

Our Aggregate Debt Seals the Fate of Economic Depression Starting 2008-2010

Four “Real Economy” Debt Axioms:

1. On average, one cannot consume more Goods and Services than one can produce in a lifetime, assuming inventory is not depleted.
2. On average, one cannot repay more debt for Goods and Services received than one can produce in a lifetime, assuming inventory is not depleted.
3. Interest payments and debt redemption defaults are included within the scope of the first two axioms.
4. Given the axioms above, on an ongoing real-time basis the aggregate real debt incurred cannot exceed output, otherwise an **incremental accumulation** of illusory debt in excess of output would develop over an extended period of time, which is impossible to repay, assuming again inventory is not depleted.

Is the U.S. Economy Strong?

Was the “economy strong” in 1929? Was the Real Wealth¹ (including capital goods, durables, consumables, delivered services, human capital, and etc.) greater than it was in 1900? In 1850? The common answer was a resounding YES! But...

The problem with our economy today as it was in 1929 is not the perceived “strength” in the commonly quoted metrics (GDP & GDP growth rate, low unemployment, total number of jobs and job growth, productivity improvement, asset valuations and their increases, etc.), but it is the OUT OF BALANCE conditions.

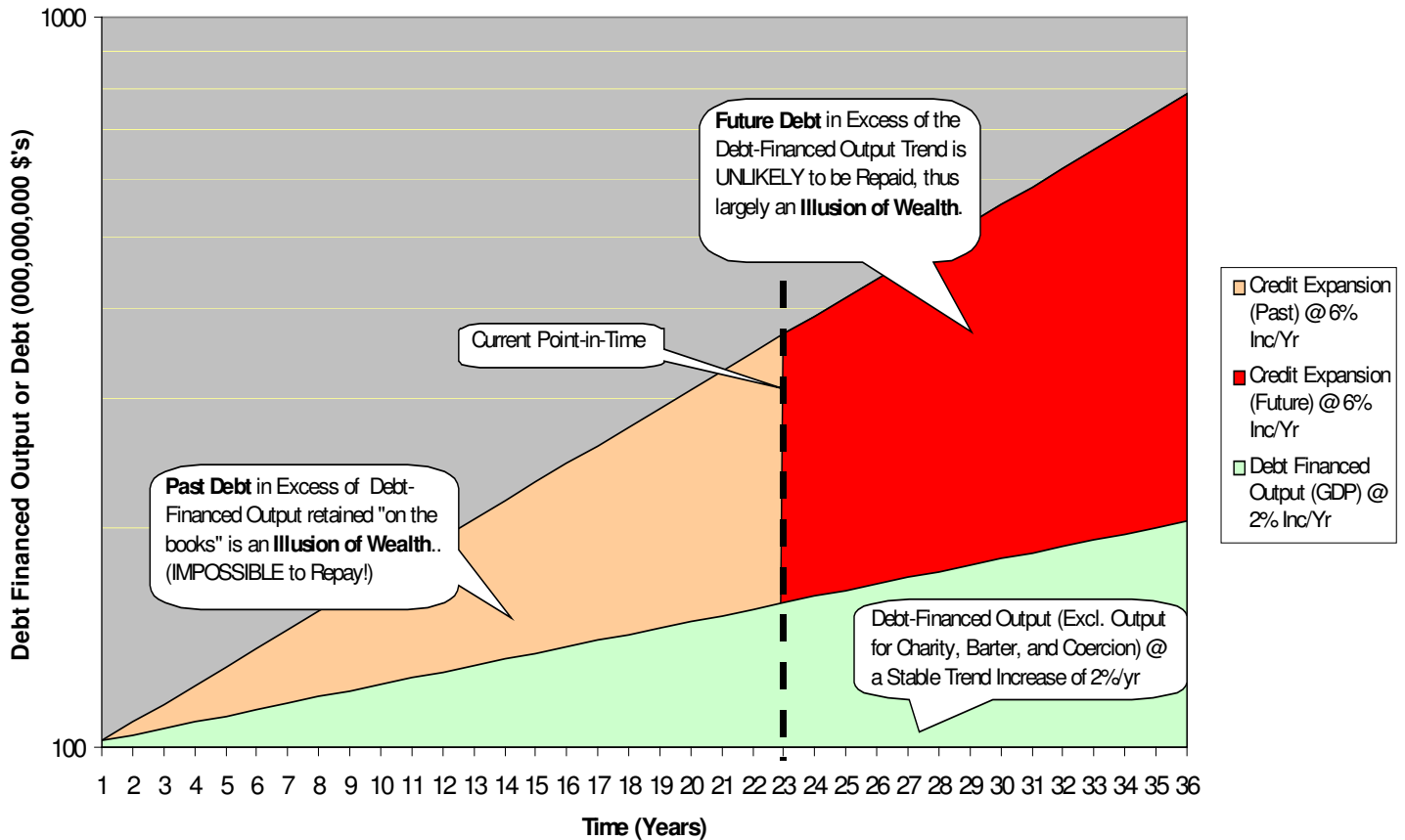
“Austrian Enginomics” focuses upon: a) Overvaluation of real estate, bonds, and stocks, and b) misallocation of resources. If easy money policies that enable worldwide floods of liquidity in the form of inflation and credit expansion are practiced long enough in a fiat currency world, then overvaluation of the noted assets and misallocation of resources will develop. The artificially suppressed interest rates and easy loan qualification conditions become systemically embedded into our financial infrastructure. The dynamic of the growth of any bubble feeds upon itself via speculation and the infamous Ponzi schemes where increase begets increase begets increase. This financial world mindset enables a total detachment from the real economy. I have calculated and concluded that today we have the greatest magnitude of overvaluation and resource misallocation than any time in the history of the Republic. This will portend a full-scale global depression when the noted bubbles are discovered. This discovery *must* happen when the Boomers around the world begin to retire in mass (2008-10) and attempt to cash in on their paper asset spoils at the same time they are exiting the work force. All the money Ben Bernanke can drop from helicopters attempting to paper over the illusion with yet another illusion will not stop this discovery. As an aside, I’m committed to share, via Austrian Enginomics, the reasons we got into this mess and offer logic to avoid these global-wide systemically enabled extraordinary bubble blowing occurrences in the future. Will my suggestions prevent recessions? Absolutely not! In fact they are a necessary, and albeit painful correction of imbalances caused by hopefully localized speculation rather than nation-wide or global systemic asset distortions resulting from central bank machinations.

