Timing of the Upcoming Economic Collapse; 2008-10?

The "Stage"

Imagine an island with a fully functioning economy along with a young Mr. "Bubbles" in charge of their fiat money system. The island has a steady population level such that two people are born every year, two graduate from school and enter the work force every year, two retire every year, and of course, two die each year. Yes, a boring, steady-state condition. Further, assume in this "boring" community that the economy is "steady-state" as well. i.e. there are no natural resource scarcities, no productivity improvements or reductions, etc. The "economic engine" of the community is comprised of all businesses, which own all of the capital goods (manufacturing equipment, commercial buildings, tooling, etc.) on the island. These capital goods enable the working labor to produce all goods and services enjoyed by the community. As these capital goods depreciate, they are evenly replaced each year. The community enjoys a consistent standard of living.

The "Boomer"

Unexpectedly, a third baby is born one year (yes…. "Boomer"!). There is a bit more stress for the community and especially the immediate family to feed and educate the child as he grows up, but they "tighten their belts" and consume a little less as they must feed, clothe, and educate Boomer *out of the same pool of goods and services that the "economic engine" has been producing all along*. So far there has been no reason for "Bubbles" to expand their fiat money supply because there have been no more goods and services produced and Boomer is not of age to vote.

As Boomer enters the work force he is equipped with a desk, chair, phone, and computer (incremental capital goods) to produce some product or service. We are now in the stage where the island is enjoying the "fruits of its labor" from raising and schooling Boomer. He is now in the production stage of his life and the island is enjoying collectively a little more prosperity per capita due to this incremental bulge in the working force, while at the same time there are no incremental children to educate or retires to feed. Everything seems just wonderful on the island!

The Uncertainty

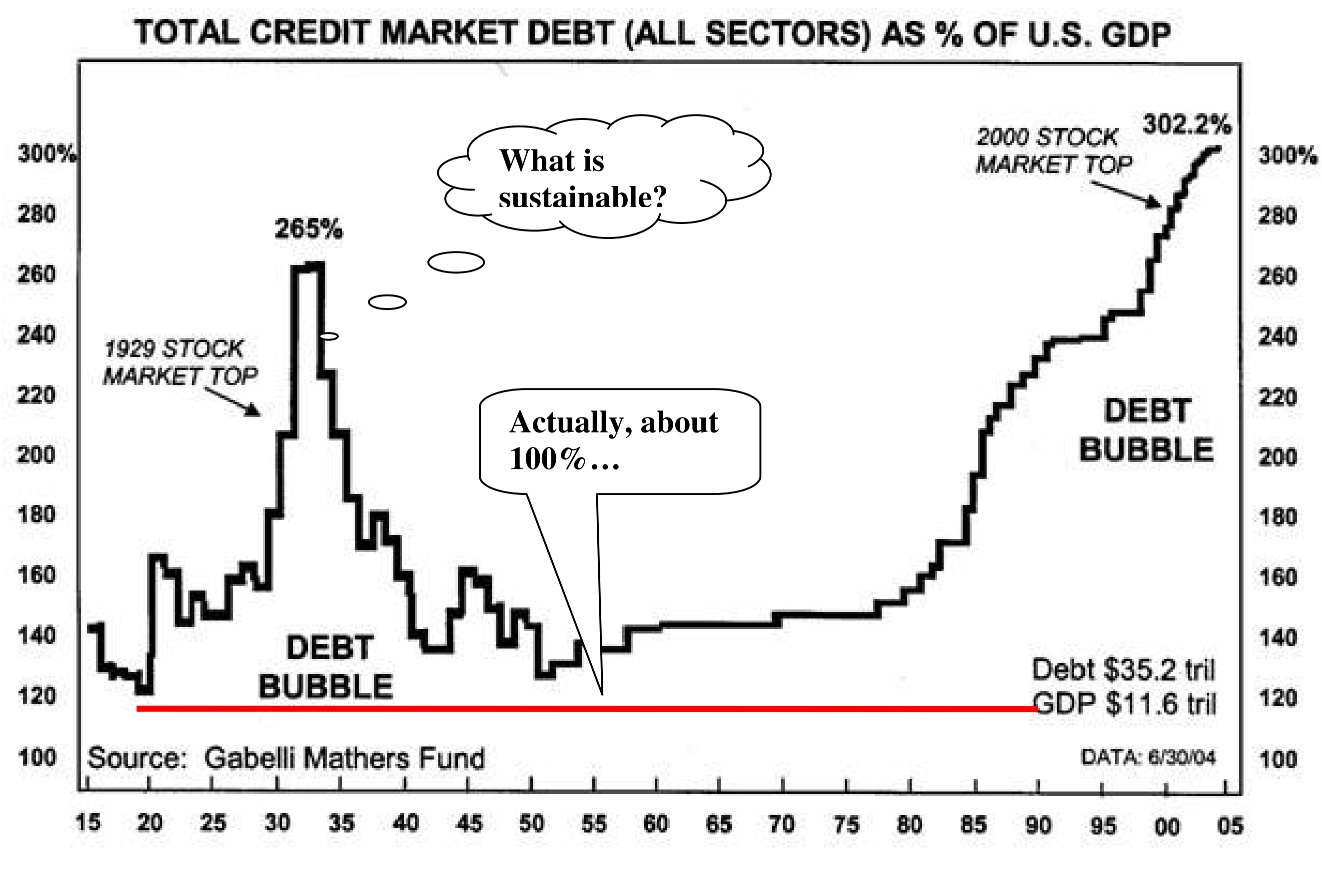
The natives on the island were getting restless about the impending retirement of Boomer in a few years. They implored Bubbles to **do something**! The always-creative Bubbles generated a wonderful idea. He suggested they increase the fiat currency amount just a bit each year for the remainder of Boomer's working years not only to match the incremental good and service output from Boomer, thus preventing the evil deflation, but more than enough to encourage those nearing retirement to invest the excess liquidity in some new financial "paper" assets called "Treasury Bubble Bonds".

