A Value Creation Theory Of The Economy

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Abstract

The purpose of this economic study, using the grounded theory research design and an extensive review of, and incorporation of, other economic and financial models and theories, is to explore how free-market based, capitalistic economies operate through business enterprises to create economic prosperity. The current study follows from the author's previous research in creating a theory in the field of finance that explored the drivers that create value in enterprises. The basic premise of the current study is that it is the creation of enterprise value by businesses that creates value in the economy, which leads to economic prosperity for all economic actors and participants. The discounted cash flow analysis (DCF) approach was used in the previous exploration of enterprise value creation and is being developed as a part of this new economic theory. The following is the primary research question for the current economic study: What is the link between value creation for enterprise shareholders and the value creation in the economy, both of which lead to economic prosperity? The grounded theory design for developing theories and an extensive review of, and incorporation of, other economic and financial models and theories is used to conduct the current economic study. The problem is that it is not widely understood the role that businesses and private enterprise play in fostering economic prosperity by creating value for their shareholders and how businesses act as the primary driver of economic activity in their pursuit of enterprise value creation. Accordingly, the purpose of the current economic study is to explore how free-market based, capitalistic economies operate through business enterprises to create economic prosperity. A universal theory of the economy is also explored and proposed.

Introduction

This is a profit-making organization - that's the way it was intended, and that's the way it is ~ A sign in a stock brokerage office, circa 1972

The sign in the stock brokerage office (circa 1972) typified the prevailing attitude of the time - that business was good; those businesses were supposed to make a profit; that the entrepreneurs that took the risks to start and run business enterprises were supposed to benefit from their risk-taking activities; and that the actions of these entrepreneurs and the businesses they created led to economic prosperity for everyone. These favorable attitudes toward entrepreneurs and businesses have shifted over time. Today, much of the prevailing attitudes toward businesses and entrepreneurs have become considerably less favorable. Mackey (2019) notes that socialism is often favored over capitalism and trust in corporate leaders has been in a decline. Mackey (2014) further notes that: "Despite enabling widespread prosperity, free-enterprise capitalism has earned little respect from intellectuals and almost no affection from the masses" (p.15).

The purpose of this economic study, using the grounded theory research design and review of, and incorporation of, other economic and financial models and theories, is to explore how free-market based, capitalistic economies operate through business enterprises to create economic prosperity. The current study follows from the author's previous research in creating a theory in the field of finance known as value driver theory (Wendee 2011; Wendee, Sussan et al. 2018). Appendix 1 has a graph showing the key relationships that are part of value driver theory. The basic premise of the current study is that it is the creation of enterprise value by businesses that create value in the economy, which in turn leads to economic prosperity for all economic actors and participants. The discounted cash flow analysis (DCF) approach is used in value driver theory and is being developed as a part of a new economic theory to be known formally as, a value creation theory of the economy (also informally known as, Intrinsinomics). The economic study will sometimes be referred to as the "economic study" or "Intrinsinomics" in this paper.

Overall, this study attempts to achieve three objectives: (1) put forth and describe a new theory of the economy known as, a value creation theory of the economy; (2) formally establish the idea of a "universal theory of economics"; and (3) argue for the use of universally sound and more mainstream economic policies based on the idea of a universal theory of economics which seeks to avoid "fringe" elements of economic theory in establishing public policy. These latter two notions will be explored further in later sections of the paper.

Background

The U.S. political and economic climate is moving strongly against the long-held belief that private enterprise is at the center of economic value creation and economic prosperity. While this is not a new trend, it has advanced considerably under the Biden Administration and the current Congress which is controlled by the Democrats. While a complete discussion of the current political and economic environment is beyond the scope of this paper, the discussion that follows highlights and reviews some of the major policy and philosophical shifts taking place in the current environment that are relevant to the development of, and need for, this new theory (model) of the economy. The discussion that follows is conducted using excerpts in four major categories from recent news releases and opinion pieces, mostly gathered from the Wall Street Journal. A final section has excerpts highlighting the successes and favorable views of capitalism.

Big Government. The Biden Administration, with the support of most of the Democrats in Congress, has shown increasing support for greater government involvement in the political and economic arenas of the United States. The following excerpts highlight a few of these trends.

President Biden has embarked on an ambitious plan to have government play a bigger role in economic development. As Lucey and Siddiqui (2021) note: "...the Democratic president's proposals represent an ambitious effort to redefine the government's role in shaping the economy. Betting that government can be a driving force for growth, the White House is shifting away from long-held assumptions within both parties that the public sector is inherently less efficient than the private and that policy makers should generally defer to markets."

Schlesinger and Restuccia (2021) agree, noting that: “It all marks a major turning point for economic policy. The gamble underlying the agenda is a belief that government can be a primary driver for growth. It’s an attempt to recalibrate assumptions that have shaped economic policy of both parties since the 1980s: that the public sector is inherently less efficient than the private, and bureaucrats should generally defer to markets.”

Stephen Moore, a former Trump economic adviser, observes that: “Critics of big-government projects have long argued that bureaucrats are less skilled than market forces in allocating resources. ‘What they’re trying to do is re-establish government as a major positive force in the economy, and I believe government is a massive negative force’ in it. There really is a micromanagement of the economy from the left” (Schlesinger and Restuccia, 2021).

