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The market economy in transition and the accuracy of the economic results. A theoretical approach (first part)

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Summary – 1. A brief theorethical stop – 2. The consumer's supremacy and the dimension of the economic results – 3. Real economy-monetary economy ratio, source of diversity or unity in the methodology of economic results determination?

Abstract

The way the results of the human activity are measured has been and still is a major theoretical and practical concern of the economic world. In this article we are particularly interested in analyzing the circumstances that provide a real image for the economic results at macroeconomic level. We keep as our main interest the technology of value making process in market economy and the relationship between real and nominal economy in this process. We apply the theoretical aspects on Romania in order to analyze the way macroeconomic indicators are reflected in the population living standards.

Keywords: transition, economic growth, consumer, competition

1 – A brief theoretical stop

The way the results of the human activity are measured has been and still is a major theoretical and practical concern of the economic world. Reasons of statistic evidence or comparative analysis, or simply the human curiosity to find out how the human effort is rated in certain fields or historic periods fully explain such concerns.

We know today, retrospectively judging things, the methodology that has been at the foundation of the rating of created values has defined the aspect and philosophy of two great schools: the classic and neo-classic school.

They have essentially marked the evolution of economic thought. The first school has operated with the absolute value criterion; the second one, with the relative value criterion. Having in common the fact that both schools agree that work is the main source of value, interference areas disappear when it comes to the issue of the "technology" of value.

To someone like Ricardo, Mill, and especially Marx, the value is a fact, a whole belonging to production that is split up in parts on the way of delivery, with each participant getting a bigger or smaller "slice", according to his status on the social value scale. Anyway, the process is developing according to the rule of the game with sum zero and within an environment which doesn't lack contradictions. All this because someone's plus cannot be defined by somebody else's minus, with the whole thing to be distributed according to given *a priori* dimensions. This way of judging things suits the measuring process and an as appealing "econometrics" as deceptive it can be. Moreover, it has consumed minds to obsession. "In search of an absolute dimension of value" is the title of the note book which Ricardo, with a final gesture, "rested" his head on. Out of the famous formula M= c+v+p Marx made his title of glory and left, accepting the fact that he found out the magic equation with which we should detect the results in exact rates. Incidentally, it wouldn't have been bad if he had succeeded. He would have made our economic estimations easier and anyway, the economic relations would have been guided by much more stable guidelines. Yet, the reality, more "stubborn" than the theory, has proved to be relative by itself. The endeavor to estimate in absolute measures has found, though, representatives in almost all great periods of the history of economic theory. We only mention here two names: P Sraffa and V. Pareto. Publisher and promoter of the Ricardian work, in 1972 Sraffa writes his work "Production of Commodities by Means of Commodities", to conclude, finally, that he is the prisoner of a tricky circle; i.e. commodities are produced out of commodities, and someone's' outputs are somebody else's inputs; as a consequence, an exact, absolute measure for what each individual made remains a mirage. Pareto, though belonging to a different school and a different doctrine philosophy, doesn't get away from the obsession of measuring the absolute value. So it appears that "the hard core", in a Lakatosian sense of the optimum theory is related to Ricardo and not to Marshall; someone's extra happiness is objectively related to and explained by somebody else's misery. And all these because, in his case too, the members of the society share a "social cake" with pre-set dimensions.

For the sake of substance of our topic, we consider it is more than useful to stop to what we call Smith's "heresy", what economic theory books in former communist countries called Smith's "dogma". We refer to the fact that, stepping out of the line, the author of "The Wealth of Nations", with his outstanding intuition, understood that value is not a given fact to be split up, but the result of accumulating three incomes (wage, profit and rent), to "the value of consumed materials". The new value, as "the sum of the three incomes" confused Marx, who found this

"Trinitarian formula" to be vitiated by logic and wrote that "... instead of splitting up the exchange value in wage, profit and rent, Smith declares them to be, on the contrary, elements making up the exchange value"1.

Keeping only the *technology of value making process* as our main interest, we realized experience proved more than enough Marx's claims to be groundless and confirmed Smith's good intuition: when goods get to be distributed/delivered, they don't have a pre-set value. By the time they get to the end of the road, to the final destination, namely the consumer, they gain value, step-by-step, with each participant adding a share of value to the process of reproduction, whose dimension depends on this participant's place and role on this route. And this dependence makes the dimension of each newly-added part to be relative. Not even the human effort expressed in commodities, apparently easy to estimate, is absolute any longer. The beneficiary of the commodity has to admit this effort is necessary. This acknowledgement occurs on and through the market, and here one does not operate with absolute values, but with value references, in other words with relative values.

