Appendix

What Creates Wealth? Production vs. Overhead

by John Hoefle

There is a critical need to put people back to work, to restore employment that will allow them to survive. But putting people back to work in the same types of jobs they had before the financial system exploded will not solve our problems. Jobs are not just about providing money to pay the bills; what a population does for its living determines whether that society will prosper or decline.

Economic activity is best measured in terms of production versus overhead. These are not value judgments on how well a person does his or her job, but are based upon the nature of the work being performed. A good example of productive activity is manufacturing, such as the chain of processes that turn ores into finished metals, and turn those metals into products like machine tools and power plants. Wealth is created in this manner, since the value of the outputs are greater than the costs of the inputs and the processing.

On the other hand, banking is an example of overhead. Banks do not create wealth, but merely move it from one pocket to another.

The distinction is crucial. Productive activity creates wealth, while overhead activity consumes that wealth. Some of that consumption is necessary. We gladly pay the costs of caring for our children, and perhaps less happily pay the costs of the roads, water and sewer systems, and related common infrastructure that allow our society to function. In fact, if we didn't make such investments—as in research and development, major infrastructure projects such as the TVA, and education—our society would stagnate and die. But in a properly structured economy, the wealth created by productive activity exceeds the amounts spent on necessary overhead by a considerable margin, making the necessary overhead easily affordable.

If a society abandons productive activity in favor of overhead—if it ceases producing wealth in favor of merely consuming its own surplus and wealth produced by others—then the costs of overhead activities become burdensome, even deadly. This is where we are today.

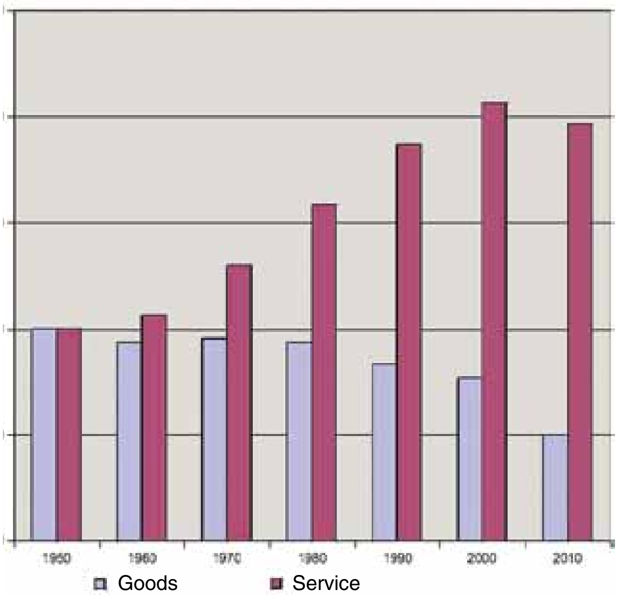
Look at Labor

The essence of the problem can be seen in Figure 2 (p. 36), which compares the contributions to GDP from the manufacturing sector with the contributions to GDP from the FIRE (finance, insurance, real estate) sector, as reported by the U.S. Bureau of Economic Analysis.

However, the truth is actually worse, as the graph itself is a constructive fraud, in that it presents the activities of the FIRE sector as *contributing* to the economy, when in truth, many of those activities are parasitical. According to the official GDP calculations, the egregious frauds by Wall Street, the derivatives bets at the big banks and AIG, and the run-up in real estate values caused by financial speculation—activities which blew a giant hole in the U.S. and global economies and threw millions out of work—all *contributed* to our economic product. It's the equivalent of counting the growth of a giant tumor as proof the patient is thriving, or counting shoplifting as sales.

Not everything in the FIRE sector is theft. The real estate market provides places for people to live and work, and the banking sector provides essential financial services, for example; overhead, but necessary overhead. However, much of what occurs in the FIRE sector is malignant. The same banking system that provides your checking account also manipulates interest rates, supports the drug trade by laundering its money, finances the movement of productive jobs offshore, jacks your credit-card interest payments through the roof, illegally forecloses on homes, funnels billions into Washington to prevent corrective regulations like the reinstatement of Glass-Steagall, and a host of other crimes. All of which, according to the Bureau of Economic Analysis, contribute to the fiction known as GDP.

FIGURE 1
Goods-Producers vs. Service Workers, Per Capita



Source: Bureau of Labor Statistic

Production Deficit

Now look at a related aspect of this problem, by comparing employment in the production of goods to employment in the providing of services (Figure 4, p. 37). The goods-producing category includes manufacturing, construction, mining and logging—all useful activities. The service-providing sector includes trade, transportation, utilities, information processing, financial activities, professional and business services, education, health care, leisure and hospitality, and other miscellaneous services.

Many of these services are quite useful, even essential. But economically speaking, they are a cost which must be paid out of the profits generated by production. Since 1950, employment in goods-production has remained essentially flat, growing from 17.3 million to 18.4 million, whereas employment in services has more than quadrupled, from 28 million to 115 million.

As bad as that is, it understates the problem, since our population has doubled since 1950. **Figure 1** shows the same employment figures on a *per-capita* basis, indexed to 1950 to give a different view of the changes. The accelerating decline in the proportion of our population involved in goods production is both obvious and ominous, but so is the decline between 2000 and 2010 in the service workers. We see the rise of an unsustainable system, and the beginning—but only the beginning—of its collapse, The worst is yet to come.

To put these changes in the context of the workforce as a whole, we have Figure 3 (p. 37), which shows the relative proportions of employment in manufacturing; non-manufacturing goods production; trade, transportation, and utilities (TTL); government; and other private services. The latter three categories (TTL, government, and other private services) collectively comprise the service sector.

In 1950, manufacturing (31%) and non-manufacturing goods production (7%) accounted for 38% of total employment, but by 2012, that had fallen to 9% and 5%, respectively, or 14% of total employment. On the service side, TTL went from 21% to 19% for the same period, while government went from 14% to 16%, and other private services nearly doubled, from 27% to 51%. Overall, services grew from 62% of jobs in 1950 to 86% in 2012.

It should be obvious by this point that simply putting people back to work in the same types of jobs they had before, will not solve the problem. What we were doing before, collectively, *is* the problem. We became a nation of consumers, not producers.