While many of the items on Biden’s agenda are now being debated and negotiated in Congress, and even within his own party, the following are the core themes that Biden started out with at the beginning of his term earlier this year (Schlesinger, 2021):

> —Expand the reach of the government social safety net well beyond retirement security, healthcare and income support, pushing more deeply into attempting to offer a federal guarantee for child-care, preschool, and college.
>
> —Extend the federal role in building infrastructure and redefine what it means beyond the traditional understanding of roads and bridges to high-speed internet service and caregiving, freeing up workers who would otherwise have to stay home to tend to children, or elderly parents.

—Give Washington a new role in developing critical industries from semiconductors to electric cars, to compete with foreign rivals such as China, and to attack climate emissions.

__extend the power and remit of regulation to advance a long list of goals, from curbing emissions to giving workers more bargaining power.

Schlesinger (2021) notes:

> The vision that Mr. Biden is explicitly rejecting is the one laid out by Mr. [Ronald] Reagan in the 1980s, and has in some form defined economic policy-making for the following four decades under presidents of both parties. Under that vision, lower taxes combined with deregulation was generally the best formula for faster growth and broadly shared prosperity. While presidents did expand Washington's reach in some key areas during this period, the prevailing view was that reducing the government burden on businesses and investors would also benefit the working class.
>
> Mr. Biden and his aides argue that more direct government support is a better way to support most Americans…

According to Schlesinger (2021): "A driving principle behind the Biden $6-trillion plan is that 'we have to rebuild trust in government to solve big problems,' says Bharat Ramamurti, the deputy director of the White House National Economic Council. Or as Cecilia Rouse, head of the Council of Economic Advisers puts it: 'government shouldn't be a dirty word.' "

It is not just the Biden Administration and Democratic legislators that are supporting the notion of increased government involvement in the affairs of Americans. According to Schlesinger and Restuccia (2021) in citing a Gallup poll, public support for big government has been growing. Over the past three decades, more Americans said that government was doing too much. In 2020, a majority of Americans said that government should do more to solve problems.

Socialist and Leftist Orientation. There is a trend toward more left-leaning and socialist beliefs and policies, as indicated by the following examples.

Noting how the general population views business and capitalism, according to a Harris Poll in 2012, eighty-six percent of Americans believed big companies had too much influence on government. This number was up from eighty-three percent in 2004. Furthermore, in a 2018 Gallup Poll, it was revealed that only forty-five percent of Millennials had a positive view of capitalism, while fifty-one percent of Millennials had a positive view of socialism (Mackey, 2019).

Observing how the current political environment is shifting more to the left and toward a more socialist orientation, Restuccia and Schlesinger (2021) note that "… [President] Biden and his aides have often compared the ambition of his economic program to the transformative agendas of Franklin D. Roosevelt's 1930s New Deal and Lyndon B. Johnson's 1960s Great Society."

In another sign of the trend toward a more socialistic society, there is a definite desire in the Biden Administration and the Democratic controlled Congress to redistribute wealth. As noted in Rubin (2021): "Beyond expanding the size and scope of government, Mr. Biden's program aims to redistribute trillions of dollars of resources from the highest-earning households and businesses to everyone making less than $400,000 a year. Using the income-tax system to help redistribute wealth is one part of the plan. The changes, when combined with the expanded child tax credit available to households with no income, make the income-tax system much more of a tool for redistribution, said Lawrence Zelenak, a law professor at Duke University. 'It's using the income tax to take money from only half the population and using it to distribute money to half the population', he said."

"The president also called for Congress to back a slew of Democratic priorities, including raising the federal minimum wage to $15 an hour, closing the gender pay gap and strengthening worker bargaining rights. He called for expanding access to healthcare and reducing prescription drug prices" (Lucey and Siddqui, 2021).

In contrast, according to Schlesinger (2021): "Republicans warn that the higher taxes and spending risk undermining the fundamentals of the economy that was booming before the pandemic hit, and the nascent recovery now under way."

Regulation. Increased regulation has been a hallmark of the Biden Administration and Democratically controlled Congress. This is not unusual as the political winds shift to the Left from the Right at various times. The following are a few examples.

As noted by Restuccia and Schlesinger (2021):

> President Biden's sweeping order Friday seeking to spur competition and curb the power of big business highlights his willingness to use the presidential pen to rewrite economic policy, sidestepping a divided Congress unlikely to enact his most ambitious proposals.
>
> The Friday action was unusually broad, even by recent standards, in directing at one time more than a dozen agencies to explore 72 actions touching an array of issues, including expanding labor rights, lowering prescription drug prices, restricting airline fees, and giving bank customers more flexibility to change accounts…
>
> Democrats have made competition policy and antitrust enforcement a key part of their agenda, arguing that the federal government hasn't done enough to preserve healthy, competitive markets. Republicans have agreed in some circumstances, particularly in the

> tech sector, but they say the Biden administration's moves risk making the U.S. economy less productive. Democrats have narrow majorities in Congress, meaning most bills require the approval of Republicans to pass.

