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# MINNPOST

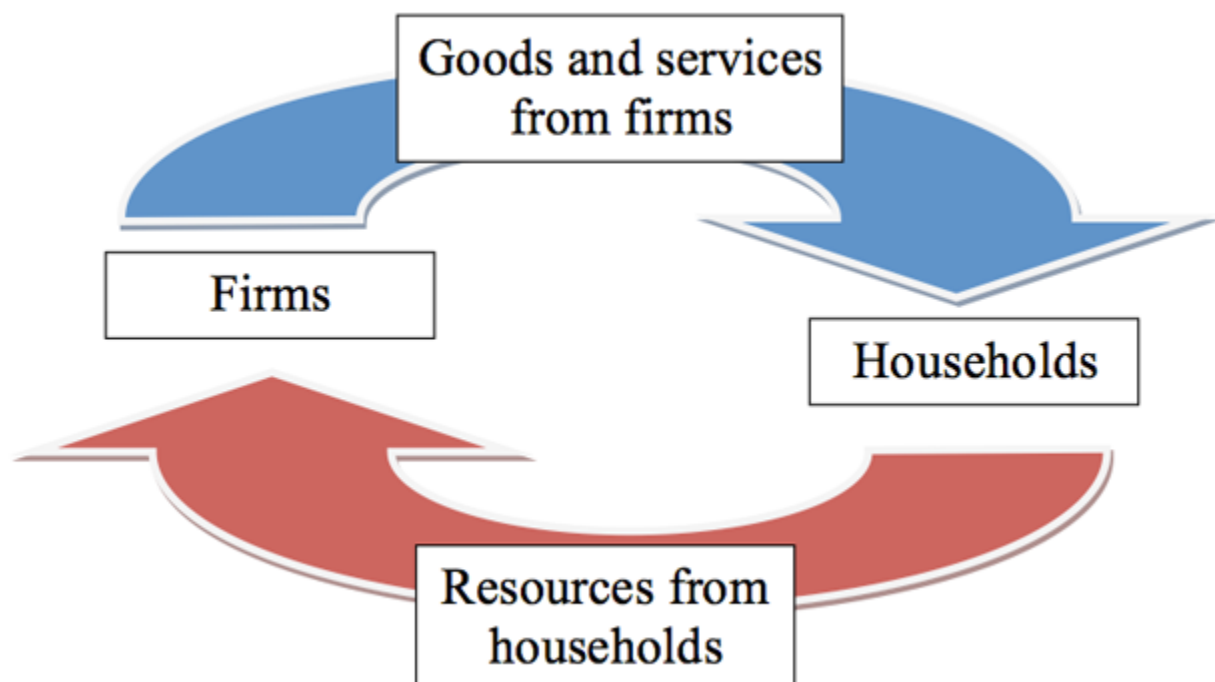
## Why Rep. Steve Gottwalt's view of the economy doesn't make sense

By [Louis D. Johnston](#) | 05/10/12

What is an economy? This might seem like a silly question given that we are daily participants in our local economy, but a couple of recent episodes lead me to believe that it's a question worth exploring.

Here's my definition: An economy is an interdependent system of organizations and individuals working together to produce goods and services people need and want. The organizations include households, businesses, non-profits and government. Organizations and individuals produce and exchange goods and services through markets and in non-market settings such as households.

How does this all work? Economists use simplified models to understand complex phenomena, and one of the first models we use in introductory economics courses is called the circular flow. The circular flow is a way of illustrating the interdependent nature of an economy. The diagram below shows a simple version of the circular flow.



The model starts by assuming there are two groups in society: firms and households. Firms have the know-how for producing goods and services while households have the resources (human capital, physical capital, natural capital) the firms need in order to produce goods and services.



