Sources of Investable Funds (Reading III,E)

Highlights for Study, W96

Vocabulary

Cash flow

CCA (Capital Consumption Allowance)

Closed economy

Discretionary

Drive (a system)

Impute; imputed rent, interest, etc.

Open economy

Repatriation

Trade deficit

1. New saving

This is now mostly from corporations and institutions, and occasionally governments (e.g., Alberta and Alaska, from their oil revenues).

2. Capital recovery

A. Hard producer capital

"Cash flow" from an asset is the cash it yields after deducting current expenses (e.g., the rents of an apartment less expenses for janitorial service, administration, utilities, etc.).

Cash flow is then divided into two parts: capital recovery and income. Income consists of rents and interest. These may be paid out in cash, or paid internally by allocating parts of cash flow to different accounts. The second procedure is used where the asset is fully owned by the entrepreneur, free of debt. This procedure is invisible to outsiders, but is just as real as cash payment. It is called "imputing." "Imputed interest" is income you pay to yourself to compensate yourself for the use of the capital you put up.

Income claims are prior to capital recovery, both in theory and in law. Capital recovery is a residual, after incomes have been paid. In the national accounts (NIPA), capital recovery is labeled CCA, or Capital Consumption Allowance. I will refer to it hereafter as CCA, and so may you on exams.

CCAs are normally reinvested as received; incomes are normally spent mainly on consumption.

Normally, when investors have made good forecasts and things pay out as planned, CCA will about equal depreciation of an asset from year to year, and will exactly equal it over the full life of an asset. Normally, when big capital projects are financed with borrowed money, the CCA will about equal debt amortization (lowering of the unpaid balance).

B. Hard consumer capital

Consumer-owned capitals, like cars and houses, also wear out and need replacing. They provide a large reservoir of potential funds to invest in producer capital in emergencies, when the consumer capital is let run down without replacement. The national accounts handle this poorly, and treat it like net saving by the homeowner. It happens routinely in wartime.

C. Soft capital (e.g., inventories)

These are treated separately from hard capitals in the national accounts, and also in this reading, where they are fifteen. Logically, however, soft capital is just capital that turns over faster than hard capital.

3. Foreign sources

From a world view, these are not a separate source; from a national view, they are. The first is called "closed economy"; the second, "open economy."

Until about 1980, the United States exported capital to the world; since then we have imported it. "Capital import" takes the form mostly not of capital goods themselves, but of consumer goods that flow to us in excess of our exports: a trade deficit. This is just like what happened to Chicago during its boom, 1830-1836. Like Chicago then, the United States today exports IOUs to pay for the import balance. This results in a degree of alien ownership and control of assets in the United States.[1]

The U.S. trade deficit (import balance) is not the cause of our capital import, but the result.

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[1]Example. The Texaco Station on University Avenue, across from Highlander Hall, is being condemned by the City of Riverside to round out the new project being planned and built in that block. The city had planned to let it stay, but the Japanese bank that is financing the project is requiring that it be removed. Rich lenders can push around city governments, and even an international major oil company.

4. Bank Expansion

When banks lend by creating new deposits, they in effect extract loans from those who receive the new deposits in payment. No individual is forced to hold onto the new deposits, but collectively we all do. This is because what A spends, B receives. This is often called "forced saving."