Volume Title: The Flow-of Funds Approach to Social Accounting: Appraisals, Analysis, and Applications

Volume Author/Editor: Conference on Research in Income and Wealth

Volume Publisher: Princeton University Press

Volume ISBN: 0-870-14182-1

Volume URL: http://www.nber.org/books/unkn62-1

Publication Date: 1962

Chapter Title: Comment

Chapter Author: John C. Dawson

Chapter URL: http://www.nber.org/chapters/c2047

Chapter pages in book: (p. 465 - 467)

Comment

JOHN C. DAWSON

COMMISSION ON MONEY AND CREDIT

JUDGING both from conference papers and the discussion, it appears that flow-of-funds users are searching for a conceptual framework that will organize and direct their analyses. In this connection it seems to me that national income and product analysis provides us with a useful analogy. There, a basic schema—the income circuit—is built into the data presentation, enabling the user to grasp the meaning of significant totals that can be analyzed. Many different GNP models have been developed, all using this basic schema. Although no one of these models has yet been agreed to as an adequate over-all model of the economy, the income circuit schema has enabled analytical use of these data to proceed effectively. What we need in flow-of-funds analysis is a general schema that can play a similar role.

I would like to propose a candidate for this central flow-of-funds conception. It is the process by which financial saving flows from ultimate lending, through financial channels (partly via financial institutions and partly directly), to ultimate borrowing, and thence into tangible investment. Something like this conception, which might be referred to as the savings-investment process, seems to underlie a good deal of financial analysis. Yet, so far, no quantitative conventions have crystallized in the measurement of these flow concepts. Flow-of-funds data could be arranged to help do so.

Presumably, a standard measure of ultimate borrowing would be some concept of funds raised by nonfinancial sectors—major components of which would be issues of federal obligations, state and local obligations, business loans and securities, mortgages, and consumer credit. Ultimate lending would be a measure of funds advanced by nonfinancial sectors—major components of which would be nonfinancial-sector increases in cash, savings deposits and shares, and savings in life insurance and pension funds, as well as increases in holdings of the credit instruments listed above. Financial-institution sectors would lie between the two, absorbing a large share of the issues involved in ultimate borrowing, and simultaneously creating debts to be absorbed by ultimate lending. Ultimate borrowing would, presumably, be equal to ultimate lending, and the financial-savings flow could thus be measured and analyzed differently at the various points along its path. In this unspecified form the schema is simple and familiar.

However, at least two aspects of this schema run counter to current flow-of-funds customs. First, the notion of financial-flow measures that are significant as totals bothers some flow-of-funds analysts. But the ultimate borrowing and lending measures could, I think, be so designed as to provide totals that are significant in judging financial performance. They would bear on how well the financial system meets the needs of borrowers and savers. Also, I would hope these total measures would be significant in that, when analyzed into components, they would ordinarily tell us a good deal about how the financial system is operating. Ultimate borrowing components might well vary with GNP expenditure components.

Secondly, to use the savings-investment process schema, we must depart from the straight and narrow path of never breaking up institutional sectors. The financial savings flow is here conceived to be a one-directional flow from ultimate lending to ultimate borrowing. When we look at the process in any detail, it becomes apparent that each of the nonfinancial sectors lends and borrows at the same time. If, to preserve the one-directional flow, we assemble the lending of these sectors at one end of our schema and the borrowing at the other end, we are forced to split up the various nonfinancial sectors. But there does not seem to me any a priori ground for avoiding this procedure if it sheds light on how the financial system operates.

Let me close by mentioning one problem connected with this approach to the use of flow-of-funds data. Consider federal government security issues. Presumably, most of us would wish to include the federal issues accompanying a federal deficit as a component of ultimate borrowing. But should the retirement of federal debt that might accompany a federal surplus be viewed the same way, i.e. as negative ultimate borrowing? Or should it be viewed as positive ultimate lending, being placed at the other end of the savings-flow scheme? On the former view, the substantial federal surpluses following World War II would offset the borrowing of private sectors in the ultimate-borrowing total. It would seem more revealing of postwar finance to view private sector borrowing at this time as having been facilitated by the absorption of federal obligations by the federal government as an ultimate lender.

In more general terms, the problem might be stated: To what extent should the flow-of-funds data be grossed by transferring a sector's negative sources of funds into positive uses of funds (and by transferring negative uses of funds into positive sources)? In this form the question also bears on how we view the process of financial intermediation. In the postwar years, financial institutions were able to lend large amounts to private sectors partly by selling federal obligations to obtain funds. If we count such negative uses of funds as positive sources, a larger volume of funds can pass through life insurance companies, for example, than is represented by "saving in life insurance." And, viewed this way, life companies have that much more discretion over the volume of intermediation.

It should be added that the present flow-of-funds presentation is by no means neutral in regard to this question. It seems to me that the Federal Reserve Board has made too much of the distinction between a neutral presentation of accounts and a prescription of particular flow-of-funds theories. There is between the two much tenable ground on which the Board, like the Department of Commerce in the case of the national income and product accounts, might be able to stand in presenting the data in such a way that the lay economist could easily grasp their broad analytical orientation. The new presentation in terms of savings concepts is a step in this direction.