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Saving and Investment: A Praxeological Approach

William Barnett II[i] and Walter Block[ii]

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Abstract: Clarity in language in the sin qua non of any intellectual pursuit. If we cannot communicate accurately with one another, there is no hope of progress in scientific endeavor. Nowhere is this more true, at least in economics, than with regard to such concepts as real, as opposed to financial, saving and investment. The present paper constitutes an attempt to clarify the sometimes confusing dialogue that often ensues in this arena when sufficient care is not taken to distinguish between these very different topics. To wit, it is our hypothesis that while financial saving and investment may indeed and often do diverge from one another, the same is not at all true of real saving and real investment. In the latter case, real saving does not precede real investment; rather, it is *coincident* with it.

[i] William Barnett II – Chase Distinguished Professor of International Business and Professor of Economics, Joseph A. Butt, S. J. College of Business, Loyola University New Orleans, wbarnett@loyno.edu.

[ii] Dr. Walter Block, Ph.D. – Harold E. Wirth Eminent Scholar Endowed Chair and Professor of Economics, College of Business Administration, Loyola University New Orleans, wblock@loyno.edu, http://www.WalterBlock.com.

1 Introduction

Science requires, *inter alia*, precision and consistency with respect to its fundamental concepts. One problem of long standing that sets economics apart from the natural sciences is the equivocal and inconsistent use by economists of expressions intended to convey a technical meaning. This paper considers difficulties involved with the concepts and uses of the terms "saving" and "investment."

In section II we discuss saving and investment, in an attempt to dispel some of this confusion, and move toward systematizing matters in this regard. We conclude in section III.

2 Saving and Investment[1]

Much confusion in economic theory arises because of an unscientific failure by economists to use words and terms consistently and unambiguously. In the case at hand, we focus on the failure to distinguish between "real" saving and investment and "financial" saving and investment. As soon as one understands leisure to be a form of consumption and exchange a form of production,[2] it is obvious that all one can do as an economic actor is produce or consume. There is no other alternative, though it is possible to produce and consume at the same time, and some people do so not infrequently.[3] But that raises some interesting questions. For example, what does "he saved" or "he invested," or "saving precedes investment," mean?

We begin with saving. It is clear that saving is not consumption. It is, after all, a temporary renunciation of something enjoyable. Therefore, it must be production.

[1] We eschew, throughout this paper, any consideration of the concept of "human capital" and its relation to saving and investment.

[2] For an argument that exchange is not a category of action separate from production, and, that, therefore, money is a capital good, see: Barnett and Block (2005).

[3] For example, a farmer enjoys planting crops. He is engaged in production (placing seeds in the ground is a necessary step in the direction of creating food for sale), and also in consumption (he takes pleasure in this process at present.) Or, a professional musician performs in a concert, or an athlete in a sporting event; they do so for pay, to be converted into future consumption, but they also directly gain utility from engaging in these activities.

The real meaning, in this context, of "to save" is "to prepare for the future;" i.e., to arrange for future acts of consumption that are expected to be greater than otherwise would have been the case, though the specifics of the future consumption are not necessarily predetermined. Alternatively, saving is the difference between physical production and physical consumption, this is what is, or rather should be, meant by real saving.[4] "To consume," in this context, means to act so as to directly satisfy a want; i.e., consumption is an act intended to directly satisfy a present desire. The standard textbook definition of saving is in terms of foregoing consumption (Samuelson and Nordhaus, 1985., pp. 52 –53; Mankiw, 2001, pp. 274-275).[5] But, as we have seen, the only way one can forego consumption (act in a way that does not directly satisfy a want) is to *produce*; i.e., the only alternative to consumption is production.

Production is action that is expected to add value; i.e., it is expected, in the ex ante sense, to in the future increase human want satisfaction, directly or indirectly. Alternatively, it may be thought of as action that transforms goods from a higher (earlier) to a lower (later) order. Goods[6] can be categorized as consumers' goods[7] or producers' goods (capital goods). Consumers' goods are used to directly satisfy wants; capital goods are used in the production of yet other goods, either consumers' or capital. Production, then, consists of producing consumers' services, tangible consumers' goods, capital services, or tangible capital goods.[8]

[4] Although real saving is often taken to be the monetary value of saving (i.e., financial saving) adjusted for changes in the price level (i.e., the purchasing power of money), because of problems with the data, not to mention the more important conceptual problems involved, such a measure is problematical, at best.