"The president's budget and regulatory proposals could disrupt major industries, boosting renewable-energy companies over fossil-fuel firms and expanding markets for emerging technologies. Business groups and Republicans warn that new regulations could stifle growth" (Schlesinger and Restuccia).

Taxes on the Rich and Business. The massive social programs that have been proposed require funding. Taxing the wealthy and business is a favored source for funding these types of programs. The following excerpts provide some examples.

According to Collins (2021): "To fund the programs, Democrats say they plan to raise taxes on corporations, investors and high-income business owners, with the size of the tax increases potentially being scaled back if the spending plans are narrowed. The details remain in flux. Mr. [Bernie] Sanders and Democrats have said they expect new revenue to cover the full price of the package."

"Democratic leaders have proposed paying for well over a trillion dollars in expanded government services, in part, by higher taxes. Top Democrats acknowledge that would have been considered too liberal a few years ago but say that it now has broad party support. At least one Democrat in the Senate has voiced opposition to the idea" (Collins and Parti, 2021).

According to Francis and Rubin (2021):

> Business trade associations, including the U.S. Chamber of Commerce and the Business Roundtable, have blasted the proposal for raising taxes generally, and some executives have warned that it will crimp business investment and jobs.

> 'If you pay out more in taxes, you're going to pay out less elsewhere, whether that's investment in jobs, wages or R&D facilities,' Brian Swartz, chief financial officer of Genesys Telecommunications Laboratories Inc., a closely held Daly City, Calif., company, said Monday.

Capitalism. Despite the criticisms of capitalism and a general move to the political left, capitalism has its supporters. Three of these supporters, and excerpts from them follow. John Mackey (2014) writes:

> In the long arc of history, no human creation has had a greater positive impact on more people more rapidly than free-enterprise capitalism. It is unquestionably the greatest system for innovation and social cooperation that has ever existed. The system has afforded billions of us the opportunity to join in the great enterprise of earning our sustenance and finding meaning by creating value for each other…much of the Western world has benefited from the fruits of free-enterprise capitalism for about two centuries now. The success of free-enterprise capitalism in improving the quality of our lives in countless ways is the most extraordinary but poorly understood story of the past two hundred years. It has enabled human kind to progress at a rate unprecedented in all of history. (p.11)

Authors Note: Mackey (2014) details many of the accomplishments of capitalism in the sections of his book following the above passage, and throughout his book.

Another ardent supporter of capitalism is The Heritage Foundation. The Heritage Foundation has, for twenty-seven years, measured the impact of liberty and free-markets on a global basis through its Index of Economic Freedom. The Index of Economic Freedom has shown a formidable positive relationship between economic freedom and progress over its twenty-seven years of tracking ("Index of Economic Freedom." 2021).

Lastly, as noted by Skousen (2016): “Adam Smith advocated maximum economic freedom, in the microeconomic behavior of individuals and the firm, and minimal macroeconomic intervention by the state. The countries that have come closest to adopting Smith’s vision of laissez-faire capitalism have achieved the highest standards of living” (pp. 7-8).

Problem Statement, Purpose Statement, and Research Question

Problem Statement. The problem is that it is not widely understood the role that businesses and private enterprise play in fostering economic prosperity by creating value for their shareholders and how businesses and private enterprise act as the primary driver of economic activity in their pursuit of enterprise value creation. As has been discussed, a general movement away from capitalism, with a more favorable view toward socialism, suggests the importance of reexaming the role that private enterprise plays in creating economic value and prosperity. This paper is a rethinking of the role that private enterprise plays in the economic landscape.

Purpose Statement. The purpose of the economic study was to explore how free-market based, capitalistic economies operate through business enterprises to create economic prosperity. This purpose was accomplished by utilizing the grounded theory research design and a review of, and incorporation of, other economic and financial models and theories. An “umbrella model (theory)” (Idzorek, T. M., et al., 2021) was created which combines elements discovered in the grounded theory process and the review of economic and financial models to explore and explain how free-market based, capitalistic economies operate through business enterprises to create economic prosperity.

This paper provides a comprehensive view and shows a clear path of how value creation starts with the entrepreneur; then moves to the firm through value drivers and management tools; then transitions to the broader economy to create economic prosperity. There are no new steps to value creation that are being established in this paper. The uniqueness of this theory is in connecting and highlighting the steps that have long been present in the creation of economic value and prosperity and explicitly discussing what has not been extensively explored or discussed in previous studies of which the author is aware. In essence, it is a theory that describes how the two concepts of: (1) firms creating value for their shareholders; and (2) firms creating economic prosperity, are connected in a well-functioning economy.

Research Question. The central phenomenon for this study was the role of business and private enterprise as a primary driver of economic activity which leads to economic prosperity. The primary research question for the study was: What is the link between value creation for enterprise shareholders and the value creation in the economy, which leads to economic prosperity?

From the research question, and using the research generated by the literature review and review of, and incorporation of, other economic and financial models and theories, the value creation theory of the economy was developed. The value creation theory of the economy has been presented as a working paper concept at the International Leadership Society's (ILA) global conferences in 2019, 2020, and 2021.

