# The Gist of Growth and Our Malaise

By Keith Eubanks
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http://www.dynamicforecasting.com/

"All production is for the purpose of ultimately satisfying the consumer." British economist John Maynard Keynes said this in the 1930s[1], and he was right. All the things we produce are ultimately for the purpose of consumption. In fact, all life both consumes to live and lives to consume.

The production of the goods and services we consume requires the application of capital and labor. Capital is the physical and intellectual means of production: our tools, land, buildings, knowledge and knowhow. Labor is the physical and intellectual efforts that we, humans, provide.

Although all production is for ultimately satisfying the consumer, it is not all for the immediate satisfaction of the consumer. Some of our capital and labor must be applied toward creating the means of production, i.e., toward creating future capital for future production. Capital wears out over time and must be replaced for production and consumption to continue. Furthermore, an expanding population requires additional capital to produce for its growing membership. And if we wish to increase our standard of living, new capital must be more productive than that which it replaces. This enables us to gradually produce more with our individual labors, and our standard of living is defined by the quality and quantity of what we produce and consume.

Real economic growth is defined by production; specifically, how quickly the quality and quantity of production grows (goods and services). This growth is controlled by how rapidly we accumulate additional capital and how rapidly the productivity of that capital improves. Capital accumulation and productivity improvement are driven by how we allocate our current capital and labor – toward producing capital or consumables. The more of our capital and labor we apply toward creating future capital the faster the economy can grow. The more of our capital and labor we apply toward creating consumables the slower the economy grows.

Recessions occur when some portion of current capital and labor can no longer generate income. There are many causes, including over-investment, wars, and natural disasters. If this loss of income is sufficiently large, large enough that new capital emerging from the existing investment pipeline cannot replace the lost income quickly, a re-enforcing

[1] Keynes, John Maynard "The General Theory of Employment, Interest, and Money", Prometheus Books, New York, 1997, p. 46

process develops where the ultimate decline in income is greater than the initial losses. This downward spiral develops as the lost purchasing power spreads from one producer to the next: the baker sells less bread and so buys less flour; the miller sells less flour and so buys less wheat, and so on. The downward spiral of recession stops when prices move to align production with income, distributing the loss of income across a broad swath of society.

Recessions force a choice. Since real income has declined, real spending allocations must be curtailed. But how: maintain consumption by reducing investment, cut both consumption and investment, or maintain investment by curtailing consumption? Recovery occurs when the lost income is replaced. No matter the cause, replacing real income requires investment to expand the production of goods and services that people want to buy. Of course, investment is a choice to curtail current consumption in favor of future consumption, a choice to acquire capital instead of consumables.

At any point in time, recession or not, society can only move forward with what it has. Society's present ability to produce and generate income represents the accumulation of past decisions, for better or worse. Within the constraints of these past decisions, the future is malleable. The economic path that unfolds going forward will result from the daily choices made in the allocation of capital and labor, and in this allocation there will continually be an explicit trade between the present and the future: i.e., between current consumption and future consumption. Growing real income requires expanding production, and this requires income to be allocated toward productive capital investments: i.e., investments that generate more income than the cost to acquire them.

In response to the recession of 2008, government in the United States appropriated a larger share of the nation's declining income. Government spending was labeled a "stimulus" to the economy, but appropriating a larger share of national income meant the private sector retained a smaller share. "Stimulus" displaced private sector spending. Worse, "stimulus" spending was deficit financed: i.e., society's savings were borrowed and spent by government. Savings represent income that has been allocated for future consumption, yet government spending is overwhelmingly consumption oriented. The government's "stimulus" spending augmented current consumption at the expense of future consumption; it was an explicit choice to trade private investment for government oriented consumption. The federal government's response to declining national income slowed the accumulation of productive private capital and hindered the nation's ability to grow and recover from the recession.

The $14 trillion debt owed by the federal government of the United States represents the accumulation of society's savings that were largely consumed rather than productively invested. The U.S. Treasuries owned by our nation's creditors do not represent real wealth. The money borrowed did not buy income producing assets. It was by and large consumed. U.S. Treasuries are simply a claim on future income. The larger cost of this debt is not the future taxes required but the economic growth forgone because society's savings were re-directed toward government oriented consumption. This is not to say that Medicare, Medicaid, welfare, food stamps, unemployment insurance, wars and many other government services are not of value, but they do represent an explicit trade with economic growth.

Some argue that deficit financed transfers such as unemployment insurance will increase profits and hence investment.  It is true that increased consumption will increase revenues and subsequently profits for consumable oriented firms.  But, a dollar of savings can finance a dollar of investment; a dollar of savings borrowed and reallocated toward consumption can at best finance 5 or 10 cents of investment, since corporate profits will be a moderate fraction of revenues.  Borrowing society's savings to finance consumption dramatically reduces potential investment resources and hence economic growth.

Our current economic malaise, our current lack luster recovery, can be directly attributed to government "stimulus" and other policies that have pushed and pulled income away from private investment and toward government spending.  Returning to robust economic growth will require a reversal of these policies.  Each day, society faces a choice in how existing capital and labor are allocated – toward current consumption or future consumption.  Within the constraints of the past, the future is malleable.  Restoring robust economic growth will require a renewed focus on the future – on productive capital investment.

As British economist John Maynard Keynes said "All production is for the purpose of ultimately satisfying the consumer."  But, if future consumers, our children, are to be able to consume more tomorrow than their parents today, the trades our government continues to make must be unwound.