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We're Living in the Age of Capital Consumption

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When capital is mentioned in the present-day political debate, the term is usually subject to a rather one-dimensional interpretation: Whether capital saved by citizens, the question of capital reserves held by pension funds, the start-up capital of young entrepreneurs or capital gains taxes on investments are discussed – in all these cases capital is equivalent to “money.” Yet capital is distinct from money, it is a largely irreversible, definite structure, composed of heterogeneous elements which can be (loosely) described as goods, knowledge, context, human beings, talents and experience. Money is “only” the simplifying aid that enables us to record the incredibly complex heterogeneous capital structure in a uniform manner. It serves as a basis for assessing the value of these diverse forms of capital.

Modern economics textbooks usually refer to capital with the letter “C”. This conceptual approach blurs the important fact that capital is not merely a single magnitude, an economic variable representing a magically self-replicating homogenous blob but a heterogeneous structure. Among the various economic schools of thought it is first and foremost the Austrian School of Economics, which stresses the heterogeneity of capital. Furthermore, Austrians have correctly recognized, that capital does not automatically grow or perpetuate itself. Capital must be actively created and maintained, through production, saving, and sensible investment.

Moreover, Austrians emphasize that one has to differentiate between two types of goods in the production process: consumer goods and capital goods. Consumer goods are used in immediate consumption – such as food. Consumer goods are a means to achieve an end directly. Thus, food helps to directly achieve the end of satisfying the basic need for nutrition. Capital goods differ from consumer goods in that they are way-stations toward the production of consumer goods which can be used to achieve ultimate ends. Capital goods therefore are means to achieve ends indirectly. A commercial oven (used for commercial purposes) is a capital good, which enables the baker to produce bread for consumers.

Through capital formation, one creates the potential means to boost productivity. The logical precondition for this is that the production of consumer goods must be temporarily decreased or even stopped, as scarce resources are redeployed toward the production of capital goods. If current production processes generate only fewer or no consumer goods, it follows that consumption will have to be reduced by the quantity of consumer goods no longer produced. Every deepening of the production structure therefore involves taking detours.

Capital formation is therefore always an attempt to generate larger returns in the long term by adopting more roundabout methods of production. Such higher returns are by no means guaranteed though, as the roundabout methods chosen may turn out to be misguided. In the best case only those roundabout methods will ultimately be continued, which do result in greater productivity. It is therefore fair to assume that a more capital-intensive production structure will generate more output than a less capital-intensive one. The more prosperous an economic region, the more capital-intensive its production structure is. The fact that the generations currently living in our society are able to enjoy such a high standard of living is the result of decades or even centuries of both cultural and economic capital accumulation by our forebears.

Once a stock of capital has been accumulated, it is not destined to be eternal. Capital is thoroughly transitory, it wears out, it is used up in the production process, or becomes entirely obsolete. Existing capital requires regularly recurring reinvestment, which can usually be funded directly out of the return capital generates. If reinvestment is neglected because the entire output or more is consumed, the result is capital consumption.

It is not only the dwindling understanding of the nature of capital that leads us to consume it without being aware of it. It is also the framework of the real economy which unwittingly drives us to do so. In 1971 money was finally cut loose entirely from the gold anchor and we entered the “paper money era.” In retrospect, it has to be stated that cutting the last tie to gold was a fatal mistake. Among other things, it has triggered unprecedented instability in interest rates. While interest rates displayed relatively little volatility as long as money was still tied to gold, they surged dramatically after 1971, reaching a peak of approximately 16 percent in 1981 (10-year treasury yield), before beginning a nosedive that continues until today. This massive decline in interest rates over the past 35 years has gradually eroded the capital stock.

An immediately obvious effect is the decline in so-called “yield purchasing power”. The concept describes what the income from savings, or more precisely the interest return on savings, will purchase in terms of goods. The opportunity to generate interest income from savings has of course decreased quite drastically. Once zero or even negative interest rate territory is reached, the return on saved capital is obviously no longer large enough to enable one to live from it, let alone finance a reasonable standard of living. Consequently, saved capital has to be consumed in order to secure one's survival. Capital consumption is glaringly obvious in this case.

It is beyond question that massive capital consumption is taking place nowadays, yet not all people are affected by it to the same extent. On the one hand, the policy of artificially reducing the interest as orchestrated by the central banks does negatively influence the entrepreneurs’ tasks. Investments, especially capital-intensive investments seem to be more profitable as compared to a realistic, i. e. non-interventionist level, profits are thus higher and reserves lower. These and other inflation-induced errors promote capital consumption.

On the other hand, counteracting capital consumption are technological progress and the rapid expansion of our areas of economic activity into Eastern Europe and Asia in recent decades, due to the collapse of communism and the fact that many countries belatedly caught up with the monetary and industrial revolution in its wake. Without this catching-up process it would have been necessary to restrict consumption in Western countries a long time ago already.

At the same time, the all-encompassing redistributive welfare state, which either directly through taxes or indirectly through the monetary system continually shifts and reallocates large amounts of capital, manages to paper over the effects of capital consumption to some extent. It remains to be seen how much longer this can continue. Once the stock of capital is depleted, the awakening will be rude. We are certain, that gold is an essential part of any portfolio in this stage of the economic cycle.

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