This fact was to get an outstanding theoretical demonstration from the second school – the neo-classic school – and confirmed by the entire actual experience of the civilized world.

What conclusion is this theoretical tour getting us to? In short, it shows us that according to Smith's good and accurate tradition, the market is mostly responsible for the way the "technology" of value is achieved; for the way producers in the process of reproduction afford to add more or less to what we finally call the value of the end/finished product.

2 – The consumer's supremacy and the dimension of the economic results

Apparently the commanding consumer doesn't have anything to do with the process of estimating the results of the economic activity. Those who made out of the consumer the final judge[2] guessed the extraordinary significance of this "brand" of market economy. We consider they are right for two reasons:

First of all, whether the economy is functional or not depends on the signs coming from the "captain" of the ship. "The entrepreneurs, farmers or capitalists, Mises writes, are not the ones who dictate what has to be produced. The consumer is the one. If a businessman doesn't strictly comply with the orders conveyed by means of market prices, he faces losses, goes bankrupt and is immediately eliminated".[3]

[1] K.Marx, "*Theories on surplus value*", part II, Political Publishing House, Bucharest, 1960, p.178
[2] It's enough to stop to Mises and Hayek who achieved this demonstration completely and unquestionably.
[3] Ludwig von Mises," L'Action Humaine, Traité d'économie", PUF, Paris, 1985, p.285

Second, writing that "... any consumer has to earn the money he spends one way or another"[4], Mises, whom we consider to be representative to our demonstration, means the producer is different from the consumer only in theory and analysis; only here those who pay the wages are different from those who get the paycheck. In practice, these two characters seem to overlap one another.

For the sake of our demonstration, a note is necessary here. In building the market economy theory, with the never-failing "king" consumer, Mises relied on the producer's morality/moral conduct. Only relying on this feeling he thought the producer wouldn't add a too bigger profit (if the market allowed him) because, by the time he becomes the consumer, he supports this addition with the price he pays. This statement is true only under the terms of a narrow interpretation of the outlet law (Say), according to which the supply creates its own command.

Yet, we know the Say law applies only on the economy in general and each producer buys only a few of his products and a lot of others' products. Aware of that fact, it is unlikely he will be guided by the moral conduct and won't add more profit to the price of his product, provided he gets the opportunity and he's not the one who purchases it as a consumer.

Beyond this possible interpretation, the king consumer is and has to remain an absolutely mandatory goal to achieve.

Why? Because he is the supreme indication that an economy is functioning according to the principles of the market.

The competitive market makes each participant to reproduction to add his share of surplus product according to the position he doesn't set, but the market does, with that extraordinary feed-back web which is connecting them in an informal, yet real partnership, with a powerful educating role.

When every producer, under the unseen surveillance of the competitive market, is adding exactly as much as the market tells him to, only then he will feel comfortable in the consumer's shoes. In other words, the competitive market:

- compels the state, as a general producer and also as a general manager to add as much VAD (value added tax), not only as much as general goals for public expenses require, but also according to how much the consumer can take;
- determines the furniture producer, for instance (competing with other furniture producers) to adjust the profit not only according to his own needs and goals, but also to how much the consumer is willing to pay for the product; he has on his side the opportunity to choose out of many producers and, very likely, out of many prices;

[4] Ludwig von Mises, " Politique économique" , PUF, Paris, 1986, p.10

- determines the trader (retail or wholesale) to set his share of addition according to the information he gets from his competition environment; a higher share may make him go bankrupt if he doesn't relate to the trader's purchasing power; etc.

Overall, competition disciplines and leads to responsible behavior even in the field of technology, shaping values and prices. In addition, it establishes ratios of value on a real basis, meeting the requirements imposed by the fundamental laws of an economy, mainly the law of supply and demand. The economic agent wouldn't afford to transmit into the price of his good and consequently into GDP, but that part of plus product that respects the tensional supply-demand ratio. This is the only way to reach a healthy economy and the chance to make GDP a fine reflection of the results of human efforts.