They all cheered the idea, so off they went. Each year Bubbles would inject a new dose of fiat money (liquidity) into the monetary system and the work force was excited about investing the added liquidity into the new Treasury Bubble Bonds knowing they could cash them in upon retirement, and enjoy the usual retirement standard of living, even with the addition of Boomer! *Bubbles calculated that **"inflation was contained"** because the workforce was "investing" the newly injected liquidity that he created "out of thin air" directly into the Bubble Bonds, and the new "financial assets" did not count against Bubble's carefully calculated inflation index.* In fact, when the investors went astray and began spending more of the newly injected liquidity on food and pushing its price up rather than investing in the Bubble Bonds, Bubbles emphasized this would be short-lived and confidently announced the "core" rate of inflation (excluding food) was still "under control".

The Discovery
There was one "contrary" Austrian economist who pondered a "doomsayer" question: If the capital goods that Boomer was using during his productive life to produce his quota of goods and services became unused after he retired due to the reduction in the work force, then the island's economic engine would be the same size as it always was prior to Boomer's birth producing the same output as always. If so, what good are these incremental new Treasury Bubble Bonds for those retiring? We will soon have an enlarged retirement group with Boomer and exactly the same stream of goods and services produced by the same economic engine and work force that existed before Boomer came along!

The Result
Before Bubbles could introduce his next new idea of "monetizing" the Treasury Bubble Bonds and creating inflation to spread the lowered standard of living **pain** to all those holding the fiat currency and fiat currency-based assets, the community publicly hung him and burned burlap bags stuffed with Treasury Bubble Bonds in effigy because he sold them an illusion of wealth, and led them to believe the economy was always "strong" and "growing".

