



Imputing

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Imputing

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It is important to reward functional effort. Must identify, measure, and gear payments to it. Good management of firm requires same reasoning as social justice or equity in distribution as a macro social issue. People in the firm see it that way, too; it is not just a technical or efficiency matter, but a morale factor.

Economic and managerial analysis deal with *imputing returns to "factor" inputs rather than to persons as such*. Imputation is the art of knowing what specific inputs add to the product of the enterprise, and hence are worth. Learn to dissociate the person from the thing the person owns - a trick the human race has had trouble with for eons. The "Fallacy of Personification" dies hard.

"Profit" means a return to a person, and may combine returns from several objective inputs, hence is not much used here. Work gets wages, salaries, commissions, etc. --- generically, simply wages. Capital gets an increase per year, (often expressed as a percentage), which has never received a short, pithy label of universal usage. Keynes said "marginal efficiency of capital." Some have said "internal rate of return." I shall write "TRK," for "True Return to Capital" (it is customary to use K for Capital, from the German spelling).

Land gets "rent." This also appears in many models as "gain to fixed factor," where land is the fixed factor. By extension, in some analyses buildings and so on may be fixed during the period of analysis, and "rent" used to include that, too. I do not use the confusing second concept of rent, which you often meet, as a return to any factor above opportunity cost.

Economic and managerial analysis do not always use words, or measure things either, in the same way as traditional Accounting. A major difference is that most accounting looks backwards to historical costs. Economics values things in terms of their present and future possibilities. Accounting changes values when assets are bought and sold, or formally depreciated on the books. Economics values assets at the market at all times.

Accounting makes only halting moves in the direction of using current values. Examples follow.

In 1980 or so Accountants moved to "Reserve Recognition Accounting" for oil companies. They had the firms treat as income the increase in value of oil in the ground. For some of them this quadrupled their reported income. But the method went

back out after a year - too much public light was let into how these firms make their money.

Paper accounting, e.g. valuing the paper held by banks, sometimes "marks to market," meaning valuing paper at current market value regardless of historical cost. Even this simple, obvious device is vigorously opposed by many, and may not be assumed to occur routinely. Periodically some firms, after great travail, will "write down" bad assets, and "take a loss," all of which is gravely reported in the press, although the real loss occurred earlier when the assets lost value.

An economist should be aware of accounting conventions, however wrong he may think they are, because they affect the way other people behave, however foolishly. Common in human behavior are Myths and Fallacies and Groupthink, and institutions based on them. A good manager needs to know these, to predict the behavior of others. Reluctance of banks to "recognize" losses, sometimes results in frozen assets and overstated assets. There is much reluctance of quasi-public officials (that includes managers of large public corporations) to recognize losses and risk public censure. On the other side, there is taxation according to accounting fictions. Here, the bias is to exaggerate costs and understate taxable gains.

Factoral imputation as a management tool

Factoral imputation differs from personal distribution. "Profit" and "income" are terms referring to personal gains. They should not be used in managerial economics because they combine and meld gains from several sources, depending on individual circumstances. They give us little clue as to whether resources are well-used, or how they could be used better. They do not help us make specific decisions about the use of specific resources.

We need factoral imputation to guide us in adapting to changes in costs, prices, interest rates and rents. Consider, for example, the function of land rent in decisions about land use. Rent has been called the "sorter and arranger" of land uses. Market forces continually lure and pressure landholders to put land to the best use. In deciding whether to add or subtract land to or from an operation we need to know its MP, or its residual rent, and it helps to realize they are the same. In deciding whether to subdivide or assemble land we need to know the MNP of land, and how it changes with scale. In deciding when

to clear and renew land we need to know the rent. Rent as a cost provides a performance standard to let us know if we are making good use of the limited national resources with which the nation, the great landlord, has entrusted us. It also lets us as citizens, stockholders in the nation, know how our managers are doing with our property.

There is great, powerful and persistent opposition to the use of marginal productivity theory. There are those with strong interests in avoiding giving specific credit where credit is due. Their view is summed up in the phrase "You cannot unscramble an omelette", meaning that you cannot credit specific contributions to specific inputs once they join forces in a firm. We may call this the "Omelette School". It has at least three major sources of support, aid and comfort.

On the left wing are some socialists. Their objective is to discredit the market system, to make it seem meaningless and unworkable. The slogan is "From each according to ability; to each according to need."

On the right wing are those who receive unearned income, in a curious and uneasy alliance with the socialists on this point. Naturally they devote much thought and effort, and great riches, to rationalizing their place in the scheme of things. They endow and subsidize universities and learned journals. They sink their tentacles deep into the processes by which economic thought is generated and transmitted.

Many managers join the Omelette School to avoid subjection to a performance standard. One who presides over a honey pot of great treasures generally prefers to be judged on the gross performance, not on his net addition to it. This applies both in the private and public sectors: it would be hard to choose which set of managers is more abusive (although some people think they know, by faith).

Last are anti-rationalists, those who never learned to bear the pain of thinking, nor to taste its rewards and pleasures. They are usually a majority. They are manipulated by the other groups mentioned; together they form a powerful force.