

Fallacies About Capital Theory, Finance, etc.
By [Dr. Mason Gaffney]

Article citation:
[Gaffney, Mason]. "Fallacies About Capital Theory, Finance, etc." N.d. Study guide.

Fair Use Disclaimer
The Robert Schalkenbach Foundation, a non profit private foundation, is publishing this article, at no cost, pursuant to the Fair Use provisions of Section 107 of the Copyright Act which states that under certain circumstances, the fair use of a copyrighted material for purposes of criticism, comment, teaching, scholarship and research is not an infringement of copyright. If you have any concerns about the publication of this article, please contact us at **info@schalkenbach.org.**

The Robert Schalkenbach Foundation's Digital Collections and Archives is an extension of the Robert Schalkenbach Foundation's Engel Georgist Library. It collects, organizes, preserves, and provides free online access to researchers and the general public of Georgist literature including books, newspapers, pamphlets, scholarly articles and archival materials.

RSF is particularly proud to offer free online access to the works of the late Georgist scholar Mason Gaffney, made possible through the generosity of the Danica Foundation and with the consent of the Mason and Letitia Gaffney Trust.

Robert Schalkenbach Foundation: https://schalkenbach.org/
Engel Georgist Library: https://www.librarycat.org/lib/EngelGeorgistLibrary
RSF Digital Collections and Archives: https://schalkenbach.starter1ua.preservica.com/

Fallacies about Capital Theory, Finance, etc.

F-1. Fallacy of Abstracting from time.

a. Treating investing in durables as a current expense, q.v.

b. Fallacy of disappearing inventory, q.v.

c. J.B. Clark and Frank Knight on capital - they denied it has a period of investment, making it just like land. Sadly, much of modern micro incorporates this fallacy, which explains why micro is virtually timeless - it deals with relations of coexistence, ignoring relations of sequence.

d. Confusing supply curves with historical records of supply response: i.e., ignoring that historical response is irreversible, while the "supply curves" of micro are instantaneous.

e. In petroleum engineering, Fallacy of the "Maximum Efficient Rate" of extraction. Here, "efficiency" is given a particular, narrow meaning as the volume of petroleum recovered over time as a fraction of the volume originally in place. It gives no value to recovering it sooner.

F-2. Fallacy of giving capital recovery priority over interest and rent.

Example: calculating "Payback time" as original capital input divided by cash flow (or service flow, or cash savings).

F-3. Fallacy of identifying the carcass with the economic value of capital.

a. Fallacy that Demolishing an old building destroys a lot of capital value.

b. Fallacy that the owner recovers his capital by demolishing the old building. [What she recovers and recycles is the site taken up by the building.]

F-4. Fallacy that Capital is stored-up labor, hence a form of labor. Rather:

a. Capital includes stored-up services of land and earlier capital. Consider, for example, a stand of mature timber.

b. Capital is formed by saving and investing, from any source of income, not just labor.

F-5. Fallacy of treating capital outlays as current expenses.

a. Failing to annualize, thereby overstating Long-run Marginal Costs (LMC).

b. Expensing exploration outlays, on grounds you are replacing reserves just used, barrel for barrel. De facto expensing sneaks in when the outlay comes from profits, and is used to replace something like an old building, an exhausted mine.

c. Fallacy of internalizing company profits, claiming they are not profits but current expenses when reinvested in the firm. Capital thus captured by firm's management often accumulates beyond the firm's capacity to manage productively.

Actually, a proper economic goal is total efficiency. [See under Micro.] This is the same as max net product (aka rent) of a fixed input. To see this as a ratio, like efficiency, add the full cost of the fixed input (G) to the cost of the variable input (W), and max P/(G+W). It's really quite simple and basic. It can only be lost when someone is trying to muddy the waters, and others are letting her get away with it.

In this example, "G" is the accumulation of fixed assets added to by ploughing back (internalizing) profits. The fallacy comes in when managers treat this money as having no cost, because they needn't pay interest on it.

d. Equating GST or VAT with income tax.

F-6. Fallacy of Disappearing inventory.

The Fallacy is to say that "In a going concern, with normalized (staggered) investments, the lapse of time between investing and liquidating capital is eliminated."

Example: many (like Frank Knight, granddaddy of the virulent Chicago School) say that conclusions drawn from "even-aged

models" of, say, forest management, are repealed when the model is "normalized" (one cohort of every age). They say, in effect, that "In a going concern, the lapse of time between investing and liquidating capital is eliminated." This is like saying that when a college balances the outflow of graduates with the inflow of freshmen, students get their degrees the moment they enter college.

