"Austrian Enginomics" Clarity vs "Mainstream Economics" Illusion and What to Do? From: **http://www.austrianenginomics.com/id1.html**

Why does "Austrian Enginomics" offer such clarity in understanding the economy, along with the same clarity on personally managing through the upcoming economic storm or even profiting from it?

The "Enginomic" approach focuses upon the "Real Economy" vs the "Financial Economy". The "Real Economy" is based upon maintenance, and enhancement of "Real Wealth", where the "Financial Economy" is based upon U.S. dollars, a fiat currency. *Money (U.S. Dollar currency) is NOT real wealth; it is at best a contract to ACQUIRE wealth.* For example, if all of our fiat currency instantly doubled, those holding it throughout the world would be no wealthier. We would simply have twice the quantity of fiat dollars chasing after the same real wealth that existed an instant earlier, which would become hyperinflation immediately. Your dollars would be worth about half as much. The same concept applies to debt securities. If you instantly doubled the total par value of all bonds and debt instruments, again, we would still not increase real wealth. In this case there would be a combination of immediate debt-instrument market devaluations along with an illusion of wealth remaining in securities that did not devalue 50% immediately. In any event we would be no wealthier in aggregate.

What is "Real Wealth"?
"Austrian Enginomics" adapts the definition of many early economists including Fredrick Soddy[(1)]. Stated in practical terms the following categories in aggregate are "real wealth":

- Capital equipment
- Capital facilities
- Infrastructure (Utilities, Roads, etc.)
- Goods
- Delivered Services
- Skill Sets (human capital)

The critical condition of "real wealth" creation is that work (labor resources) and natural resources are required to create it. In contrasting *value* from "real wealth", one person may *value* a good, for example, more than another. If two people exchanged goods of no *value,* and benefited after the exchange from the newfound *value*, the "real wealth" has not changed at all. It was certainly a positive exchange, but no additional work or natural resources were expended.

This very critical distinction helps you understand that from the "Austrian Enginomic" perspective you can never have real wealth *in aggregate* inflated in value (see exceptions [(2)]). Existing aggregate real wealth only deteriorates or is rendered useless. New real wealth created requires work and natural resources. Of course, you can encounter relatively scarce commodities or skill sets which might increase in value (e.g. oil), but for any increase in those particular examples, there must be an equal decrease in value of real wealth elsewhere such that the aggregate real wealth will not increase. In the "Financial Economic" world you can easily have massive overvaluations, where the owner of an inflated financial asset believes it has buying power of real wealth in the future far greater than ever possible. I.e. a "bubble"…

Mainstream economists generally agree with the inflation scenario in the opening paragraph above, but do NOT generally agree with the debt instrument scenario. They believe that a bond is "real wealth".

Below are other points of contrast between most government and mainstream economists, and the "Austrian Enginomic" perspective:

Most Government and Mainstream economists:

- Believe the historical stock market valuation increase averages 10.7% per year as indicated by the Dow Jones Industrial Average over the past 50+ years (1950 to 2004).

The "Austrian Enginomics" Perspective is:

- Starting with the noted 10.7%, reduce 5.7% for inflation, 1.5% for the DJIA turnover impact (replacing relatively weaker companies with stronger ones), and 1.5% for the employment increase (to learn "per capita" valuation increase), then you end up with **2.0%.** i.e. the "real" market valuation increase of **2.0%** is exactly the same as the productivity increases over the same period, which is the sole core driver of real aggregate stock valuation increases.

Most Government and Mainstream economists:

- Believe the stock market is "efficient". I.e. valuations are legitimate every day as stocks are freely bought and sold at market clearing prices.

The "Austrian Enginomics" Perspective is:

- The stock market is "efficient" in processing transactions, but massively manipulated directly and indirectly to satisfy government and Wall Street self-serving agendas. It might be considered efficient over a 30-40 year period, which is enough time to encompass an economic full-cycle secular "bull" and "bear" market.

Most Government and Mainstream economists:

- Believe the "Boomer" generation shifting into retirement from 2008 through 2030 will create an overwhelming burden upon the next generation. The dependency ratios commonly quoted deteriorate from 3 people working today supporting 1 in retirement down to 2 supporting 1 in year 2030. The un-funded obligations according to the trustees for the two largest government support programs are: $68.1 trillion for Medicare and $13.7 trillion for Social Security, implying massive service cuts or tax increases are imminent.