[5] It might be argued that not to use up all or a portion of a preexisting stock of goods is to save. However, to fail to do something is not an act and, therefore, irrelevant to economics. Moreover, that would trivialize the concept, for then any preexisting good would constitute an infinite amount of saving. For example, if one had a can of corn and did not consume it instantly, the can would be continually saved and, therefore, the quantity of saving would be potentially infinite. The stock of preexisting goods constitutes *savings*, and the flow of newly produced goods that are not consumed constitute *saving* and adds to the stock of savings while the using up of preexisting consumers' goods and the physical depreciation of capital goods subtracts from the stock of savings. Net saving which augments savings, then, is saving minus the using up of preexisting capital goods including the physical depreciation of capital goods. And, although saving can never be negative, net saving certainly can be.

[6] Throughout, "goods" also refers to intangibles, i.e., services, and leisure as well as tangibles.

[7] Leisure is both a consumption and an intangible consumers' good. (Not all goods are produced, for example, apple trees growing in nature.)

[8] Examples of each are, respectively: a concert, leisure clothes, legal advice in a business matter, and construction of a factory.

Production of capital services and tangible capital goods is saving; or, alternatively expressed, one can (attempt to)[9] save by producing capital services and tangible capital goods, and one is saving when one is producing such goods. As with goods, all services are either consumers' services or capital services. The former are intended to directly satisfy a human want, e.g., a haircut, where the recipient desires this service for reasons having to do with his role as a consumer, not as a producer. The latter are intended to cooperate in the production of other goods, thereby indirectly satisfying a human want, e.g., the professional services of a petroleum engineer employed by an oil company. But the production of capital services and tangible capital goods is precisely what is referred to as real, in contradistinction to financial, investment. Financial investment consists in exchanging an asset, usually money, for the title to another asset.[10] Therefore, at least insofar as capital services and tangible capital goods are concerned, the act of saving is the act of production of those goods, which is, in turn, the act of investment in those goods. This type of saving and investment is referred to as capitalist saving and investment.

But what of the production of consumer services and tangible consumer goods? Here matters are a little more complex. The reason is that all production is forward looking; we produce now to consume in the future, no matter how short the time span between the production and the consumption. This is true even with respect to those acts of production that are also acts of consumption for the producer, i.e., for the producer/consumer. See footnote 3, supra, for examples.

Moreover, all tangible consumers' goods are durable to a greater or lesser extent. This leads to an arbitrary, but analytically very useful, distinction. Tangible consumer goods may be categorized as either consumables or durables based on the greater or lesser extent of their useful lives.[11] The arbitrariness necessarily arises because durability is a matter of degree, and, therefore, no objective criterion or criteria exist that can determine where the line that separates consumables from durables is to be drawn. It is tempting, because of the term "consumables," to think in terms of criteria

[9] Because all action is forward looking, one can never be sure that the end aimed at will be achieved by the means chosen.

[10] The only production involved in such exchanges are the actual capital services involved, e.g., a broker's services.

[11] Here "useful life" refers to economically-useful life, i.e., the time-span during which it can be used to satisfy, directly or indirectly, human wants.

related to the physical using up of the good in the process of consumption. However, this also would entail subjectivity, as all tangible consumers' goods are, sooner or later, used up in the consumption process. However, as what is of interest is a good's ability to satisfy wants in the future, whether or not it could also satisfy them in the present, it would seem that perishability or physical durability is the key criterion. Again, there is no objective way to determine the length of time beyond which a consumers' good's continued existence qualifies it as a durable rather than a consumable. Production of consumables as well as of consumer services is not considered to be preparation for future consumption. Rather, these goods are produced for consumption in the "extended present." Therefore, such production is not properly considered an act of saving. Production of consumer durables is, however, preparation for future consumption, and, therefore, is an act of saving. Insofar as durable consumer goods are concerned, the act of saving is the act of production of those goods and is also the act of investment in those goods. This type of saving and investment is properly referred to as plain saving[12] and investment.

We have now established that real saving and real investment are the same thing: production of goods intended to satisfy wants, directly (in the case of plain saving and investment) or indirectly (in the case of capitalist saving and investment); but in either case, they are both intended to satisfy wants primarily in the more distant future, or long run, rather than the extended present, or short run, i.e., "later" rather than "now."

Thus, real saving does not precede real investment; rather, it is *coincident* with it, consisting in the very same action. However, yet other questions are raised by these answers. Consider only two: what does it mean to save or invest one's money or funds, and how then can saving be greater than or less than investment? These questions relate to financial, not real, investment.