This study's results help fill the void in the existing literature on economics regarding the creation of economic value and prosperity, and the role that private enterprise plays in the creation of economic value and prosperity. This theory is particularly important now that economies around the world are having to consider how to recover from the pandemic. It is also important to reexamine the role that private enterprise plays in economic value creation and prosperity, as there has been a shift in the United States toward a more socialistic orientation to organizing the economy.

Significance of the Study

The focus of this study is on the firm and its role in creating economic value and prosperity. It is an explanation and exploration of how businesses create value and prosperity in the economy by creating value for their shareholders, all of whom are members of the Household Sector, as shown in Appendix 2.

The significance and importance of this study is the positioning of the new theory (model) of economic value creation and economic prosperity in the contexts of history, theory, and practice in the fields of economics and finance. The development of the value creation theory of the economy was a process of discovery.

The value creation theory of the economy is built upon value driver theory (formally known as, a theory of value drivers). The value creation theory of the economy is an extension of value driver theory. It is the next stage in the evolution from the theory of investment value (Williams, 1938) to the theory of value drivers (Wendee, 2011) to the value creation theory of the economy (Wendee, 2021), as shown in Figure 1.

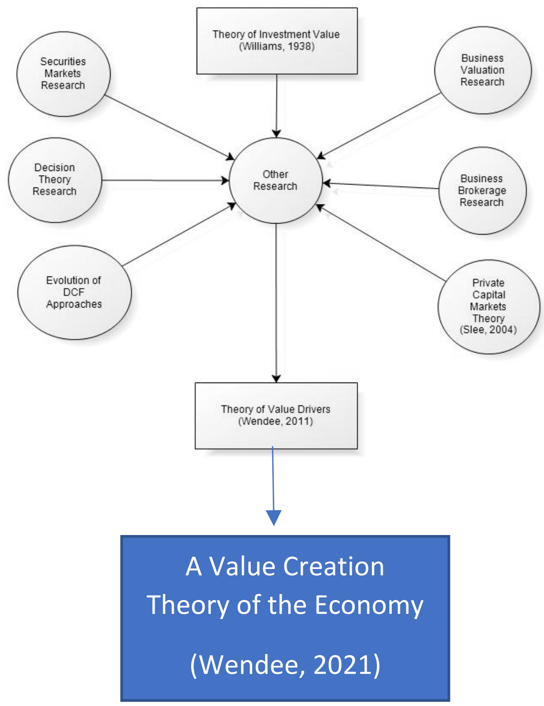

Figure 1. *Evolution from the theory of investment value to the theory of value drivers to a value creation theory of the economy.* Adapted from Wendee, 2011.

Mackey (2019) states that there are problems and that business is good at solving problems. However, as has been discussed, there has been a shift in thinking toward a less favorable view about business and private enterprise. This paper seeks to reassert the importance of business and private enterprise in the formation of economic value and economic prosperity.

This paper is for policy makers, business owners, the general public, and others as a means to help them better understand the functioning of the economy, particularly as it pertains to the role that private enterprise plays in creating economic value and economic prosperity.

Literature Review and Methodology

The development of the value creation theory of the economy was a process of discovery. The literature review revealed no research linking the value creation in firms with the value creation in the economy. The research for the current study commenced in the Spring of 2019 and was accomplished by utilizing the grounded theory research design and an extensive review of, and incorporation of, other economic and financial models and theories. Several hundred references were reviewed for this study, including over three hundred references used in the development of value driver theory.

The grounded theory approach for developing theories was used in conducting the economic study. Grounded theory is a useful method for generating a theory from data and was used to develop the value creation theory of the economy. The coded results of the literature review and the extensive review of, and incorporation of, other economic and financial models and theories comprised the data used to generate the theory.

In conducting the study for the development of value driver theory, it was learned that sometimes it is necessary or desirable to use the literature earlier in the grounded theory research study than is normally thought to be desirable. In such cases, Glaser (1998) suggested the following:

> In order to prevent the preconceiving, grabbing effects of the literature search the researcher should turn his review into data collection to be constantly compared as the review is done. The attitude is data collection, not reverence for the authenticity and authority of the printed word and the published author. After all, that is all the literature is, just more data. (p. 72)

This was affirmed in a personal conversation that the author of this study had with Glaser in 2011, while attending Glaser's annual grounded theory training (Glaser, 2011).

It became apparent in conducting the literature review for the current study that a theory was emerging from the data in the literature itself. Once this became apparent, the focus of the paper shifted from simply providing a listing of various literature sources to incorporating the literature into the study as part of the various elements of conducing grounded theory research.

Additionally, an extensive review of, and incorporation of, other economic and financial models and theories from many sources were used to develop the current theory. Besides developing the value creation theory of the economy, Proposition 19 (discussed below), proposes a universal theory of the economy.

