10

Closing the Little Circle

Meet the players

The previous chapters of Part Two introduced the major actors in the economy and their assigned tasks. This chapter now fits them all together in a circular loop that reflects the repeating cycle of the economy: work, production (using tools), income distribution, consumption, and reproduction. These are the core functions and relationships that make up capitalism. We'll even draw a simple map of this circular system. We'll call this map the "little circle." In later chapters, this map will get bigger as we consider more of capitalism's real-world complexity (including the roles of competition, the environment, banks, government, and globalization).

You can't tell the players without a program, so here's a handy listing of the key actors, what they do, and where they work and live:

- **Workers** These people (and their families) make up the vast majority of the population (around 85 percent) of advanced capitalist economies. They own no economically meaningful property (other than, for many, their own homes). To survive, they must sell their labour for wages and salaries to private companies, which they do not meaningfully own or control. At any point in time some workers are not working: they may be unemployed, supported by their families, receiving government income support, or retired. But even those who are not currently employed are still "workers", on the basis of their lifetime dependence on employment for their basic livelihood.
- **Capitalists** These people (and their families) make up only a couple of percent of the population of advanced capitalist economies. They own the clear majority of financial wealth (including most business wealth – via either direct ownership of companies, or large holdings of corporate shares). They also control the operation of large businesses, either directly as owner-managers or indirectly through their appointment of professional executives (who themselves own large stakes in the businesses they run). Hired employees do most of the work in these businesses. Capitalists do not need to work to survive, since their ownership of financial wealth generates sufficient income to live very comfortably. However, many do work (including as managers of their own firms), and that work is productive (unlike their status as owners – which is not, in and of itself, productive).

- **Small business owners and farmers** These people (and their families) make up 10-15 percent of the population of advanced capitalist economies (and a larger share in less developed countries). They work, nominally for themselves, in small companies or farms, in which they (and often their family members) perform most of the work required for production. These small operations may sell goods and services to consumers (like a neighbourhood corner store) or to other, larger businesses (like a photocopy shop). Either way, they are always dependent on the more important, central "loop" of capitalism: namely, the decisions by larger businesses to invest, hire labour, and produce. The profits received by small business owners reflect a combination of hard work and their status as owners. But most can be safely ascribed to their work effort, since the average total incomes of small business owners (despite their long hours and high stress) are generally no higher than those of paid workers. (To keep our map simple, we don't draw small businesses directly, reflecting this subsidiary economic role.)
- **Worker households** This is where wage-labourers live and reproduce themselves. They raise and educate children; feed, clothe, and care for each other (including sick and elderly family members); and spend essentially all of their wages and salaries to buy the consumer goods and services that they need to survive and enjoy life. A great deal of unpaid, unmarketed work occurs inside the household, most of it performed by women.
- **Capitalist households** The capitalists live here, and in fine style. Like workers, they also buy goods and services for consumption: in greater quantities than workers, and higher quality. Some of their income (most of which comes from profits or their financial wealth) is saved – supposedly to be re-invested back into their companies (although in practice that does not necessarily occur).
- **Private companies** Workers go here to perform their labour in return for wages and salaries. The capitalist (or a hired executive) also works here, to organize production and supervise and discipline the workers. The output of this labour is a good or service which the company then sells. Hopefully, the resulting revenue is sufficient to cover wages and salaries, the wear and tear of machinery, and any raw materials or inputs used in production. What's left is a bottom-line profit for the owner. The output from these companies is sold into three distinct markets. Worker households buy run-of-the-mill consumer goods. Capitalist households buy luxury consumption goods. And other companies buy things (like machinery, equipment, and supplies) needed for production. If for some reason the company can't sell its output, the capitalist will never see the hoped-for profits, and production will slow or stop altogether. (We will discuss how and why this actually happens in Chapter 25.)

Follow the money

We've introduced the main players. Now let's sit back and watch the show. Figure 10.1 illustrates how these players interact with each other, in a normal day (or year) of work.

In addition to the players and places introduced above, our map also illustrates the major flows of money resulting from their productive activity. We label these money flows with shorthand symbols commonly used in economics. Like a forensic accountant trying to solve a corporate fraud, following the trail of money around the circle is a good way to understand what actually happens as capitalism unfolds. In fact, there's a whole branch of economics – called **CIRCUIT THEORY** – which is based on "following the money" in this manner.

Let's discuss each flow of money, in the order in which it appears on the economic stage:

***Step 1*: Investment (I)** Before anything else happens in capitalism, the capitalist must decide to make an initial investment: establishing their company and starting production. This requires an initial expenditure on **FIXED CAPITAL** (including the workplace itself, and all the machinery and tools inside). The capitalist must also provide some **WORKING CAPITAL**, to pay the initial wages of the company's employees, buy raw materials and supplies, and meet other day-to-day expenses; hence the capitalist needs a certain revolving fund of cash to get production started. (After a full cycle of production has occurred, the company can use some of its revenues to pay for those expenses in the next production cycle.)

