## Why Will Government Intervention Efforts Fail to Avert the Depression?

**Austrian Enginomics Fundamentals**
The fundamental premise of Austrian Enginomics is described on my home page (www.austrianenginomics.com), and it references two macroeconomic conditions, 1) Resource misallocation, and 2) Overvaluation of assets (bubbles) in Stocks, Bonds, and Real Estate. These conditions have built up to unprecedented extremes during the past 35 years reaching a pinnacle about one year ago.

In our modern day world of virtual reality people have been conditioned to believe financial assets are "real wealth"[(1)]. It’s not surprising because we are all used to exchanging financial assets for “real wealth”; hence we all believe that the greater our financial asset stash, the wealthier (and more secure) we are. A written financial bank or brokerage statement is very convincing. If one’s 401K indicates a grand total of $223,549.38, then it MUST be worth $223,549.38! If a mysterious force reduces that total, then we feel the LOSS of wealth, and believe our buying power is less than it was prior to the drop. Conversely, if it gains in value, then we believe we’ve earned real wealth with increased buying power. But…What if the entire basis of the “$” measurement is largely an illusion? What if it were possible for a very powerful force to manipulate the quantity and value of those “$’s”, and lead you to believe there is more buying power there than exists? How could that powerful force be motivated to do such a thing?

**The Truth**
Cash (fiat currency), all debt securities, and the overvalued portion of stocks and real estate are NOT "real wealth". At best, they are contracts to acquire "real wealth". When they have been allowed to expand at a rate faster than GDP Output, illusions of wealth or bubbles are formed.

Near the end of last year (2007) the aggregate size of the bubbles in stocks, bonds, and real estate peaked. I recognize this bubble size as the gap between the calculated fundamental level of those assets and their current market values. Please reference my graph here http://www.austrianenginomics.com/id10.html . Ultimately, the markets correct from these bubbles as they are discovered. The real estate bubble began its discovery process in early 2006. The Stock market bubble began is discovery process in October 2007. The last and most dangerous bond market bubble is peaking and in discovery TODAY.

**Why Will Government Efforts Fail?**
Government intervention efforts will fail to prevent the upcoming depression! Again, the fundamental macroeconomic issues plaguing us are the aggregate market overvaluation and the misallocation of resources. Government intervention (e.g. nationalizing companies) will not address their overvaluation or misallocation of resources. In fact, government does just the opposite by design. They will continue efforts to keep all markets levitated and keep the illusion alive. Government also supports efforts to resist liquidation of misallocated resources and allow them a return to market-justified enterprises.

Government has the power to shift one illusion (bubble) to another by debasing our currency (inflation). Their goal is to prevent the overvalued market nominal levels (stocks, bonds, and real estate) from falling due to natural market pressures by simply monetizing debt as necessary to devalue the real value of the assets. For example, if a $20 share of Citigroup is really worth $5 in today's dollars, then simply inflate the currency system by 400% and, magic, you now have Citigroup worth a “legitimate” $20 in the newly cheapened currency valuation. Will one share of Citigroup buy more real wealth after the currency destruction than before? Of course not, but government can claim you have lost nothing....! Add the ongoing inflation data calculation distortions into the mix, and you have no clue what your real buying power is!

**How Bad Is It?**
I have calculated and maintained for some time the aggregate overvaluation magnitude is approx. $30 trillion [(2)]. When government supports or nationalizes a company there is typically an immediate positive stock market response (e.g. Fannie and Freddie), hence the bubble is maintained. The knee-jerk market reaction is reflecting the belief that "this aggressive and necessary intervention will enable the problem to work itself out given sufficient time..." The basis for this logic is the widespread belief that **market levels are legitimate** and only technical or short-term "liquidity" problems may exist. Therefore, government can solve the short-term liquidity problems, give businesses a bit of time to solve their minor problems, and then the elevated price levels become legitimate. Wrong….! What ever happened to the concept that market price levels must reflect fundamental real wealth values… right now… not later??

To solve the bubble conditions either the markets must fall $30 trillion from nominal levels reached in early 2007, OR the currency must be debased approx. 40% OR a combination of both.

Since **governments cannot create real wealth**, they will exercise their powers to rapidly debase the currency. HOWEVER, it will not take long for those holding U.S. dollars and dollar-based financial assets all over the world to "get it" when they see Ben (Bernanke) and his cohort-in-crime Hank (Paulson) cranking on the currency printing press handle at lightning speed. When these investors see this most pathetic activity, and recognize it will entail far more than a short-term boost for one-time emergencies (e.g. 9-11 or Katrina), they will begin to divest out of the dollar and dollar-based assets in a relentless self-reinforcing fashion. As this "divestiture" begins to snowball and destroy the dollar, you will begin to appreciate how the next great depression will become unstoppable.

**Can The Economic Imbalance Mess Be Fixed?**
We all have the tendency to feel good when the market is recovering as though we are on the mend. The thought never seems to enter the mind that valuations of financial assets elevated too quickly in the past and have not settled down to fundamentally justified levels; especially when they were elevated for a number of years. We also want to feel that an empowered state will prevent the worst economic calamity, another great depression. Therein lies the disconnect… How can the organization most responsible for enabling the creation of the bubbles and misallocation of resources correct the imbalances by attempting to fix an illusion that **cannot be fixed**. If one has labored away to produce a bucket of bolts (real wealth), can the state credibly say you have the buying power of two buckets of bolts when you know very well that one of those buckets is an illusion of wealth?

The root cause of this mess was empowering the State to control the quantity and price of our currency. We gave up on any monetary and credit constraint on the fateful day Bretton Woods was abandoned in 1971. The financial economic system has been floating into an illusory oblivion ever since. We must return to a real-wealth backed monetary system (e.g. gold) to empower the MARKET to control the valuation of any money that is utilized for storage of wealth or the exchange of goods and services, rather than government.

**Conclusion:**
It is not government intervention that solves or mitigates the enginomic fundamental misallocation of resources, and overvaluation of assets. Government can only create an alternate illusion. The Austrian Economists have known this for over one hundred years. My efforts in

enginomics have been to develop dimensions of the aggregate asset overvaluations, and determine the severity of the upcoming bust as the inevitable discovery of the illusions of wealth unfold when the Boomer begin retiring in mass (2008-2010) and attempt to cash-in on the illusory bubbles.

Unfortunately all bubbles **overcorrect** when discovered. So, fasten you seat belts for a year or two of grueling market crashes each followed by ever more desperate and damaging government intervention and short teaser market rallies before the Central Bank ultimately gets the upper hand and hyper-inflates our currency along with all financial assets and commodities. I expect we will follow the same path as most countries who have traveled this path before. Hyperinflation depression conditions will last for a number of years before normalcy resumes.

References:
(1) Real Wealth is defined in the second paragraph of this article:
http://austrianenginomics.com/IfStockMarketsJumpUporDownDoesRealWealthChangeA.pdf
(2) See graphical depiction here: http://www.austrianenginomics.com/id10.html by Russ Randall 12-31-2007

By Russell M. Randall 9-21-2008
Home page: www.austrianenginomics.com