As the study involved the use of the grounded theory approach to generate a theory, reviewing the general perspective on the characteristics and formulation of theories is important. Theories are products of the minds of theorists. Dubin (1978) stated, "The locus of theory is the human mind" (p. 5). Dubin described a theorist as "someone who observes a portion of the world around him and seeks to find order in the booming, bustling confusion that is the realm of experience" (p. 5). A. Kaplan (1998) stated,

> A theory is a symbolic construction . . . theories are a human creation even though if sound they must somehow answer to what is in God's world. At any rate, that theories are symbolic means that they do not share the ineluctability of fact. (p. 296)

According to Dubin (1978), "Theories of social and human behavior address themselves to two distinct goals of science: (1) prediction and (2) understanding" (p. 18). Whetten (1989) made the important observation that "most organizational scholars are not going to generate a new theory from scratch. Instead, they generally work on improving what already exists" (p. 492).

Whetten (1989) suggested theorists should recognize that "over time their ideas will be refined" (p. 490). Whetten noted, "By definition, all the relationships in the [theoretical] model have not been tested. If all links have been empirically verified, the model is ready for the classroom and is of little value in the laboratory" (p. 491).

Dubin (1978) attempted to explain what causes one theory to be accepted while another is rejected. Dubin provided one possible answer in saying, “Broadly speaking, the preference for one theoretical model over another is a matter of consensus” (p. 13). Dubin stated, “What is meant by consensus is that a group of people sharing an interest in some set of observations come to agree that one theoretical model best provides understanding or permits accurate predictions about the observational set” (p. 13). Dubin asked and answered the important question, “But can the consensus be wrong? The answer is ‘yes’” (p. 13).

Limitations and Delimitations

A problem with the understanding of economics is that it is not an exact science like the physical sciences. As noted by Hannon and Harrison (2021): “Economics and other social sciences have limited opportunities for carrying out the randomized experiments that allow researchers in the physical sciences to test causal relationships, for both practical and ethical reasons.” Angrist, one of the economists receiving the 2021 Nobel Economics Prize for their work on natural experiments, states: “Earlier economists had relied on models and equations and studied how accurate the models were in describing the world” (Angrist, as cited in Hannon and Harrison, 2021). The study in this paper is based on a grounded theory approach and a review of the literature to propose a revised model of how the economy works that reemphasizes the critical role that business and private enterprise play in the creation of economic value and economic prosperity.

According to Jeremy Rudd, a staff economist with the Federal Reserve: “Mainstream economics is replete with ideas that ‘everyone knows’ to be true, but that are actually arrant nonsense.” Rudd further accuses economists of “…routinely making assumptions because they suit their models and theories, not because they fit the facts” (Rudd, as quoted in Ip, 2021).

David Card, one of the 2021 recipients of the Nobel Economics Prize, and Alan Krueger, who co-authored a 2016 paper with Card on fast-food workers and the minimum wage, noted that "… at the time empirical analysis appeared in less than 40% of economics papers and usually to 'confirm the basic prediction of a theory' rather than 'test…the underlying economic model. They added: Economics cannot claim to be a scientific field if its main theories are not subject to empirical testing and possible rejection" (Card, as quoted in Ip, 2021).

Wall Street Journal economics columnist, Greg Ip, writes: "Ultimately, evidence and theory matter less to good decisions than being open minded enough to know when either leads you astray" (Ip, 2021).

Results

The purpose of this paper is to provide direct and indirect linkages between the value that is created for shareholders of a firm and the value that is created in the economy, which in turn leads to economic prosperity. The direct benefits include benefits to labor and benefits to shareholders, which includes labor, because households and labor are themselves shareholders.

The indirect linkages are described by the value creation process in the firm as a detailed component process that happens in firms that are themselves creating value in the economy. The study provides a comprehensive view of how value creation starts with the entrepreneur; then goes to the firm through value drivers and management tools; then translates over to the economy. It shows a clear path in the value creation process that starts with the firm and accretes to the economy.

This study is not creating a new process of value creation in the economy. This study is simply "connecting the dots", as it were. There are no new steps being described. The uniqueness of this theory is in realizing the relationships that have existed and explicitly discussing what has not been extensively explored or discussed prior to this study. In essence, it is a theory that describes how the two concepts of: (1) firms creating value for their shareholders; and (2) firms creating economic prosperity, are connected in a well-functioning economy.

This paper consolidates the material from the literature reviewed and the results of the research conducted through the grounded theory study and a review of, and incorporation of, other economic and financial models and theories. The data were consolidated into the value creation theory of the economy. Similar to the work done by Williams (1938) in creating the theory of investment value, the value creation theory of the economy should be considered both a finance theory and an economics theory. All of this has been a process of discovery. Glaser and Strauss (1967) placed emphasis on "the discovery of theory from data systematically obtained from social research" (p. 2). The theory of value drivers was discovered and generated with the grounded theory method suggested by Glaser and Strauss.

Once it became apparent that a theory was emerging from the literature review (Glaser, 1998; Glaser & Strauss, 1967), the decision was made to pursue a grounded theory approach in developing the value creation theory of the economy. From this point forward, the discovery of the value creation theory of the economy began taking place. The present paper codified the results of the literature review and the review of economic and financial models that generated the value creation theory of the economy. Much later in the study, it was discovered that the value creation theory of the economy might be the next logical step in a progression of ideas on investment valuation and economic value creation that started with the generation of a theory linking present value concepts with investment value, codified by Williams (1938), and called the theory of investment value. Williams' theory codified how investment value is determined, and the theory of value drivers, discussed next, codifies how investment value is created. Once this discovery was made, it was decided to explicitly discuss that the new theory of the value creation theory of the economy is perhaps the next logical step in a natural progression of ideas on valuation. This relationship is illustrated in Figure 1.