This article will analyze DEBT. The four axioms at the beginning of the article focus upon one segment of the Austrian Enginomic analysis, which is the overvaluation of bonds (all debt securities). i.e. the magnitude of outstanding Total Credit Market Debt is far in excess of the capability of the U.S. economy to repay in real terms. Much of the TCMD in aggregate is either impossible or highly unlikely to ever be repaid.

Further Examination of Debt...

Axiom #4 implies we cannot accumulate more real debt in a specific time period than we produce in output such that axioms #1-3 are violated. Imagine the U.S. has an existing level of Total Credit Market Debt (TCMD) of say \$12 trillion, and then in the following year we produce and sell G&S priced at \$10 trillion. If during that year \$10 trillion of TCMD is repaid, but \$13 trillion of new TCMD is established, my assertion is that \$3 trillion of that newly established debt “on the books” is an illusion of wealth at the end of the year. Going forward in time each dollar of new GDP will be matched with a new dollar of debt, thus NEVER enabling the noted \$3 trillion to be repaid in aggregate. Further, let’s now recognize the always-present charity, coercion, and barter, and say they all amounted to \$3 trillion of the \$10 trillion output during the noted year. In that case the real debt maximum that could be incurred is \$7 trillion ($\$10 - \3) during that period. Under this model there would be \$6 trillion ($\$13 - \7) of illusory TCMD. Under no circumstance can the debt that will be repaid exceed output assuming inventory is not depleted.

