

5. Growing by Saving and Investing

The theory of the dynamic production structure is an important contribution of the Austrian School. Menger, Mises but also Hayek (the 'Hayekian triangle') explained about the various phases in the production process. Additional investments make it possible to deepen this production structure. The stronger a production structure, the more wealthy a society is, because it is the production structure that enables people to consume on an ongoing basis.

By investing in and expanding our production structure, we are able to consume more later. Or, this allows us to produce in a more efficient or cleaner way, which gives us more free time or more clean air later on. By investing well in our agriculture, buildings, technologies, projects, infrastructure and in small and large companies ('companies', altogether), we can accomplish the future desired way of life. Without investments, the production structure will deteriorate. After all, without maintenance wear and tear will take place and things will break down.

Where is the money invested?

An investor makes a return by investing in companies active in a certain production phase (for instance greenhouses) and by selling their products (fruit and vegetables) to companies in a higher stage (retailers) of the production structure. At each stage, value is added over time, which allows the companies to selling their products at higher revenues. What matters is the price or revenue ratio between the successive production phases and the added value over time. This ratio and value addition allows the producer to pay back interest in the case of a loan and dividend in the case of an equity investment. If a company is able to increase this dividend payment each period, the value of the equity investment will go up as well.

The production structure adapts to the preferences of society. Savings are invested there where the highest return is to be expected. These are companies that supply products and/or services that are most in demand and where prices will therefore be the highest relative to others.

If society is getting older on average, the market interest rate tends to go up and less money is available for investing, as explained in the previous article. With less money available, there is less competition from other investors. The investors will invest in the projects and ventures with the highest expected return. The demand by the 'older on average society' is for different products and services compared to a younger society. It is for instance likely that the demand for healthcare goes up. Due to the higher demand, prices of healthcare services will go up compared to other prices.

For investors, money is to be made in healthcare. This can result in a deepening of the healthcare production structure, by investing in new health technologies, to make the healthcare sector more efficient and productive. Part of the investment will be spent on wages of people working in the healthcare sector. The healthcare wages will rise relatively to wages in other sectors. As a consequence, more people will want to work in healthcare, to meet with the growing demand of the older and growing part of society, because this is where more money is to be made.

More or less growth?

If we invest just enough to maintain the production structure, we can continue producing the same amount of consumption. The economy will then neither shrink nor grow. If we invest more

for later, the economy will grow. The production structure will be expanded and we can consume more or work less later on.

If less is invested than it is necessary to maintain the production structure, the economy will shrink. This is not bad. An aging and shrinking population, for example, gradually needs less consumption. It does not matter whether the economy grows or shrinks, as long as this is the result of the voluntary choices of society.

Economists often speak of 'economic growth' when the Gross National Product (GNP) is increasing. A simple formula for GNP is: $GNP = C + G + I + NX$.

- C stands for Consumption expenditure
- G for Government expenditure
- I for Investments and
- NX for net exports (so, Export minus Import)

Important to mention is that National Statistics Bureaus only include the added value in the production chain in the GNP. This is explained in Mark Skousen's classis 'The Structure of Production'. As a result Consumption makes up the biggest part of almost all national GNPs worldwide.

An increase in consumption is seen as positive by economists, because it increases the GNP number, which supports the idea that 'the economy is growing'. If an economy is shrinking, politicians tend to respond by stimulating Consumption, because this has the biggest impact on increasing the GNP number and on 'improving the economy'. This idea is a cornerstone of Keynesian Theory, with the idea that an increase in consumption will stimulate investors to investing more, resulting in more employment, more consumption, and so on.

The Austrian School holds the opposite view: a lower consumption and an increase in investment is a sign of economic growth. Only if less is consumed now, more can be saved and more can be invested. Consuming more now does not always mean that people also want to consume more in the future. It is this time elements that is completely absent in Keynesian theory. Investors and entrepreneurs invest more if they expect a higher consumption in the future. Producing more goods and services cannot be accomplished overnight, this takes time.

Investments are made in production goods, which are sold in the chain of the production structure to an higher stage. This ultimately results in more consumer goods being offered, and results in an improvement of our well-being. The engine of 'the economy' is not consumption, but the savings with which to invest.