This initial investment creates new jobs in its own right (both inside the company itself, and in the companies which produce capital equipment, raw materials, and other inputs). Even more crucially, this initial investment pushes the "Start" button on the whole process of production. Investment is the most important form of spending required for the successful functioning of capitalism. When investment is strong, capitalism is vibrant and growing. When investment is weak, capitalism stagnates.

Where did the capitalist get the money to make this initial investment? We'll discuss this in Chapters 17–19, when we discuss money, banking, finance, and stock markets. For now, all we need to know is that the capitalist only needs a credible business plan and a bit of start-up **EQUITY**; they can then borrow all the additional funds they need, in one form or another, from the financial system. Importantly, the capitalist doesn't need to first *save* all this money, in order to *invest* it.

***Step 2*: Wages (W)** Once workers start their new jobs and perform their work, they begin to earn wages and salaries.

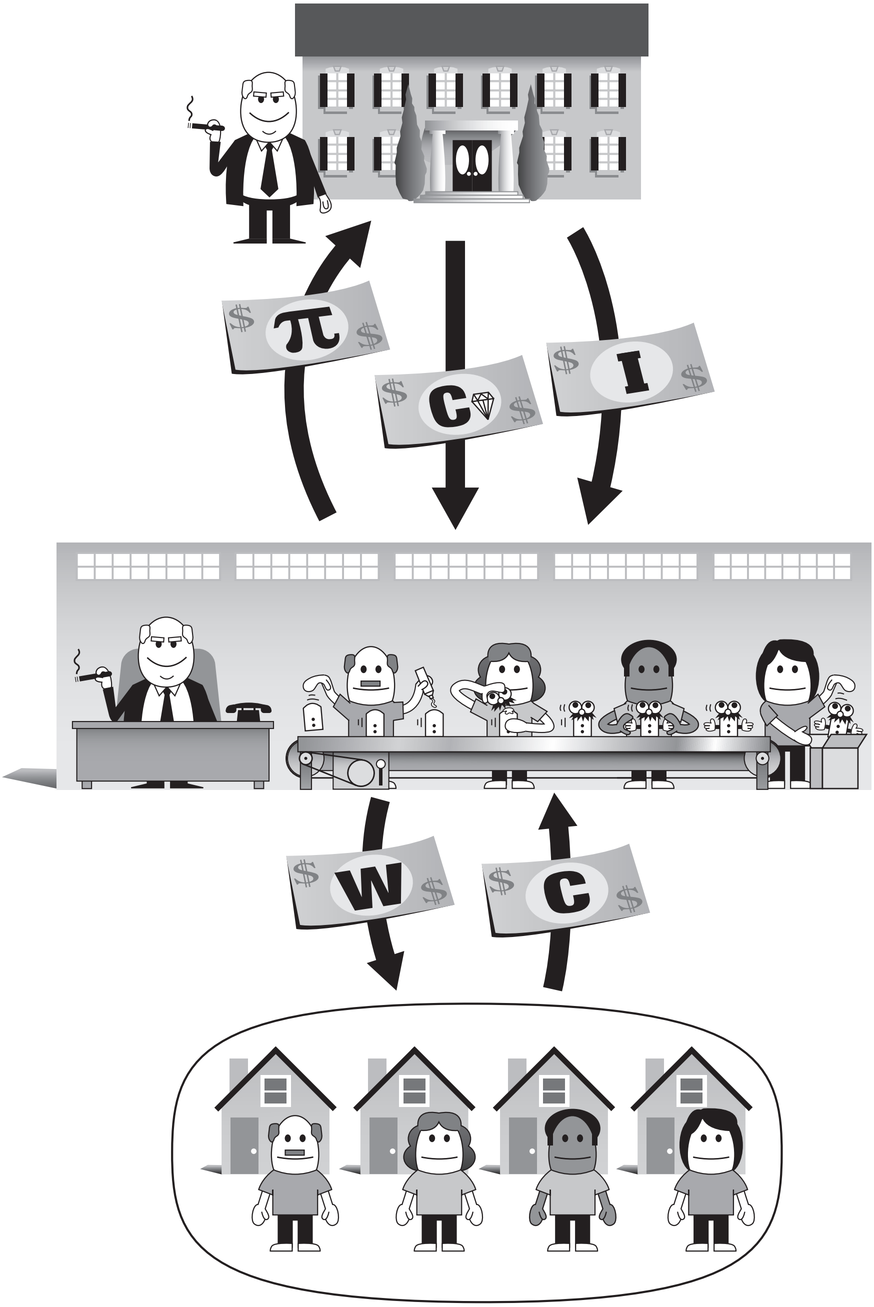

Figure 10.1 Economic Road Map: Little Circle

Step 3**: Consumption (C)** The take-home pay earned by workers doesn't gather dust. As soon as they get their first paycheques, workers begin spending it. (In fact, thanks to the magic of credit cards, workers can start spending even before that first paycheque arrives!) In aggregate, workers spend all their income on consumer goods and services, which are consumed inside the home to reproduce themselves and their families (and, hopefully, enjoy life a bit in the process). The money goes back to the private companies which produced those goods and services.