Before we can analyze these issues, it is first necessary to come to an understanding of the nature of money as a good. Money comes into existence as the transformation of an existing durable consumers' good or of an existing capital good to money, which is itself a form of capital good. In either case, part of the stock of savings, i.e.,

[12] See on "plain saving" Mises (1996, 531; http://www.mises.org/humanaction/chap19sec2.asp); Rothbard (1993, 40; http://www.mises.org/rothbard/mes/chap1d.asp).

the stocks of capital goods and durable consumers' goods, has been converted from some non-monetary use to a monetary use. Therefore, an act of saving is necessarily prior to the evolution of money. Fiat money, for all practical purposes, is created ex nihilo (Barnett and Block, 2005; Hoppe, et. al, 1998).

There are only two types of goods: capital goods and consumers' goods; these two are exhaustive.[13] If this is so, it then follows logically that either money is a capital or a consumers' good.[14] Moreover, as we have seen, all that one can do is either produce or consume. Therefore, "trade"[15] is either an act of production or of consumption. But trade, even in the case of the individual for whom the trading process itself is an act of consumption, is also an act of production, Mises and Rothbard to the contrary notwithstanding.[16] Therefore, because money is "the" quintessential trade good, i.e., the medium of exchange *par excellence*, it must be a capital good. Now, as monetary

[13] But not mutually exclusive. A fishing rod may at-one-and-the-same time be both a capital good and a consumers' good.

[14] Although money qua money is always a capital good, specific items of money, e.g., a beautiful, gold coin, may simultaneously be a consumers' good, at least for some individual whose want for aesthetic gratification is satisfied, at least in part, by the coin in his possession before he spends it. Then, of course, there is the mother of all examples in this regard: Scrooge McDuck pouring money all over himself in a delirious paroxysm of joy.

[15] "Trade" here refers to all exchanges of rights, barter as well as those involving money. This is to prevent any confusion that might arise because of Mises's (1996, pp. 97-98) use of the term "exchange" to refer to all actions; i.e., every action is an attempt to exchange a less desirable for a more desirable state of affairs.

[16] Rothbard (1993, pp. 60-61) states: "Goods being directly and presently consumed are *present goods*. A *future good* is the present expectation of enjoying a consumers' good at some point in the future. A future good may be a claim on future consumers' goods, or it may be a capital good, which will be transformed into a consumers' good in the future. Since a good is a way station (and nature-given factors are original stations) on the route to consumers' goods, capital goods and nature-given factors are both future goods." He also avers: "In the monetary economy, since money enters into all transactions, the discount of the future good against the present good can, in all cases, be expressed in terms of one good: money. This is so because the money commodity is a present good and because claims to future goods are almost always expressed in terms of future money income" (Rothbard, 1993, p. 298). Therefore, for money to be a present good it must be "directly and presently consumed" in mediating a transaction. This obviously is not the case. For if money is not a present good, it must be a future good, of which there are only two types: claims on future consumers' goods or capital goods. But any asset can be used as a claim on future consumers' goods. That is, the category "claims on future consumers' goods" is so broad as to be almost meaningless. Therefore, Rothbard contradicts himself because inasmuch as money is not a present good, it is, it must be, a capital good. On this point, see Barnett and Block, 2005. It should be noted that Mises's and Rothbard's concept, "future goods," is praxeologically meaningless because action, whether production using capital goods or consumption, takes place in the ever changing present and can only involve existing goods. Goods are means, and as such either exist in the present or not at all.

gold (gold in the form of coins or bullion intended to be used as media of exchange) may also satisfy consumers' aesthetic wants, it may be, and is for the relevant consumers, simultaneously, a consumers' good. Nevertheless, though money may be concurrently a consumers' good, it must always and necessarily be a capital good.

Consider, then, what it means to "save" or "invest" one's money. There are two ways to "save" one's money.[17]

First, one can refrain from spending it on *anything*. This is referred to as hoarding.[18] Of course, *not spending* is not an action – it is neither production nor consumption. During the time one is abstaining from spending, one is necessarily doing something else. Therefore, hoarding is not saving; it is merely the non-action of re-

