Prosperity, or Not

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Prosperity is but one path upon which humanity may travel; it is not a guaranteed path. Our choices and actions determine whether we as individuals and as a nation will enjoy a prosperous future – or not. Today, in the United States of America, the engine of economic growth is stalling. The reason is that our savings are not being invested into productive capital assets. Too much of our income is being directed toward consumption and non-productive assets by policies the Federal Government of the United States has undertaken in response to the "Great Recession of 2008". The deficit-funded spending spree currently underway has not stimulated our economy. To the contrary, it is hampering current economic growth and making our children poorer. Many have commented on the burden that future generations will face when repaying the debt now being accumulated: a burden that will force their living standards downward. But few comment on what we are not leaving our children. By diverting our savings away from private investment and toward consumption-oriented government spending, we leave future generations with fewer means to produce the goods and services that generate income. So, not only do we leave our children with a mountain of debt, we leave them less capable of generating income and paying that debt. We are steering our nation onto a path less prosperous.

Prosperity is not a mystery. To continually advance living standards, a portion of our current labors must be allocated toward creating the means to increase future production. There is no other way. Economic growth requires savings and requires that saving be invested into productive assets: machine tools, tractors, trains, ships, computers, facilities, knowledge and knowhow – the things that enable us to produce goods and services.

The accumulation of productive capital assets is the driving engine of economic growth. Using capital assets, people apply their labors toward production. Successful exchange of the resulting goods and services generates income that people may consume or save. If invested savings create more new capital assets than are consumed in the process of creating goods and services, productive capital assets accumulate. More productive capital assets leads to more production, more savings, more investment and yet more productive capital assets. This is the positive feedback mechanism driving economic growth and rising living standards.

During the 1990s and early 2000s, Americans over-invested in real-estate, causing a boom, then bust in the housing market. Workers up and down the housing supply chain lost their jobs as excess capacity was progressively shuttered. Mortgage failures transferred losses from the home buyer to the mortgage owner. Throughout 2008, the impacts of this mal-investment on our national income were becoming increasingly apparent: the United States' ability to generate income was declining. The declining income forced unemployment upward because there simply was not enough income being generated to keep everyone employed at then current wages. Wages had to come down or unemployment had to go up to balance employment with the economy's ability to generate income. To grow the nation's real income back to prior levels, the people of the United States needed to invest in new productive capital assets that could support the production of goods and services that people wanted to buy. We did not do this and the primary reason is government.

In the third quarter of 2008, Lehman Brother's failed, AIG went underwater and several large banks were on the verge of insolvency. At this point, the government panicked. It created the Troubled Asset Relieve Program (TARP) and later massive stimulus spending. Neither effort encouraged the private investments that could expand our nation's income-generating capacity so necessary for recovery. By diverting our limited savings away from private investment, the government's response to the developing recession and banking crises made the recession worse in magnitude and longer in duration.

The funds for TARP and the stimulus spending came primarily from government borrowing. This created a monumental disruption in the flow of savings and credit. Private investment tanked with every dollar the government borrowed. According to the Bureau of Economic Analysis, net private investment in the United States approached zero in 2009 and is not much better today. When net private investment is zero, the engine of economic growth is turned off. Since it takes many months, potentially a few years, for changes in private investment to materialize in production, the United States has yet to experience the full impact on production of its deficit-funded spending spree. If we have a double dip recession, the diversion of private investment resources into government spending will be a major contributor.

Why would everyone lend the government their savings at near zero rates? Fear and uncertainty! With its aggressive response to the banking "crisis" that often bent the rule of law, the government introduced enormous uncertainty into the economy. In response, investors parked income in non-productive assets such as gold, silver and Treasuries. This movement of savings into non-productive assets has slowed economic growth.

Today, United States Treasuries are a non-productive investment: most government debt is financing consumption oriented spending rather than investments that increase our production capacity. Because of this, Treasury sales are driving a reduction in the effective saving rate of the United States. People save for the future, but their savings are re-directed by the government toward consumption and away from the private investments that could grow our economy. This is how the deficit-funded spending spree has slow economic growth in the United States.

It may seem counter intuitive to some that government spending can be contractionary. Many people think government spending is expansionary. It is not government spending that expands an economy; it is investment in the means to produce. To the degree that government spending and policy supports this, they are expansionary. To the degree that government spending and policy hinder this, they are contractionary.

At any point in time, the only way to grow an economy is to allocate current income toward productive investments. When investment exceeds capital depreciation, the economy can grow. Past allocations are sunk. Either past income was invested in productive capital assets or not. If past income was consumed in eating bread or parked in gold or Treasuries, it is gone. It cannot grow the economy today. Yesterday's labors cannot be reallocated. Going forward, we have our accumulated capital assets, our accumulated knowledge and our labors. That's it. Each day we choose anew whether to allocate our labors toward consumption or toward increasing the means to produce in the future. Economic growth comes from increasing the means to produce.

There is one and only one prosperous path out of our current economic mess: accelerate the accumulation of productive capital assets. The only way to do this is to stop the deficit-funded spending spree by Uncle Sam and direct our savings into private capital investments. This will require down sizing government. Cut taxes, especially those that incentivize investment such as capital gains and corporate income taxes. Cut government spending: cut to the point where surpluses are retiring Treasuries. If prosperity for our children is an objective, there is no other way.