public sector size on its abscise and on its ordinate the opposite to one-another ***social marginal benefit (SMB↑)*** and ***social marginal cost (SMC↓)***. The meaning of SMB and SMC evolving like these two curves referring to the public sector size is that: (i) for low public sector size benefit is high and costs much lower, that would make the same public sector as efficient as private sector entities, while it would never be supposed to work like this for being what it is; (2) for high size public sector, the last gets overweighted in favour od cost increasing and benefit lowering, as a real burden to the economy. Finally , (3) there might be imagined the optimum size of the

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[7] *E,g, let us remind the well known episode of the 'Abba' musical group giving up their Swedish citizenships for too high income tax levels to pay home.*

[8] pp. 284-285

public sector as the OB segment on the abscise – i.e. for which SMB=SMC, actually AB=BC segments on this Graph. Theorists here find such an equality – i.e. the *optimal size* -- as the *long-term* equivalent to what means *budget equilibrium* – i.e. here between governemnt spending and revenues, these last highly dominated by taxation -- on the short term, certainly for the same *State-public*[9] *sector*.

One more difference between this and the other zone of thinking is that this one seems to work not too close to the reality of economic policies and practice. This is why the literature rather here finds two *'benchmark-substitutes'* in context. The one is (a) the *'social disturbance'* hypothesis(Peacock & Weiseman[10]) assuming a demcratic society with corresponding political decision taking. There will be likely the so-called *cycle of social disturbance* – i.e. a succession of specific facts firstly action on short terms, then these time terms get extended. The *social disturbance* is likely to induce public spending rising(↑G) on the short term, of course together with that of taxation(↑T), and on longer term the same public spending (G) firstly rising gets stable at a new level higher than the one pre-existent of the last social disturbance cycle.

The other (b) *public goods over-supply* hypothesis (Buchanan & Tullock[11]) assumes the G=T equality as budget equilibrium expressed and so any imaginable *public goods over-supply* actually induces a social perception about 'low taxes'.

4. The rest of the world and open economy.

First reviewing the *circular flow* model, part of the whole *Macro-model,* with its three above diagrams in order to, second, finally detect the *rest of the world* part. Third, the most obvious specific of this *rest of the world-open economy* intrusion is an obvious 'lost' of connection between the two here additional flows – i.e. *imports (M)* and *exports (X)*. This is while, obviously again, in the other cases of economic entity categories, savings(S) and investments(I) were connected on both time terms (i.e. for banks) and taxes(T) and government's expenditure(G) were very connected on the short term (i.e. for the State sector).

Though, similarly to the State's economic involving case – i.e. in which, on the households' side, taxation was reduced to the direct taxes (the ones directly applied to the incomes, actually to the current national income here figured by the main circular flow part) – in the *rest of the world* case – i.e. and equally on the households' side – the *imports (M)* reduce to the *consumption*-related ones. Or, the result here is that rupture of flows – i.e. of course, consumption imports couldn't ever be able to 'feed' the firms' exports in any way.

In fact, *Macro-model* skips the imports-exports connection, while the reality yet doesn't – i.e. imports include their *production*-related part, which's ups and downs follow the ones of exports, or actually these imports directly push exports. This is about those imports of components, semi-finished goods and spare parts of goods of which production – i.e. instead of ever staying located in an individual factory establishment – rather shares between establishments working in several countries and parts of the world

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[9] i.e. on this side of analyses theorists seem to deliberately skip what might be called 'private' property or interests of the State.

[10] [8].

[11] [9]; [10]

and certainly cooperating amongst. In reality, moreover, ‚pure' policies to boost exports and curb imports are decreasingly available in the ever interventionism portfolio either.

Or, *Macro-model,* on its side again, here claims to have overcome those limits of the Quesnay-Say's old *closed economy* image. Such a progress seems to get its own price, as well, in reality -- i.e. rather no capability of the households related imports to ever support the firms' exports, as much as savings and taxes paid by the same households really support banks' credited investments and Government spending.

The other significant aspect of this part of *Macro-model* relates to flow direction – i.e. *imports* are issues (of) and *exports* are entries in the national economy, which isn't true for exports-imports real flows, but for their money-payment flows. Or, since the old classics all macroeconomic flows – i.e. including firms-households and here households-banks and households-State flows -- were *real economy* based. In another expression, exports repaid by the rest of the world – i.e. as an entrance flow, in money terms only and market values not related to the domestic market – isn't the same with the same exports, seen as domestic productions to be directed abroad, to the international market – i.e. as in real economy and domestic cost terms. All the more, when taking into account the openess degree of the economy[11] proper thought as based on the ‚real economy' side shows to be right of the other, the Keynesian one, proper to Macro-model.

So these above are at least two aspects of the Keynesian Macro-model that might be found as ‚licentious', but paradoxes aren't missing either: the ‚External Balance of Payments Manual' of the IMF (IMF 2013) keeps ‚ultra-Keynesian'. And let us explain it through the above equalities here taken over:

$$\mathbf{Y = C + S + T + M}$$

$$\mathbf{C + I + G + X = AD}$$

since further assuming market equilibrium as:

$$\mathbf{Y = AD}$$

for which, this way:

$$\mathbf{C + S + T + M = C + I + G + X}$$

re-arranged as:

$$\mathbf{(X-M) = (S-I) + (T-G)}$$

Or, this is the first so-called *external balance of payment postulate* – i.e. that is quite Keynesian: the external equilibrium/balance (i.e. the left hand side member of the equality) bases on the other two balances that are ‚ultra-internal' for the same macro-system. These balances of the right hand side of equality are the *savings-investments (S-I)* and the *State budget* ones.

And as in detail, the external balance of payments' (EBP's) favourable position [12] naturally relates to exports(X), but the same as to savings (S) and to harsh taxation(T) – i.e. on the contrary, investments (I) and public spending (G), as the ‚motor' for economic growth and development, are both inflationary (i.e. through aggregate demand/AD) and affecting the external equilibrium, as the ‚price paid' for.

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