Value Creation

There are two main parts to the value creation theory of the economy. The first part, which describes how firms create value for their shareholders, is described by value driver theory. The Value Creation Process Chart is a tool used to illustrate value driver theory. The chart and its description are in Appendix 1.

After the Value Creation Process Chart is discussed in this section, the following sections discuss the Intrinsinomics Model of the Circular Flow of the Economy, which graphically shows the link between the value created by the firm for its shareholders and the value that is created in the overall economy.

A theory of value drivers (Wendee, 2011), informally known as value driver theory, shows the sources of value creation, and the process by which that value is created. As stated in the study on value driver theory:

> By centering the business strategy analysis and formulation process on the theory of value drivers, business managers, strategists, and analysts should be able to make more intelligent and informed decisions regarding value creation in the enterprises they study and manage. Use of the theory of value drivers can provide insight into the range of value creation possibilities and foster dialogue and analysis within organizations by providing a systematic and organized approach to value creation and by providing 72 value drivers

> that can be used as a starting point for value driver analysis. The key is to understand which value drivers are affecting a particular organization. (Wendee, 2011, p.162)
>
> The theory of value drivers includes its own set of tools that emerged during the theory discovery process. First, the theory of value drivers is itself a tool for the analysis of the value drivers that affect a business, and it is a long-range planning and strategy tool for developing ways to create value for an enterprise. Second, it has been shown how all value drivers affect value through the discounted cash flow (DCF) model and how an alternative methodology for evaluating primary and secondary value drivers using the net present value model can be used. Third, the theory of value drivers has provided 72 value drivers, ranked in order of importance, for use by business managers and analysts in understanding which value drivers may hold the greatest promise for increasing value for an enterprise. Fourth, luck has been shown to be a value driver that does not have to be accepted as an inevitable part of business life. Luck, to some extent, can be quantified and controlled. (Wendee, 2011, p. 164)

The theory of value drivers study can be accessed through ProQuest or The Intrinsic Value Wealth Report.

Propositions of The Value Creation Theory of the Economy

This section includes a discussion of the elements of a value creation theory of the economy. These elements follow from the research conducted in a study of the elements of a value creation theory of the economy. The elements are presented and discussed as a series of propositions. Appendix 2 graphically depicts the relationships and properties of the value creation theory of the economy. The discussion of the propositions refers to Appendix 2 as appropriate. Appendix 2 was developed from the value creation theory of the economy.

Proposition 1 − Free markets are usually the best at organizing economic activities. In the long-run, free markets are usually the best way to organize economic activity. For a discussion of this point, see (Mankiw 2018a, Mankiw 2018b).

Proposition 2 − Circular flow model of the economy. The circular flow model of the economy as illustrated in Appendix 2 is a useful, general model for analyzing how an economy works. The circular flow model of the economy is widely accepted by economists and is often used in university courses to teach economics.

Proposition 3 − Firms are at the center of value creation in the economy. Upon examination of the circular flow model in Appendix 2, it becomes apparent that firms, along with households, are at the center of value creation in an economy.

Proposition 4 − Factors of production. There are four generally recognized factors of production in an economy. (1) land; (2) labor; (3) capital; and (4) entrepreneurship.

Proposition 5 − Entrepreneurship. The entrepreneur is a main driver of the engine of economic growth. According to the St. Louis Federal Reserve (2019):

An entrepreneur is a person who combines the other factors of production - land, labor, and capital - to earn a profit. The most successful entrepreneurs are innovators who find new ways to produce goods and services or who develop new goods and services to bring to market. Without the entrepreneur combining land, labor, and capital in new ways, many of the innovations we see around us would not exist. Think of the entrepreneurship of Henry Ford or Bill Gates. Entrepreneurs are a vital engine of economic growth helping to build some of the largest firms in the world as well as some of the small businesses in your neighborhood. Entrepreneurs thrive in economies where they have the freedom to start businesses and buy resources freely. The payment to entrepreneurship is profit.

Proposition 6 – Labor is a factor of production, not a driver of economic growth. As a factor of production, labor is a necessary and vital component of economic growth. But it is not a driver of economic growth. The value of labor derives from its marginal product. The marginal product of labor can be defined as the "increase in the amount of output from an additional unit of labor" (Mankiw, 2018b, p. 364). Furthermore, to account for the difference in wages in a competitive market for labor, a worker that produces a product that is of greater market value than another, will get higher wages (for example, a doctor versus a janitor). The wages reflect the market prices of the goods and services that these workers produce. Wages are at least partly determined based on the worker's ability.

Proposition 7 – Firms create value for their shareholders through the discounted cash flow (DCF) model. Using value drivers (Wendee, 2011), firms create value for their shareholders. According to Wendee:

Value drivers exert their influence on the value of an enterprise by operating, directly or indirectly, through the discounted cash flow model (DCF model) (for a discussion of the DCF model, see Brigham & Ehrhardt, 2011; Damodaran, 2002, 2006; Rappaport, 1998). The DCF model derives the value of an enterprise's operations, and with some modifications, derives the total value of the enterprise (Brigham & Ehrhardt, 2011).