The "Austrian Enginomics" Perspective is:

- The age based Dependency ratio deteriorates from 4.7 to 1 (2005) down to 2.7 to 1 (2030), which is a 42.5% reduction in those of working age (20-65) per retiree age (65+). It sounds dramatic, but the actual working-people productivity improvement necessary per year to provide retiree age persons with *exactly* the same level of real goods and service consumption is only **0.49%** [(3)], a manageable number. Why the anxiety and distress? We have been gifting significant *enhancements* to the retiree's standard of living in addition to *future program enhancements,* and building those expectations into the current retirees and Boomers. All "mainstream" economic modeling assumes these *enhancements* will continue expanding. Any "gifting" greater than the noted 0.49% level represents the magnitude of the noted *enhancement.*

Most Government and Mainstream economists:

- Believe fiat Currency (the current U.S. dollar) is not "real wealth", and has no intrinsic value.

The "Austrian Enginomics" Perspective is:

- The same

Most Government and Mainstream economists:

- Believe debt securities (e.g. bonds) represent "real wealth".

The "Austrian Enginomics" Perspective is:

- Debt securities are not "real wealth". At best, they represent a contract to *acquire* "real wealth".

Many Government and Mainstream Economists, and most individuals:

- Have a mindset that savings represents a buildup of wealth. I.e. an inventory accumulation of Goods or money that will be returned with interest later. This paradigm dates back to the "piggy bank" mentality where it was encouraged to accumulate your wealth for a "rainy day", large purchase, or retirement.

The "Austrian Enginomics" Perspective is:

- Savings are recognized as a decision to delay consumption. The "time preference" for consumption has been delayed because you are anticipating full repayment plus interest, yield, dividend, and/or capitalization increase later. In reality, if savings increases, companies direct a resource shift from the actual production of goods and services to activities including R&D, preservation of existing Capital Equipment (maintenance), or fabrication and implementation of new Capital Equipment or facilities. This "resource shift" enables greater productivity increases, thus increased real wealth generation capability. If savings decreases, the opposite occurs. Bottom line… There is no buildup of "Goods" inventory or "money" that represents real wealth.

Most Government and Mainstream Economists:

- Believe the U.S. Total Credit Market Debt is sustainable at nearly any level, and can be diffused slowly just as it increased slowly.

The "Austrian Enginomics" Perspective is:

- The Total Credit Market Debt cannot be greater than approximately the GDP output. The Total Credit Market Debt currently (Oct 2005) is approx. $35 trillion. GDP is approx. $11 trillion. Most of the $24 trillion difference is an illusion. That is too much to "diffuse slowly". Once the illusion is discovered by a critical mass of investors, asset valuations will collapse rapidly.

Most Government and Mainstream economists:

- Believe Real Estate actually increases in real value (greater than the rate of inflation), thus creating wealth.

The "Austrian Enginomics" Perspective is:

- Real Estate actually decays. Homes actually slowly decrease in real value. Aggregate home valuation increases above the rate of inflation are illusions of wealth (4).

Most Government and Mainstream economists:

- Do not question the authenticity and legitimacy of the Dept of Labor's GDP, Inflation, Productivity, Job growth, and unemployment numbers.

The "Austrian Enginomics" Perspective is:

- Inflation is understated by 2-3%, GDP is overstated by 2-3 %, Productivity is overstated by 3%, Job growth is overstated, and unemployment is understated. Massive data manipulation is designed to mask discovery of the "real economy" health, and continue feeding the ongoing "financial economy" illusion.

Most Government and Mainstream economists:

- It is important to remain "optimistic" and present a positive spin on our economic state to encourage constructive improvements and avoid undue anxiety or panic.

The "Austrian Enginomics" Perspective is:

- Transparency, integrity, and facts must accompany optimism for the future. Let's understand where we really are, and then encourage real improvement in all areas.

Most Government and Mainstream economists:

- Foreign investors and central banks are "investing" in U.S. Treasuries and bonds issued as a result of our federal and current account trade deficits.

