Net "Real" Debt Cannot Exceed GDP (Gross Domestic Product)

Can one's debt exceed one's GDP on average? Of course not…

Within our economy all those who work contribute directly or indirectly to produce a Good or Service. In every case the noted Good or Service is exchanged for dollars (our fiat currency) or real wealth (gold, silver, barter goods, etc.), or labor, which brings about the key transaction event where we recognize GDP (the final sale of the noted goods or services). Debt is the "flip side" of the equation… let's explore!

Debt Incurrence and Repayment During the Dimension of an Individual's Lifetime

The mindset most have regarding debt is viewed from a "micro" perspective. We clearly understand that debt initiates when a newly indebted party gains ownership of a product or is the beneficiary of service in exchange for a "promise to pay" the creditor in the future. For example, when buying a car the debtor receives immediate ownership of the car, and the creditor holds the "promise to pay" note obliging the debtor to pay down the debt over time. There is always a "we have time to pay it off" mentality.

The "enginomic" perspective views debt in "real terms" analyzing "real" goods and service production and consumption in "real time". We start with two simple logic principles:

- On average, one cannot be indebted to repay more Goods and Services than one can produce in a lifetime.
- On average, one cannot consume more Goods and Services than one can produce in a lifetime.

Therefore, from an individual context, over the period of anyone's lifetime **his Debt cannot exceed his GDP contribution**. (Note: Any inventory of Goods and Services is assumed to be constant per capita). Every individual working in a company contributes his small fraction of GDP to a product or service that is ultimately sold. Once the Good or Service is sold it represents that all-important voluntary exchange, which instantly establishes a debt and credit in real terms. In some cases (e.g. barter), the debt and credit are cleared within seconds. In most cases the clearing takes place over time (via fiat currency, credit cards, time payments, mortgages, etc.). ***The important conclusion is that ON AVERAGE every individual cannot OWE more than he produces in his lifetime regardless of the payment method.*** Of course, some will consume more than they produce, but there must always be another who produces more than he consumes to balance the equation.

Collective Debt Incurrence and Repayment in an Aggregate "Real Time" Dimension

Once the "new mindset" is established that "real" debt cannot exceed "real" production in one's lifetime, then we can evaluate the exchange process in an aggregate context as we move through time; i.e. a "real time" view. If we gather lifetime consumption/production profiles of all people on earth and view the process in "real time", and *assume inventory turns are constant*, then you can see that at any brief moment in time, increments of production contribution and exchanges referenced above are occurring by the millions and must effectively balance precisely every second of every day! Keep in mind if your individual lifetime production and consumption must balance, then each and every product or service you produce will have a consumer who will then immediately "owe" someone the value of what he just received in order for his lifetime production and consumption to balance. If we view a "slice of time" and somehow were able to measure all the millions of tiny contributions to producing goods and services, then you can see the thousands of exchanges (sales of goods and services) that occurred in that same "slice of time" MUST BE EQUAL, again, assuming inventory terms were constant; thus establishing an ongoing "real time" equal level of credit and debt.

If Johnny Jones is working for one minute on producing a product, Stanley Smith will be consuming the equivalent value of Johnny's production during that same minute ASSUMING INVENTORY TURNS REMAIN CONSTANT. If Johnny produces 10% more in the next minute and inventory levels do not change, then Stanley will consume 10% more. It is IMPOSSIBLE for all "consumers" to consume more than all "producers" produce. The common thread among all of them is, again, the all-important exchange that established a debt and credit value relationship at exactly ONE.

Is it possible to "over consume"? NO…. not in a "real" aggregate sense! The world in aggregate cannot consume more than it produces.

Is it possible to "under consume"? NO…. not in a "real" aggregate sense! The world in aggregate consumes exactly what it produces assuming inventory turns remain constant.

Is it possible to "over consume" services, consumer durables and consumables at the expense of capital goods (i.e. "eat your own seed corn")? Of course! Just look at the U.S. We are rapidly depleting our capital goods infrastructure (largely being replaced by the capital goods growth of our trading partners) as we consume far beyond our internal means of production.

What happens over time if we "eat our own seed corn"? At some point foreign central banks and investors holding our dollar reserves, Treasury securities, and financial assets will sell them because they will realize we have no intention of paying them back (i.e. shipping them real goods and services for our "financial paper" back in return).

