

Paradigm Change “Building Blocks” ...to Convert from a “Financial Economy” to a “Real Economy” Mindset

Block#:

1. **Humans want Real Wealth;** Humans ultimately desire Real Wealth within an economic context, which is defined as Goods (Capital Stock, Consumables, and Durables), Delivered Services, Human Capital (Skill Sets), and Natural Resources. i.e. NOT fiat currency or “paper” (financial) assets.
Add'l Resources to understand the scope of "Real Wealth":
<http://austrianenginomics.com/RealvsFinancialDebtanUnsettlingIllusion.pdf>
2. **What Creates Real Wealth?;** Real Wealth can ONLY be produced by **Work** (and natural resources). Note: The inverse is not necessarily true (i.e. Work may not necessarily produce Real Wealth such as digging a hole and filling it back in).
3. **Real Wealth on Earth is Finite and Will NOT Increase unless Work is Performed;** That includes the makeup of all businesses in the world.
4. **All work activity can never be recovered;** Passage of time cannot be reversed (yet).
5. **What is Real Tax?;** All work activity (and natural resources) directed to a government purpose is precisely and quantitatively the **Real Tax** occurring every minute of every day. The noted work activity is a close correlation to Government Spending. Hence, **GOVERNMENT SPENDING IS THE REAL TAX....** In my view any government statement claiming otherwise is misleading and likely fraudulent. The debate then is: Who shoulders the burden of this “real” tax and when? Find out here:
<http://austrianenginomics.com/WhatisaTaxIncreaseB.pdf>
Add'l Resources: <http://austrianenginomics.com/CanGovernmentCutTaxesB.pdf> & <http://austrianenginomics.com/IftheGovernmentCollectedNoTaxWouldWebeTaxed.pdf>
6. **How is Real Wealth Measured?;** The critical measure to focus upon for tracking Real Wealth creation (Real GDP Output) is the Sale Price (willing seller and buyer). I DO NOT ADDRESS VALUE....! Value is subjective and satisfies many economic purposes related to motivation and behavior, but is separate from the Real Wealth concept that I am trying to convey (e.g. the white elephant party; aggregate value may increase after the party, but Real Wealth does not).
7. **“Follow the Labor”;** Therefore, let’s “Follow the Labor” rather than “Follow the Money”! Labor is the ultimate and irreversible manifestation of any earlier decisions by entrepreneurs or government. Fiat currency may be utilized to attract labor into productive or non-productive behavior, but fiat currency is not Real Wealth and does not create Real Wealth.
8. **Real Wealth Growth;** The rate of Real Wealth creation in aggregate can only **increase** as a result of productivity improvements (new products and process changes) assuming employment is neutral.
9. **What is the “Economic Engine”?;** The “economic engine” is a segment of total Real Wealth. It is all Capital Stock owned by businesses, which includes equipment,

facilities, supporting infrastructure, human capital, and inventory. The "economic engine" creates Real Wealth. The "economic engine" must be enhanced to enable productivity improvements.

10. Productivity Improvements; Productivity improvements worldwide in aggregate range within a "tortoise" speed of 1 to 2% historically (per capita).

Historic Data is limited and questionable for most underdeveloped countries. However the International Labor Organization (ILO) assembled "World" scope data for the 10-year period noted below. The extraordinary advances in China and India since 2003 would likely bring this "World" total up to a 1.2-1.3% range recognizing the blistering pace of Asian improvement already in the baseline within the decade noted.

Annual Labor Productivity Growth Rate; Source: International Labor Organization (ILO) ⁽²⁾

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|-------------|--|
| | <u>World</u> |
| • 1993-2003 | 1.0% |
| | Ranging from -0.2% in "Sub Saharan Africa" to an extraordinary 5.8% in "East Asia" |

Another view of productivity, which excludes China and India among others, but offers more historic data, is maintained by the Organization for Economic Cooperation and Development (OECD). The G-7 countries performed very well during the periods shown below. To estimate a logical "World" performance one can compare the G-7 country performance of 2.0% (2000-2005) to the 1.0% "World" performance ILO data (above) during the recent decade, thus concluding the "World" performance during the decades of the 1970's and 1980's might be generally less than 2.0%.

Growth of GDP per hour worked; Annual Average Growth Rate; Source: OECD (Organization for Economic Cooperation and Development) ⁽³⁾

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|-------------|-------------------|-----------------------|---------------------------|
| | <u>G-7</u> | <u>OECD21</u> | <u>World (est)</u> |
| • 1970-1980 | 2.9% | | 1.9% |
| • 1980-1990 | 2.2% | | 1.2% |
| • 1990-2000 | 2.1% | | 1.1% |
| • 2000-2005 | 2.0% | 1.8% (Reference only) | 1.0% (ILO) |