Proposition 8 – Value in the economy is a function of firm value. The value that is created in the economy is a function of the value that is created by every firm in the economy.

Proposition 9 – Economic value creation is exponential. The value that is created by firms in the economy is an exponential function. It is not simply additive. This is due to the benefits of comparative advantage and other synergies that take place in an economy. The benefits of comparative advantage occur when firms or individuals produce a good at a lower opportunity cost than another producer. According to Mankiw (2018b): “When each person specializes in producing the good for which he or she has a comparative advantage, total production in the economy rises” (p. 53).

There is also the Multiplier Effect. The multiplier effect “…applies to any event that alters spending on any component of GDP - consumption, investment, government purchases, or net exports” (Mankiw, 2018a, p.452).

“The multiplier effect is an important concept in macroeconomics because it shows how the economy can amplify the impact of changes in spending. A small initial change in consumption, investment, government purchases, or net exports can end up having a large effect on aggregate demand, and therefore, the economy’s production of goods and services” (Mankiw, 2018a, p. 453).

Proposition 10 – Standard of living depends on a country’s ability to produce. Production is vitally important to an economy’s ability to foster economic prosperity. According to Mankiw (2018a): “A country’s standard of living depends on its ability to produce goods and services” (p.13).

According to Mankiw(2021a): “Almost all variations in living standards is attributable to differences in countries’ productivity – that is, the amount of goods and services produced by each unit of labor input. In nations where workers can produce a large quantity of goods and services per hour, most people enjoy a high standard of living; in nations where workers are less productive, most people endure a more meager existence. Similarly, the growth rate of a nation’s productivity determines the growth rate of its average income” (p. 11).

Proposition 11 – Three levels of economic value creation. As shown in Appendix 2, the value creation that takes place in this theory occurs at three levels:

Level 1 – Firms create value as discussed in Proposition 7.

Level 2 – As discussed above in Propositions 8 and 9, all of the firms in an economy create value for the economy as they create value for themselves. Furthermore, the value that is created in the economy is exponential – not just additive. This is also shown by the Multiplier Effect.

Level 3 – The economy creates value by acting as a business itself in the global economy as described next in Proposition 12.

The entrepreneur starts the entire value creation process beginning at the firm level.

Proposition 12 - The economy creates value by acting as a business itself in the global economy. In an open, global economy, where economies have free interaction with each other, each economy in effect acts as a business in its trading of goods and services with other economies. This is shown in Appendix 2.

Proposition 13 – Scarcity. Scarcity is an economic principle that affects all economies.

Proposition 14 – The role of government. The value creation theory of the economy discussed in this paper suggests that government should have a limited role in the economy and society at large. Some economists believe that the only proper role of government is to: (1) protect property rights; (2) adjudicate disputes; and (3) provide a legal framework in which voluntary trade is protected. See for example Government's Role in the Economy (2008).

Proposition 15 – Government and other market disrupters create deadweight losses. In general, deadweight losses are created by government, taxes, labor unions, and other factors that result from market distortions. Deadweight losses occur when total surplus in the economy falls as a result of market distortions such as those caused by government, taxes, and labor unions.

As an example, Mankiw (2008b, p. 157) states: “When the government imposes a tax, it raises the price buyers pay and lowers the price sellers receive, giving buyers an incentive to consume less and sellers an incentive to produce less. As buyers and sellers respond to these incentives, the size of the market shrinks below its optimum. Thus, because taxes distort incentives, they cause markets to allocate resources inefficiently.”

There is also the crowding-out effect. As stated by Mankiw (2021a): “The multiplier effect seems to suggest that when the government buys $20 billion of planes from Boeing, the resulting expansion in aggregate demand is necessarily larger than $20 billion. Yet another effect works in the opposite direction. While an increase in government purchase stimulates the aggregate demand for goods and services, it also causes the interest rate to rise, reducing investment spending and putting downward pressure on aggregate demand. The reduction in aggregate demand that results when a fiscal expansion raises the interest rate is called the crowding-out effect” (p. 453).

Proposition 16 − Hampering the ability of firms to create shareholder value, curtails economic growth. As this theory has shown, firms are at the heart of the economy. Firms, along with entrepreneurs, are the main driver of economic activity – starting economic activity and keeping it going. Hampering the ability of firms to create value for their shareholder curtails economic growth.

Proposition 17 − Benefits of firm value creation revert to the economy. As firms create value for their shareholders, many of the benefits that result from the process of that value creation revert to the economy in the form of wages, rents, and profits. Labor benefits from wages; landowners benefit from rent; and a large part of population in the United States owns the firms that are in the economy. Ownership of the firms can take place either directly through outright stock ownership of public companies or direct ownership of private businesses; or indirectly through ownership of retirement plans and other employee benefit plans that hold the stock of public and private businesses.