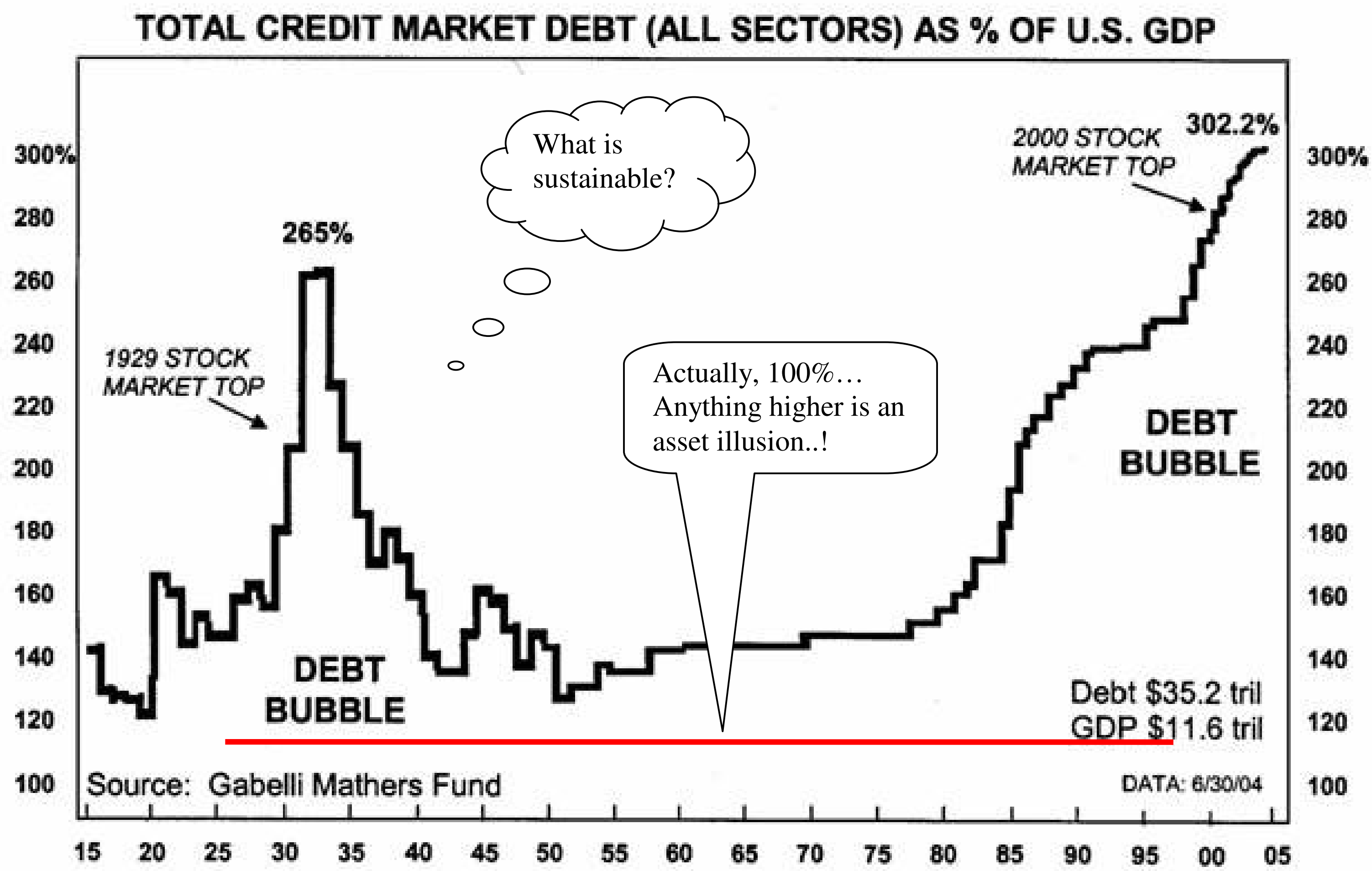
When will this "selling" of U.S. financial assets occur? It will happen when Boomers all over the world start retiring and "tasking" the financial assets bubbles in 2008-2010 or sooner. The massive perceived wealth in real estate, bonds, and equities will become recognized as the overvalued illusions they have been for some time.

Will it be a rapid and painful collapse? Yes… Since bubbles are very popular in the long-formative stage, and very abrupt when masses of investors recognize the illusion, they will stampede for very small exits as the markets collapse.

WHERE IS THE DISCONNECT??…. How can you reconcile the "financial economy" debt with the "real debt" we have discussed? Refer to the Contest article #4 here…. http://austrianenginomics.com/EconDebttoGDPRevA.pdf …see the last section before the "Conclusion" in the article. **My estimate of the debt illusion magnitude is $12-$15 trillion.**

How is this "disconnected" illusive "financial debt" bubble created? Two giant factors are the Federal debt (@ $8.2 trillion) see "Our Federal Debt is Pure Bubble" http://www.austrianenginomics.com/id7.html#1 , and housing; see "Houses do not Appreciate in Real Terms" http://www.austrianenginomics.com/id7.html#2 …
Both of these atrocities "decouple" "financial debt" from "real debt" thus creating the illusory bubbles, and are enabled by our central bank "easy money" policies and fiat currency.

The graph on the next page represents the Total Credit Market Debt relative to the U.S. GDP, and gives you a perspective of how far we've strayed in credit expansion.



CONCLUSION:

Debt cannot exceed GDP in real terms either in a lifetime of an average person, or in aggregate "real time" for all people on earth. As we move through time new debt incurred must be equal to new goods and services produced, assuming inventory levels remain constant. Although difficult to calculate, the total financial credit market debt should generally grow only as fast as GDP. We are now experiencing the largest financial illusion of wealth in the history of the Republic. Last year (2005) alone the U.S. increased Total Credit Market Debt approx. $2.9 trillion, yet our GDP grew an approx. nominal $800 billion, thus adding another $2.1 trillion to the illusion! We expect the illusions to be discovered by the masses when the Boomers retire in 2008-2010 or sooner!

By Russell Randall; 3-3-2006