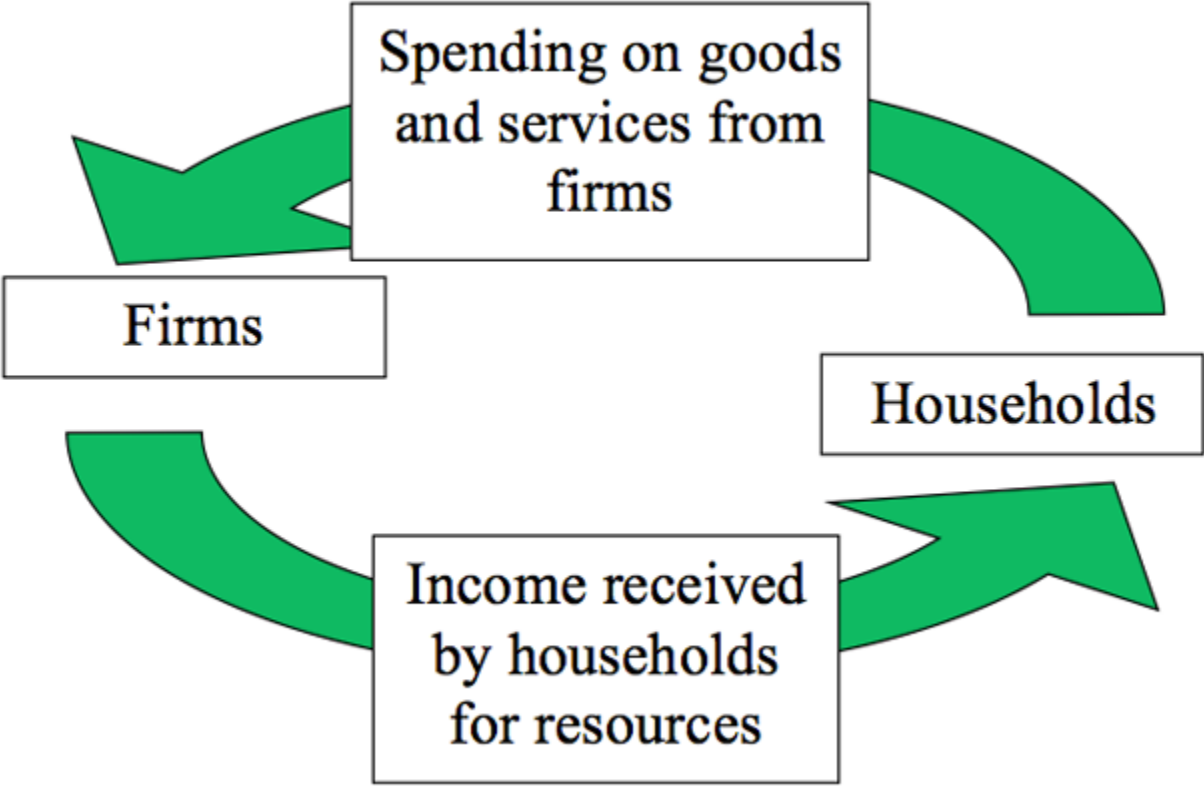
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Here is the first interdependence at the heart of an economy: firms produce goods and services and sell them to households, but firms need resources from households in order to produce goods and services. You can't have one without the other.

This version of the circular flow focuses on the physical stuff that's moving between firms and households, but we can also look at the situation from the perspective of money flows, as shown in the next diagram.



The direction of the flows is now reversed. Households send money to the firms when they purchase goods and services while firms pay for the resources they rent from households.

Here is the second interdependence. Firms receive income from households buying their goods and services. However, the only way that households have money to buy goods and services is by earning income from firms by working and saving.

In this simplified world, all of the exchanges take place through markets. We know, of course, that in the real world many exchanges take place within firms and within households, and that money doesn't

necessarily change hands within these groups.

We can also expand the circular flow to include all of the different institutions in an economy such as non-profits and governments. The diagram gets pretty complicated; just Google "circular flow" and see what you find.

## Geese and golden eggs

I've been thinking about what an economy is because of two recent events. First, the **Jefferson Center for New Democratic Processes** asked me to work with their citizens jury on the economy and the federal debt. To understand what is going on with budget deficits, taxes and debt, I believe that you must start with an understanding of what the economy is all about.



Rep. Steve Gottwalt

The circular flow helps you see the connections. Taxes levied on households affect businesses because it reduces their income and vice versa. Spending by government might divert resources away from goods and services households want to buy; on the other hand, if there are unemployed resources, government spending might put those resources to work and increase the flow of income. Once you have this framework, you can then ask questions about the size of government, the appropriate level of taxation, and the consequences of a growing national debt.

The second incident was the recent debate over a tax bill in the state House. According to the StarTribune, Rep. **Steve Gottwalt, R-St. Cloud, accused** the DFL of waging "class warfare on the House floor."

"These are job creators; these are our Main Street businesses who are sick and tired ... of the Democrat mantra of how they are somehow the evil wealthy, that they're somehow taking advantage of Minnesota," he said. "They create the jobs that put the food on the table, that create the resources for all the do-gooding you want to do." (Rep. Gottwalt's speech is available [here](#).)

This is a different view of what an economy is than the circular flow. Business *is* the economy in this world; as Rep. Gottwalt later said, business is "the goose that lays our golden eggs." The role of households, non-profits, government and everyone else in the economy is to feed this goose and hope that it keeps blessing us with its bounty.

This perspective misses the fact that the resources and income in an economy are not created by business alone, households alone, government or by any single group in society. It's all about the interaction of these groups and their interdependence on one another. We need a healthy business sector to generate jobs; businesses need robust households to purchase the goods and services they produce. Businesses and households rely on the labor of women and men who choose not to work in

the market but to produce things of value in our homes, in our churches and in our volunteer organizations. Citizens come together through the democratic process to do things that they can't do through markets.

That's what an economy is: it's all of us working together.

**ABOUT THE AUTHOR:**



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Louis Johnston writes Macro, Micro, Minnesota for MinnPost, reporting on economic developments in the news and what those developments mean to Minnesota. He is Joseph P. Farry professor in the Eugene J. McCarthy Center for Public Policy and Civic Engagement at Saint John's University. He is also a professor of economics at the university.

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