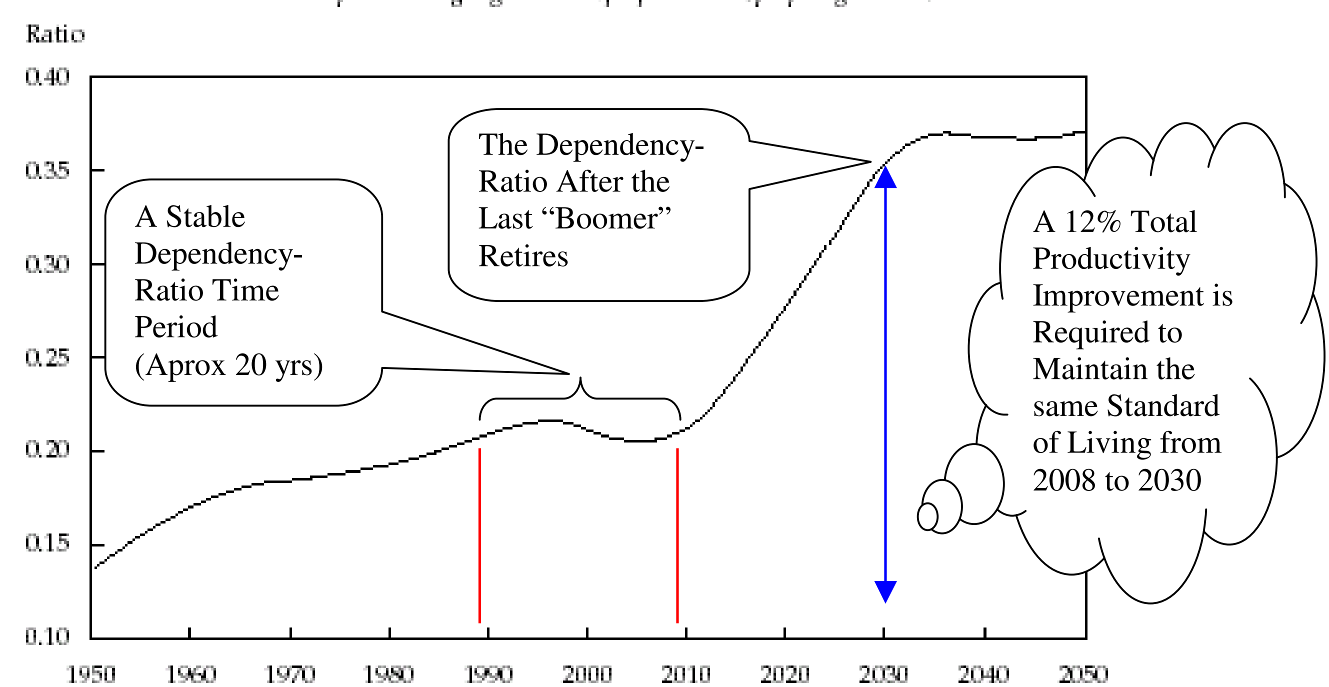
Conclusion
Clearly, a simple story, but the logic is applicable to our economy today. By viewing the "Total Credit Market Debt" graph below, or going to my calculated asset bubbles [(1)] that exist today > http://www.austrianenginomics.com/id10.html I am convinced we are currently sitting on top of collectively the largest asset bubble in the history of our Republic.



Based upon the logic in the story, and viewing the graph below, it is readily apparent the boomers will begin "tasking" (cashing in) the "Treasury Bubble Bonds" (all financial asset bubbles) in the 2008 to 2010 time frame.

Figure 3. Dependency Ratios, 1950–2050

A. Retirees per Working-Age Person (people over 65/people age 20–65)



B. Adjusted: Dependents per Working-Age Person [(people under 20/3 + people over 65)/people age 20–65]

The investing masses will become painfully aware of the bubble illusion as assets become rightfully priced either via asset devaluation or via massive new liquidity injections, which will devalue the currency base and destroy the bond market. Unfortunately, the correction process never stops abruptly at legitimate valuations, but will continue below the mean due to negative momentum, fear, massive job shifts away from industries that have grown disproportionately due to easy money policies, etc. Of course, the timing **could be sooner than 2008**. Any significant “anecdotal event” such as another terrorist attack, the start of a successful Iranian Oil Bourse, another key trading partner “divesting” its asset holdings away from the U.S. dollar, etc., could trigger an earlier collapse.

Clearly, legitimate productivity improvements can totally mitigate the economic impact of the Boomers gradually retiring... See the article “Social Security and Medicare Funding Gaps are NOT Due to the Boomer Population Age Profile Shift”[(2)]. Unfortunately, the size ($28 Trillion) of the collective bubbles bursting will overwhelm the relatively infinitesimal $100-200 billion annual “legitimate” productivity impact.

A commodity-based currency (e.g. gold) would have prevented “Bubbles” (Dr. Alan Greenspan) and those in government who empowered him from injecting the massive floods of liquidity into the world’s economy leading to the largest asset illusion in the history of the Republic.

Had the storied island lived with “honest” money (i.e. non-fiat money), and no productivity improvements were possible, then the community would be **aware** and **prepared** to “tighten their belts” by a marginal amount during Boomer’s retirement just as they had when he was a child.

By Russell Randall 1-27-2006

References:

1) “U.S. Economic Health Graphs” by Russell Randall ‘ 12-31-2005
http://www.austrianenginomics.com/id10.html

2) “Social Security and Medicare Funding Gaps are NOT Due to the Boomer Population Age Profile Shift” by Russell Randall 8-15-2005.