Proposition 18 - A New Theory of the Economy. A value creation theory of the economy is a new theory of economics in that it brings finance theories, namely (1) firm value creation through the DCF model; and (2) value driver theory, concretely into economics to show how firms and entrepreneurs create value in the economy by creating value for their shareholders.

Proposition 19 – A Universal Theory of Economics. A value creation theory of the economy can be considered a universal theory of economics. Skousen (2016) notes that there are several schools of thought in economics: neoclassical, Keynesian, monetarist, Austrian, supply side, institutionalist, Marxist (p. 5). There are at least a few other schools of thought, of which the author is aware, that currently exist, and more coming into existence on a fairly regular basis (e.g., New Keynesian Economics and Modern Monetary Theory). A value creation theory of the economy seeks to combine ideas from the different schools of thought into a universal theory of economics.

Although there is no formal economic theory known as universal theory of economics of which the author is aware, there are several economists and scholars that have described their own versions of a universal theory or approach to economics. One example comes from Skousen (2017): "…we make use of the best thinking from all schools of thought to build a universal model of the economy that is adaptable to cultural differences around the world" (p. 7). Alchian (2018) states that: "… universal "economic principles," … apply to any economic system. They reflect characteristics of individuals' preferences and productive abilities that are found everywhere" (p. 21).

The Organization for Economic Co-operation and Development (OECD) notes that over the last decade:

> New economic theories, evidence and techniques have been developed which offer richer ways of understanding how economies work, and how they can be made to work better. Analytical methods and models based on the new powers of data collection and computing, for example, have opened up insights not available to previous generations. Taken together, a 21st century economics has begun to come into view which looks more able to help policymakers find solutions to the 21st century economic problems they now confront.
>
> Since 2012 the OECD's New Approaches to Economic Challenges initiative has attempted to bring together much of this new thinking, and many parts of the OECD and member states have engaged strongly with it. (Ramos and Hynes, 2019)

In discussing the work of Adam Smith, Skousen (2016) notes that: "The work he [Adam Smith] began wasn't perfect by any means and required extensive remodeling from time to time. But its foundation is sound" (p. 6). If for no other reason than to make the free-market system work better, the attempt to combine theories into a universal theory is worthwhile.

The challenge is deciding which ideas from the various schools of thought to include in a universal theory. The ideas chosen will undoubtedly reflect the viewpoints and biases of the person doing the selecting. Nonetheless, it is useful to attempt to combine what one considers to be the "best" ideas into a unified theory. In the final analysis, there will probably be many different universal theories of economics. The benefit of these numerous attempts will be a better understanding of economics in general and a better understanding of how the various theories relate to each other in explaining how economics works.

Conclusion and Recommendations

The paper proposes a value creation theory of the economy, which is built upon a previous study known as the theory of value drivers. Both this study, and the previous theory on value drivers, are part of an evolution from the theory of investment value to the value creation theory of the economy, as shown in Figure 1. This paper is for study and use by policy makers, business owners, and the general public.

This study proposes a theory that places businesses and private enterprise at the center of economic value creation and economic prosperity. The process by which this happens is that firms strive to create value for their shareholders, and in so doing, create the economic activity that creates value in the economy, which in turn leads to economic prosperity.

A universal theory of the economy is also explored. This paper makes the first formal proposal, of which the author is aware, to establish a universal theory of the economy. While establishing only one universal theory of the economy may be quite difficult, if not impossible, the benefit of numerous attempts at establishing such a theory will be a better understanding of economics, in general, and a better understanding of how the various theories relate to each other in explaining how economics works. An idea that arose in considering the establishment of a universal theory of the economy is that moderation in economic policy-making may be a better approach than vacillating back and forth from one radical economic policy to another, as is often the case in today's modern political world.

As Mackey (2019) notes, there are significant problems in the economy and society at large, both here in the United States and on a global basis. Mackey suggests that business is good at solving problems and should be a leader in solving economic and societal problems. In their book, *Conscious Capitalism*, Mackey and Sisodia (2014) lay out a framework that harnesses the positive impact of business to drive positive societal and economic change.

Another movement which is attempting to create positive societal and economic change is one led by Poverty, Inc. (2021). Poverty, Inc. seeks to use the power of private enterprise and the market economy to effect change in poor nations by supporting free-market enterprises in those countries. While more research is needed to completely understand the background of Poverty, Inc. before giving a complete endorsement of this particular organization, this study embraces the idea of helping poor countries by helping them create sustainable free-market enterprise.

An idea embraced by many economists, and one that is strongly supported by the author of this study, is that free-market solutions should usually be considered and tried before government and non-free-market solutions are tried. As Mankiw (2021b) observes: “Instead of regulating behavior in response to an externality [the uncompensated impact of one person’s actions on the well-being of a bystander], the government can use market-based policies to align private incentives with social efficiency.” Mankiw gives this example: “Economists usually prefer corrective taxes to regulations as a way to deal with pollution because they can reduce pollution at a lower cost to society”.

In conclusion, as in Aesop’s Fables, the point of this study is to take care not to kill the goose that lays the golden egg. Business and private enterprise should be nurtured and supported – not scorned, maligned, and penalized, as it often is now. For it is business and private enterprise that lay the golden eggs for the economy.

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Appendix 1

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Appendix 2

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