Workers' consumption is the largest single expenditure that occurs in the economy. But it is also the most predictable. In effect, "workers spend what they get," and hence worker consumption spending closely tracks employment and wage levels.

Step 4**: Profit (Π)** Assuming the private company successfully sells its output and generates enough revenue to cover its costs, it then pays a profit back to its owner (the capitalist). Indeed, the hunger for profit was the motive that got the whole ball rolling in the first place. (Capitalists certainly don't invest their own money as a public service.) The capitalist eventually expects to get back their initial investment, plus some profit margin on top of that (otherwise why would they bother?). The Greek letter *pi* (Π), is commonly used in economics to symbolize profit … could that be because it resembles the ostentatious faux Greek pillars which some modern capitalists erect at the entrances to their mansions? If the capitalist borrowed some of the money for the initial investment, then some of the resulting profit must be paid back to the lender as interest.

What do capitalists do with their profit? Generally, it doesn't gather dust either. (If it does, then this economy will experience a recession.) Some of it is spent on the luxury consumption of capitalist households (we call that $C_{\lozenge}$ on the map, with the luxury diamond subscript distinguishing it from workers' more humble consumption). The rest is set aside to be re-invested (in the next cycle) in the capitalist's business: both to replace the wear and tear of the company's capital assets, and perhaps to expand the company's total output.

For completeness, we could also draw smaller flows of profits going to small business owners, and smaller flows for their own consumer spending and investment. This would make our diagram very complicated. For now, just keep in mind that small businesses play a subsidiary role in capitalism; they depend on the larger flows of corporate investment and worker consumption that are shown in this map. Imagine a stereotypical small business, like a small retail shop: it depends on larger companies both to produce the goods which it sells, and to employ the workers who are its main customers. Like a small shop, most small business is just a "go-between": facilitating spending transactions and minor production functions that ultimately depend on the larger and more powerful forces driving the whole system.

Reading the map

This map is a vast simplification of how capitalism actually works. But we can already learn some very important lessons by studying it. First, there are two broad categories of arrows (or money flows) on the map: those which flow from companies to households (both worker households and capitalist households), and those which flow from households back to companies. The arrows flowing from companies to households represent flows of *income* (wages and profits). The arrows flowing back to companies represent forms of *expenditure* (mass consumption, luxury consumption, and spending on capital goods).

Ultimately, the total flow of income will equal the total flow of expenditure. We summarize this in Table 10.1.

Table 10.1 **Income and Expenditure: Little Circle**

Class	*Income*	*Expenditure*
Workers	Wages (W)	Worker Consumption (C)
Capitalists	+ Profits (Π)	+ Luxury Consumption ($C_{\lozenge}$)
		+ Investment (I)
	= Total Income	**= Total Expenditure**

The centre column of this table shows the total income of the economy. The right column shows total expenditure. These are in fact the two methods that statistical agencies use to add up the total value of GDP (which excludes, remember, the value of unpaid work inside the home). The "GDP by income" tables report labour income, profits (broken down into corporate profits, depreciation, investment income, and small business profits), and some other, smaller categories of income. The "GDP by expenditure" tables report consumption, investment, and other forms of spending (such as government programs and exports) that we haven't considered yet. (Visit www.economicsforeveryone.com for a "how-to" guide on reading and interpreting GDP statistics.)

Recall that we identified two broad kinds of consumption: workers' mass consumption (C) and capitalists' luxury consumption ($C_{\lozenge}$). Mass consumption (C) in the right column of Table 10.1 tends to equal workers' wages (W) in the centre. Unlike workers, however, capitalists have a meaningful choice regarding how to spend their income: on luxury consumption, or reinvesting in their businesses. How much they consume, and how much they invest, will influence how strong the economy is today, and how fast it grows in the future. In earlier times, frugal capitalists tended to reinvest most of their profits, and hence capitalism developed quickly.

Today, however, capitalists consume much of their profit (or find other unproductive uses for some of it, like financial speculation), and this has been associated with a visible slowing of business investment during the years of neoliberalism. Indeed, if the goal of neoliberalism was to strengthen investment and growth, then it has clearly failed: despite new powers and freedoms, the world's capitalists invest less of their profit than in previous epochs. We will discuss this problem further in Chapter 12.

Where's the work?

Our map locates the main players in the basic economic loop that is capitalism, and the major flows of money that link them. Don't forget, though, that it is ultimately work that explains production, not money. What actual work is performed in this system, and where?

We discussed the main forms of work that occur in capitalism in Chapter 5. The biggest share of work is performed by workers in private firms in return for wages and salaries. Their work is coordinated and supervised by owners and top managers … when they do any actual work, that is! Another large share of work is performed, without pay, inside households. Smaller amounts of work are performed in small businesses and farms.