[17] St. Paul (1 Timothy 6-10) famously said, "For the love of money is the root of all evil..." This is extremely dubious. But as far as economic analysis goes, money is indeed the root of much confusion. The easiest way to see this is to investigate the essence of an economic phenomenon. In such cases, we ask if it would/could exist in a barter economy. If so, then money cannot be of the essence of the matter. More important, any definition of the phenomena that involves money is, obviously, inadequate, in that, at best, it is misleading, but usually confusing, thereby causing faulty analysis. For example, untold time and ink has been squandered developing the theory, and empirical estimates, of "the" demand for money. However, correct analysis concludes that there is no such thing. Money qua money is one side of every monetary transaction. Therefore, in the market in which X trades for dollars, the price of money is in terms of X/$; i.e., it is a quantity of X paid for a unit of money. Of course, in the market in which Y trades for dollars, the price of money is in terms of Y/$. There is then no "the" demand for money. Rather, in every market in which some good trades for money there is *a* demand for money; i.e., there are thus demand*s* for money, but not *a* demand for money. Of course, the foregoing comments apply equally to "the" supply of money. It should be noted that some Austrians, including the present authors, fall into this trap when they are not careful, e.g., when we speak of an increase in "the" supply of money, rather than in the stock of money. That Mises and Rothbard speak in terms of "the" demand for, and supply of, money is proof positive of this problem, especially as Salerno (1993, 133-134) maintains that such analysis is of the essence of monetary economics. Perhaps the beginning of the understanding of "money" is the realization it is the only necessarily-barter good in a monetary economy, and that as such there is no "the" demand for or supply of money.

[18] The matter of hoarding raises another issue. Except for the virtually instantaneous period of time in which the title to money is transferred from one individual to another, it is never spent on anything. That is, except for those split seconds in which it changes hands, money in wallets and checking accounts is virtually always being "hoarded." What, then, is the real meaning of hoarding? It is a decrease in the average rate at which money is spent, i.e., a decrease in the "velocity of money" of quantity theory fame. In praxeological terms, an individual hoards when he holds onto his money, in value terms; the longer the period of time he keeps it in his cash balances before spending it the greater is his hoarding. It should be noted that a key source of error in Keynes (1936) was his failure to comprehend the difference between the effects of hoarding in commodity-money and fiat-money systems. On this point, see: Barnett and Block (forthcoming). In common use, "hoarding" consists of holding more money in cash balances than the speaker deems appropriate.

taining title to a pre-existing capital good, money. Second, one can trade one's money for another pre-existing good, e.g., a house or a bond or a share of stock. In this case, the action is trade, a form of production. But, this action does not bring into existence either consumer durables or capital goods; i.e., there is no saving or investment involved. Rather, it "merely" swaps titles to different goods, as the parties to the exchange try to rearrange their portfolios so as to improve their conditions in life. If one offers money to another to entice him to produce a consumer durable or capital good, and the transaction is consummated, there is saving and investment, but it consists in the action of production, not of the trade of money for preexisting goods. The same can be said of the trade of money for newly created financial assets. Neither the creation of financial assets nor the trade of money, therefore, creates durable consumer goods or capital goods; consequently, neither is an act of saving or investment.

3 Conclusion

Austrian economics is based upon a simple theory, simple in the sense of Ockham's Razor, not simplistic: the choices facing the economic actor at any given time are limited to two; praxeology is in effect a binary system (Barnett and Block, unpublished). As discussed in the present paper, one may only consume or produce. There is no third alternative. Moreover, production is either for current consumption, or it is saving/investment.

This, however, is but the tip of the iceberg. The phenomenon runs like a constant refrain throughout the warp and woof of Austrian economics. For example, the only options open to the owner of property are to retain it or alienate it; he may do the latter by selling it, renting it out, giving it away, or abandoning it, but the basic options are only those two. With regard to any two goods, A and B or combinations thereof, one may prefer A to B or B to A. That, contrary to the opinion of the overwhelming majority of economists, is exhaustive of the possibilities. Indifference, a supposed third alternative, is simply not on the menu (for criticism of the viewpoint now being articulated, see Nozick, 1977, Caplan, 1999; for a defense of it see Rothbard, 1993, Block, 1980, 2003, Hülsmann, 1999). Why not? Because there is no possible way to *demonstrate* such a choice in actual human action, and the latter is the bedrock of

economics from the Austrian perspective. This, of course, is not to deny that the word "indifference" has a perfectly understandable referent; merely that it cannot past muster as a matter of technical economics. Moreover, there are only two types of goods: consumers' and capital goods. And one may only engage in labor or leisure.

This binary insight applies to barter and monetary economies, despite the fact that in the real world we typically find an admixture of both. The point is there is not any third option completely divorced from either.

When placed in such a context, the thesis of the present paper tends to become, if not more acceptable to non-Austrian economists, at least more comprehensible. It is not a stand-alone contention. Rather, our thesis is embedded in a nexus of similar binary phenomena.

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