11. Future Real Wealth Enhancement; If all countries in the world were utilizing a full commodity-backed monetary system (I.e. money that is Real Wealth), then the productivity, employment hours, scarcity (which harms productivity), and substitution (mitigates the harm from scarcity) drivers would impact the Real Wealth growth percentage. Under this condition any extraordinary surge in a business(es) or country that would attract incremental investment (Real Wealth money) would at the same time correspondingly force withdrawal of that Real Wealth money from the rest of the world, thus having an aggregate neutralizing impact to market valuations (**assuming the Total Credit Markets remained at pace with aggregate output**). If aggregate Real Wealth grew the 1-2% tortoise speed (again, assuming neutral employment), the aggregate market valuations (and Credit markets) would rise at the same tortoise speed. e.g. 2% more output with the same labor level justifies 2% greater valuation of a company assuming competition keeps aggregate company valuations at historic approx. 14-15 times Real Earnings (which again is Real Wealth).

12. **Real Wealth vs Financial Wealth;** THE PROBLEM begins when fluffy fiat currency enters the scene and **humans** control its value. Power over currency valuation enables liquidity (money and credit) to grow and shrink in an extraordinary fashion. When the chief money manipulators (Central Banks, Major Commercial Banks, Brokerage firms, Credit Agencies, and Hedge funds) collectively expand liquidity, the perceived (yes, market) valuations of financial assets and Real Estate equity turn into jackrabbit bubbles and DISCONNECT from the Real Wealth tortoise-paced fundamentals discussed above. The "Perfect Storm" scenario that has developed in the world during the past 12 years especially has enabled the extraordinary liquidity expansion to reach the U.S. bond markets and keep their valuations levitated because many foreign trading partners are sterilizing the bond assets they purchase along with U.S. dollar reserves they hold to satisfy their mercantilist motives. As a result, we have generated an unprecedented level of market overvaluations in equities, bonds, and Real Estate at the same time the FED is unbelievably declaring inflation is a paltry 2.x%...!! The influence of low cost imports from China, India, etc. has kept the carefully selective and manipulated inflation calculations low. The stoked liquidity has thus channeled into said financial assets and Real Estate equity.
13. **Fiat Currency Expansion;** More fiat currency or financial assets do not create Real Wealth. Any monetary expansion injected by government tends to only distort natural market drivers, thus creating malinvestment and harming real productivity improvement.
14. **Financial Bubbles;** If one can sense that the capacity of the worldwide "economic engine" is realistically capable of a growth range (per capita) of 1-2% due to productivity increases, then it would logically justify an aggregate asset valuation increase of the same percentage. Add in the other "real wealth" creation driver of an increased global workforce (the aggregate employment increase), one may conclude the total economic engine enhancement could be 1-3% annually. Next, add in a structural inflation increase of say 2%, then a rational gross "financial asset" increase might be 3-5% annually. Hence, why would we not conclude that **extraordinary** liquidity injections forcing "financial asset" valuations far greater than the 3-5% growth rate represent the creation of bubbles? i.e. puffed market valuations relative to the fundamental "economic engine" capability (current capacity and reasonable growth potential). The magnitude of the Financial Bubbles represents an **illusion of wealth!** For example, see my U.S. graphical bubble illustrations here: <http://www.austrianengnomics.com/id10.html>
15. **Real Wealth Analyses;** I believe the answers can be found if we pursue "REAL WEALTH" analyses. What creates it, what drives it, what harms it, etc. For example, if we can offer a simple convincing argument that Federal Spending is the REAL TAX, it should at minimum force an enlightened electorate to the polls insisting on a balanced budget... Fraud upon **others** is viewed with complacency... Fraud upon **you** encourages an enraged response! With that amendment in place, then why not lay the groundwork for a return to a commodity-backed currency to remove the power of humans to manipulate money quantities and valuations?
16. **Prevention of the Real vs Financial Disconnect;** The relative stability of the Real Wealth growth in the world along with a tight true market-controlled leash on the credit-world is more than enough to maintain healthy free market capitalism without fiat currencies. The addition of the fiat currency element, it's influence on the closely linked credit markets, and the absolutely insane derivative markets offering the perceived hedges (insurance) to cover grossly overvalued investment risks in an historically low risk premium environment today is a recipe for disaster! The return to

commodity-backed currency (e.g. gold, silver, etc.) would be painful, but it would bring about a long-term stability to the monetary system, and ensure that markets rather than humans with uncertain agendas controlled the all important interest rates.

CONCLUSION:

This particular paradigm discovery process is one of the most difficult and emotional changes one can experience. The origin of our belief that money (fiat currency or cash) and financial securities are real wealth is deeply imbedded into our thinking from childhood. The dreams of acquiring huge piles of cash and associating that with real wealth and financial independence were impossible to avoid. The childhood lessons of sacrificing and accumulating "money" in a piggy bank for a rainy day or retirement taught us only a part of the lesson to building real wealth.

It is **IMPOSSIBLE** to understand the Enginomic "real economy" concepts and contrast them to the ubiquitous "financial economy" without experiencing the Paradigm metamorphosis.

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