Post and Projected Debt Illusions



The chart above offers a graphic conceptual view. We have two distinct issues related to debt. One is the extraordinary expectation of future growth to repay current debt obligations (the red area in the chart above). i.e. looking forward in time, if the debt “hill to climb” is unprecedented in steepness, it will likely not be repaid... Possible?... Yes! ...but very unlikely. *Note: We have not decoupled the financial economy from the real economy yet.* The second issue is related to the \$6 trillion magnitude of debt that will NEVER be repaid (a fraction of the beige area in the chart above). *Note: We have now decoupled the financial economy from the real economy.*

Who is to say we cannot roll the illusory debt forward and experience an unusual productivity boost, thus repaying the entire prior obligation? The answer is that *any* new output going forward will have an equal level of associated debt dollar for dollar (assuming output is not directed to charity, coercion, or barter), thus one will NEVER (in aggregate) be able to incrementally repay the prior illusory debt in excess of prior output. Yes, there may be a specific individual's extraordinary debt that is repaid, but the work for repayment of this "specific" debt that has rolled forward (part of the \$6 trillion) will displace redemption of other new debt incurred, which by default will then NEVER be repaid in aggregate. ***Debt incurred must stay in lockstep with output in real time day by day; otherwise any incremental debt expansion relative to output would invalidate the axioms.***

Our U.S. Federal debt of approx. \$8.4 trillion is one example of many that would fall into the beige area of the graph! See "Our Federal Debt is Pure Bubble"²
<http://www.austrianenginomics.com/id7.html#1> for the practical explanation.

If, for example, GDP dropped below the 2% trend increase noted in the graph, it would severely exacerbate the TCMD redemption effort. Let's say this drop could be caused from a deadly plague. At the point in time the debt repayment is reneged upon (a debtor dies from the plague), the debt obligation from the prior healthy period must be written off to honor the axioms. Similarly any debt that can no longer be redeemed on schedule due to temporary illness must be written down (to avoid the beige area in the chart) or re-financed and rolled forward (the red area in the chart; possible, but unlikely redemption in aggregate); otherwise the debt will exist as an illusion of wealth to some creditor. How sad.

CONCLUSION:

Once governments and central banks empower themselves and by extension the banks, brokerage firms, financial institutions, and etc., to blow financial bubbles, it becomes politically and practically irresistible to continue this horrific trend. Whether real or not, if the bubble-blower engineered perception is that one's financial assets (perceived wealth) are rapidly growing it engenders an extraordinary feeling of confidence. Debt in excess of output is only one of the many bubbles that exist today. The dynamic of the growth of any bubble feeds upon itself via speculation and the infamous Ponzi schemes where increase begets increase. This financial world mindset enables a total detachment from the real economy. Today we have the greatest magnitude of overvaluation and resource misallocation than any time in the history of the Republic and its ***getting worse by the month***. The Total Credit Market Debt increased \$786.6 billion³ in the 2nd qtr. 2006, while nominal GDP increased only \$188.9 Billion⁴. Today the U.S. existing TCMD is more than an astounding **\$43 trillion!!** This will portend a full-scale global depression when the noted bubbles are discovered as the Boomers around the world begin to retire in mass (2008-10) and attempt to cash in on their financial asset illusions at the same time they are exiting the work force. We are standing by and witnessing the most extraordinary decoupling of the "Real Economy" from the "Financial Economy" in the history of the Republic.

By Russell Randall 11-13-2006

References:

- 1 See the definition of "Real Wealth" here:
<http://austrianenginomics.com/RealvsFinancialDebtanUnsettlingIllusion.pdf>
- 2 "Our Federal Debt is Pure Bubble" by Russ Randall here:
<http://www.austrianenginomics.com/id7.html#1>
- 3 Federal Reserve Statistical Release; Z-1 Flow of Funds Sept 19, 2006
- 4 U.S. Dept of Commerce