

The Oil Drum: Campfire

Discussions about Energy and Our Future

A Freddy and Fredericka Future?

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Topic: [Economics/Finance](#)

In one of my favorite non-science fiction novels, "[Freddy and Fredericka](#)", the future King and Queen of England are dropped naked from an airplane into America as sort of a rite of passage. Though heir to the throne and infinitely wealthy back home, Freddy must use only his wits, skills of persuasion and physical abilities to somehow rise to the unlikely position of the leader of the USA - if he manages this, basically from scratch, he will then have earned the throne of England not only due to hereditary decree but via his own merits. Kind of a neat concept. The book is a hilarious romp, but one of its themes, of what social and human capital might accomplish if financial capital suddenly vanished (from Freddy's perspective), is an interesting thought-parallel to today's fiat/currency situation. More below the fold.



The USA is (financially) insolvent. Given the technical definition this is a widely accepted view on Wall St as our debts are greater than our assets in financial terms. What is not widely accepted, (and hopefully will remain a minority view for some time), is that because continued servicing and retiring of our debt is completely energy dependent, the paper claims extant in our system will eventually, sometime this decade, be reset, i.e. most paper wealth we recognize today will be lost. The same goes for most other OECD countries. This system reached a fiat credit climax after supplementing energy gain with increasing amounts of debt and we're now left with a modus operandi of extend and pretend until the system breaks and/or something new emerges. This does *not* imply that our future productive capacity is insolvent or that civilization is doomed--only that the current claims structure will undergo a wrenching rebirth. The balls in the sovereign credit pinball machine will soon become blurry from fast movements - Greece, Portugal, Spain, Italy, Japan, Australia, ???? - and who knows who else before some balls disappear or the whole game tilts.

Basically, if we add up the 'financial' net worth of the USA, and subtract out the financial debt owed by the government, households, corporations, [household net worth](#), we get in the neighborhood of negative \$40,000,000,000,000**. (This includes the unfunded future liabilities like Medicare/Medicaid which are unlikely to change much because they are already expressed as a Net Present Value.) This also includes a substantial amount of built capital in the form of houses, corporate tangible assets etc. (without which the amount would be even more negative). We already require new debt dollars to the tune of ~\$4 for every new GDP \$. As global oil becomes more scarce, we will have to increasingly pay for it with more and more debt so that the next time we see \$150 oil, we'll be generating \$6-7 debt dollars to generate a new GDP dollar. Barring some unforeseen white swan, this is a financial death spiral, not for civilization or the country, but for the currency and financial system we currently use. The changeover may be bad or it may not - it depends how we prepare and react when the debt jubilee arrives, either piecemeal or in one fell swoop, sometime this decade.

Debt on its own of course doesn't tell the whole story. When I came out of MBA school, I was 100k in debt - but given the society I was graduating into, I had the ability to service and eventually pay this debt back (debt of the self-extinguishing variety). Today I'd rather come out of school in debt as an electrician than a business major. The relevant analogue being in a post peak world: not only are we seriously in debt, but we spend a majority of new debt dollars on either neurochemical entropy or investments that are dead-ends in a liquid fuel starved future. The country is in a much different situation than I was when I finished my MBA. Jobs and energy to the level required to service our growing debt are physically not sustainable the way they were in 1992. Changes will need to be made and quickly on both our consumption and production trajectories to a reset that goes beyond the financial.

Our problems are not only resource and affordability related. We have a serious within-and-between country equity problem. Growth or whatever trajectory is socially chosen must be generally available to all, or the populist angst from the have nots towards the haves will start to manifest physically. The truth, for better or worse, is that *no matter what social system replaces our current brand of capitalism*, there will be winners and losers and some social hierarchy will

either quickly or gradually emerge: some on top, some in the middle and some on bottom. If we were somehow able to remove those from the top, or from the bottom, a new top and bottom would form! This remains one of the more pressing questions facing our society today.

One of my themes in the past year or so is how financial wealth is likely to act as an albatross to well-being and adaptability going forward, as people with large sums (millions+) of financial assets will find it difficult to protect this 'perceived digital fitness' advantage in future currency resets and financial flux. They will continue to try to increase digits in the bank while losing sight of the changing cultural definition of wealth. I feel confident stating the above, because its taken me nigh 40 years to realize that it's the process of getting the spoils (whatever they are) than the spoils themselves which drives us.

It is important to realize that money itself is largely just some electronic digits on computers that people in today's age have agreed to use as markers for physical things. At some point, international currency imbalances will force our 'Story of Money' so far into a corner that we will have to develop and initiate a new story that is consistent with a new reality. When that happens, our government will basically have two options: austerity measures, draconian fiscal discipline and rationing of goods which would drop consumption by more than 1/2, or cut right to the end game of currency-destroying hyperinflation. Such would be the end of our current story of money, for it would render all digital wealth (and debt) worthless. But my biggest insight of late is when this eventually happens, our productive capacities don't disappear, only our ability to organize and direct them using the previous rules.

Which brings us to tonight's thought experiment.



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CAMPFIRE DISCUSSION

Imagine if all of our digital wealth disappeared essentially overnight - at \$40 trillion each American is around \$120,000 in financial debt. With it would go all debts and credits of the old system, mortgages, bank deposits, brokerage acct's, bond balances, etc.. All of our jobs remained, all of our salaries would be paid in a new paper scrip (Patriot dollars or some such) and all of our physical, social, natural and human capital (houses, skills, knowledge and relationships etc.) remained. In effect, the major changes would be the wealth loss to existing creditors, and a possible competition/incentive vacuum - (i.e. what would drive technology, effort, and investment forward without the cohesive impact of competing for wealth?) Such a thing has happened many times before, but never on such a scale (obviously). What would happen now?

- 1) *Would it be possible under such circumstances to maintain social stability?*
- 2) *Could we continue the current socio-economic system via pursuing something else other than accumulation of digital wealth? Or would the creation of a new currency just start the whole leveraged relative-fitness amplitude accordion all over again?*
- 3) *In such a scenario what would be some unexpected benefits? Some unexpected drawbacks?*

- 4) *How likely is such a scenario in the next decade for the USA and other developed nations?*
 - 5) *What would a new social hierarchy look like? Would we, in aggregate, respond like Freddy in the novel?*
 - 6) *What sort of plans/framework would be needed in place for when such an eventuality occurred?*
- B) *If I'm seriously out to lunch with this hypothetical, please explain why.*

Feel free to comment on any/all of above or any related insights to the fiat/credit/energy nexus you want to share.

The above scenario is not one I advocate but do think is possible. The outcome of such an experiment obviously completely depends on ones assumptions so I tried to leave the details as general as possible so we can discuss what the removal of leveraged, digital debt would imply for our society. It's in discussing these difficult subjects that some doors are closed off and others are opened.

***If you haven't watched it, I recommend Chris Martenson's "Crash Course" for a methodical, understandable video presentation of our financial system and its relation to energy. My parents listened to my esoteric language on these topics for years and after watching Chris' videos, said "Aha! Now we get it"...;-)*



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