The "Austrian Enginomics" Perspective is:

- Foreign governments will do anything to stay in power (just as those in the U.S. government). If they believe their greatest domestic economic priority is to keep the production (e.g. China) and consumption (e.g. U.S.) pattern on track, they will go to great extremes to prevent their currencies from strengthening vs the dollar. Their purchase of our U.S. Treasuries helps to keep long-term U.S. interest rates artificially suppressed and minimize the need for the U.S. Central Bank to monetize our debt (inflation), which would devalue the dollar relative to foreign currencies. They are not "investing"; they are attempting to protect their domestic economic growth via an unsustainable pattern.

Most Government and Mainstream economists:

- Believe it is more important to stimulate demand (via tax cuts or government spending) rather than reduce government spending.

The "Austrian Enginomics" Perspective is:

- Just the opposite. Excessive government spending weakens our "economic engine". Taxes must reflect actual spending rather than creating the illusion of wealth via issuing Government bonds [5].

Most Government and Mainstream economists:

- Believe the U.S. dollar currency valuation is in near balance with our major trading partners with the possible exception of China, and to a lesser extent Japan. Also, current processes in place will gradually correct the out of balance conditions.

The "Austrian Enginomics" Perspective is:

- The U.S. dollar is approx. 50% to 65% overvalued relative to foreign currencies within the weighted US Dollar Index. The result of policies enabling this extraordinary overvaluation is the highest current account trade deficit in U.S. history. This is possibly the most abhorrent out-of-balance economic condition in the history of the Republic. To gain a sense of magnitude, the 0.49% improvement (noted above) to sustain the Boomers into retirement is extremely powerful. Comparitively, a 1% current account deficit for a major advanced industrialized country is bordering on an extreme out-of-balance condition that should be addressed before it reaches irreversible consequences. We are now experiencing appalling 6-7% deficits. The artificially strong dollar policy has systematically gutted American manufacturing during the past 10-15 years.

Most Government and Mainstream economists:

- Believe a 6-8% current account trade deficit is manageable and can become balanced slowly in time with our superior productivity and growth prospects.

The "Austrian Enginomics" Perspective is:

- Not…. See prior comments.

Most Government and Mainstream economists:

- Believe the Republic will survive indefinitely, even if we experience a severe recession or depression.

The "Austrian Enginomics" Perspective is:

- We could lose the Republic, as we know it today. History has demonstrated many times a nation suffering from depression will respond to a loud, commanding, tyrannical voice, which can become a new flag to rally around. Think Al Gore empowered to impose his will! Let's not let that happen….!

What to Do About It?

Investing:

- Protect yourself…! 90+% of all stocks, bonds, and real estate are overvalued. Cash is OK short term. Precious metals (e.g. gold, silver, etc.) will be safe and appreciate long term. Generally, commodities are in a long-term bull market. If we move into a deflationary credit collapse, even commodities will be at risk short term.
- Visit the sites on "My Favorite Links" web page for companies that understand the breadth and gravity of our economic state, and recommend investments accordingly on a timely basis.

References:

(1) Wealth, Virtual Wealth, and Debt by Frederick Soddy, M.A., F.R.S.; Chapter XV , "Summary of Practical Conclusions"; "(2) There are two distinct categories of wealth….. the first category of perishable wealth the energy required is stored up for use later by life when the wealth is consumed. It includes food, fuel, explosives, fertilizers, and all materials the usefulness of which depends upon the change they suffer in use. They can only be used once…

In the second category of wealth the energy required to produce it is not stored in the product…. The category includes all classes of permanent possessions, of all degrees of actual durability,….. This category includes the whole of capital in the sense used in this book, namely, organs of production used in production."

(2) The following exceptions for real wealth deterioration are insignificant within the scope of this paper: Fine wine, antiques, select artwork, and similar.

(3) "Social Security and Medicare Funding Gaps are NOT Due to the Boomer Population Age Profile Shift"; www.austrianenginomics.com $5,000 to $500,000 Contest page by Russ Randall; 8-15-2005.

(4) "Houses Do Not Appreciate in Real Terms"; www.austrianenginomics.com $5,000 to $500,000 Contest page by Russ Randall; 8-9-2005. Also, see "The Most Egregious Bane of Over-Consumption; Housing" 10-18-2005 under the Current articles page @ the same web site.

(5) "Our Federal Debt is Pure Bubble"; www.austrianenginomics.com $5,000 to $500,000 Contest page by Russ Randall; 3-8-2005