Example, the Allowable Cut Effect (ACE) in forest regulation.[1] Under ACE, you get to cut mature timber in return for planting new. Regulating agency considers this to be an equivalent, to conserve stock of timber.

F-7. The Fallacy of "Ripening."

The Fallacy says that the prospect of rising demand, and/or technological advance, bid us defer starting durable structures (and account for idle land in and around cities).

[See RIMS for list of related fallacies.]

Actually, it can be shown that the prospect of rising future demand should move an owner to invest in improvements earlier, not later.

F-8. Fallacy that Credit markets tend to shift money from rich lenders to poor borrowers.

Rather, most money runs uphill, from median lenders to wealthy borrowers. This is how economic power gets so concentrated, and economies of scale are overstated, and diseconomies understated, by so many analysts.

F-9. Fallacy of Overvaluing Mineral Depletion

With oil at $18/bbl, every barrel I take from the ground through my well lowers the value of the reserves by $18.

Corollary: I should be allowed to deduct $18 from my taxable income.

---

[1]See WTA paper for description.

Corollary: every million bbls. of oil reserves should be valued at $18m for loan collateral, property taxation, buying and selling, etc.

Double-think: the industry wants to deduct the $18 from taxable income, all right, but not to pay property taxes on values at that rate, nor to pay capital gains taxes at values that high.

F-10. Fallacy of Subsidizing Risky Ventures

Investors avoid risk. Risk is good. Therefore, we should subsidize risky ventures, provide cheap insurance, tax breaks, etc.

F-11. Fallacy of Unphased Construction

To save capital cost per unit of capacity, one builds large buildings, highways, conduits, and even larger, integrated projects, all in one pass, thus integrating and "rationalizing" what might otherwise be a costly tangle of separate projects. The cost is, one then builds ahead of demand, and ahead of complementary investing to be done by others. Thus, much of the capital is carried for some years before its capacity is used. The solution is optimizing; the Fallacy is to focus on saving cost per unit of capacity, ignoring time of use of the capacity.

A second error here is the Fallacy of Ripening, q.v., where one waits for the full demand, holding land out of use (or in a lower use) while waiting. See RIMS for full account.

F-12. Fallacy of identifying carcass life with period of investment of capital.

A. Capital is recovered from old durable capital like buildings one year at a time, in CCAs. Carcass life depends on the reuse value of land to be released by removing the old carcass, but by this time the capital has been recovered already (normally).

B. Capital is put into growing stock (cattle, trees) one day at a time, not just when it is planted. Pruning and other "Timber Stand Improvement" (TSI) toward the end of carcass life has a very short investment cycle.

C. Fallacy that slow carcass cycles imply more net saving than fast ones.

F-13. Fallacy that all economic values are either funds or flows

A. Urban land prices are obviously not flows, but they are not funds, either. A "fund" of wealth is stored up by production and saving; land prices originate from neither. A "fund" may be drawn down by consumption and dissaving; land values cannot be. Individuals, and even nations, can sell land to others; but society as a whole cannot dissave land values. Society may shift the use of land from production to consumption (e.g. from farming to golf), but it cannot consume the corpus of land itself.

B. Common stock prices have much in common with land prices, to the extent that the corporate assets consist of land.

C. Exhaustible mineral deposits may be drawn down by consumption, and resemble "funds" in that respect. They are not, however, built up by production or saving, and so remain different from pure "funds."

D. Durable capital like that in buildings loses much of the true "fund" quality in that the capital may not be liquidated at will. Once built, they yield back their capital only at a rate of time predetermined by their initial construction, and the vagaries of demand. A tunnel, a graded pad for building, a land-fill in shallow water, highway cuts and fills, canals, dams, and the like may depreciate only slowly over several generations. They depreciate with time more than as a function of use.

F-14. Fallacy of Build it all at once: unlimited economies of synchronism.

F-15. Fallacy of Build it only as needed: unlimited economies of synchronizing supply and demand.

F-16. Fallacy that The productivity of labor always increases when a firm adds more capital, whether in fixed form like plant/equipment, or working form like expendable energy and raw materials.

F-17. Fallacy that The prospect of rising demand, and/or technological advance, bid us defer starting durable structures (and account for idle land in and around cities).
See RIMS for list of related fallacies.

F-18. Fallacy that Wicksell's grape juice model only applies to grape juice, and things like it. With other capital, other principles apply.

F-19. Fallacy that The period of production, or of investment, is indefinable and meaningless.

F-20. Fallacy that Timber is financially mature when $F'/F=i$.

F-21. Fallacy that Payback time is K/a.

F-22. Fallacy that In a going concern, the lapse of time between investing and liquidating capital is eliminated (see pdofinvt, p.8).

F-23. Fallacy that