One cannot impose this behavior to private or public monopoly. Mastering the market, the monopolist will maneuver the price as main instrument of promotion for his own interests. It is hard to believe that he can be placed in the functional scheme of Mises, where he is pressed by the possibility of being a buyer and therefore he might have altruist feelings that determine him to consequently limit his profit margin.

It is generally admitted that the presence of monopolies isn't a sign of health for the economy, based on the fact that the proportions of value are affected and influenced. That is why the economy with perfect competition remained an ideal. The same reasons explain the well-know antitrust measures in the American economy. Similar arguments impose the criterion of functional market economy as compulsory condition for the accession in an economic space where the market complies with its duties, that is the European space.

This condition has its own logic, because without it would lead to the situation of bringing together two economic spaces wanting to reach a common level in determining the results. From this point of view, the adoption of the same system of indicators doesn't appear as enough. The GDP needs to receive only those true and justified additions of value, and this mission belongs to competition market.

3 – Real economy-monetary economy ratio, source of diversity or unity in the methodology of economic results determination?

The calculus of the results of human activities was always confronted with the problem of the double reflection of the economy: real and monetary (nominal) flows. We must mention that economic analyses were influenced by this phenomenon, admitting that an economic analysis is reliable when the facts are studied in the double equation: physical and monetary. Though, screening the spatial and temporal evolution of the economy, we can state that there were, and partially still are, economists tempted to place their judgments to extremes, considering that either result in physical expression can communicate something worthy of interest, or, on the contrary, money is everything.

The fist temptation found an exact expression the economies of the ex-socialist countries. The propensity to use quantitative units of measure has its logic, up to a certain point. If, for example, one says that company X had a production of k1 linear meters of pipes with ø = 200 mm and k2 linear meters of pipes with ø = 230 mm, the things are clear and leave no room for interpretations. Yet, the high fidelity expression in physical terms does not justify excess. And excesses, just as we mentioned, reached the ridicule, illustrated by the proposition made by the official USSR economist, S.G. Strumilin to divide national income in portions.

On the other side, especially those who are advocates of standard monetarism with origins in the Chicago school, try even at present to put an aura to the monetary field, autonomy apart from real economy.

And, as a complex economy with a diversified range of goods refuses the calculus in physical terms5, the expression in nominal terms remains the unique solution. Viewing this matter as an axiom imposed by the complexity of the modern economy and by the necessity to ensure compatibility for the results obtained in different spaces and times, we try to support it by stating that a pertinent analysis integrates the currency into the real economy. By this we essentially mean that real economy is the prime factor, and the currency is secondary. When this fact was forgotten, the world lived the money illusion, having the clearest explanation in the legend of king Midas, who changed in gold everything he owned and saw himself in danger of dying of hunger. The fact that through money, using the fiscal and monetary policies can be created more or less goods does not change the very essence of things.

Admitting this hypothesis does not spare us of appealing to currency, in order to give a dimension to material, palpable reality. Or, precisely this appeal to currency for perceive reality in nominal terms, gives a larger or smaller dose of *illusion* to the economic calculus.

Why illusion? We know, as a principle, that the price is the proper monetary expression of the value of a commodity. We saw, on previous pages, that lack of competition can bring serious doubts in the process of value formation. The appeal to money in order to step from value to price has its contribution to what we called illusion, when we don't have the right to speak about a stable currency. The relativity of a measure of unit gives relativity to results.

The ideal situation would be when economic agents, through competition, would add value only to the dimension admitted by the market, and the expression of the created value in price to

[5] Thing which was generously presented by Ludwig von Mises in Human Action

be realized in a stable currency. This is the reason why European Union imposes to the aspirants to maintain inflation in reasonable limits, beside the “functional market economy” condition.

Having this healthy background ensured by a competitive market and by a managed inflation around 3%, the population becomes confident both in currency and in the implied promise of a raised GDP. The individual that lives in such an economic space expects that, when official institutions announce a raise of 6% in GDP, for example, the living standard to rise proportionally. Monetary illusion appears when these requirements aren’t met. GDP’s increase remains an artificial one. The ratios of real consume of goods and services don’t change. GDP per capita rises, but this fact has not reflection in the living standard.

This happens because, on the way, economic agents transmitted the same real values, only that they “dressed” them in much more money. And, instead of having a consistent crumb, the “social cake” looks like a “Swiss cheese” with many big holes on the inside. And the holes don’t satisfy hunger, just as money couldn’t in king Midas’ case.

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