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## Real Wealth: Avoiding false images

*Wilfred J. Hahn*

**W**hat is wealth? It is a term that is used very loosely these days. In our modern financial world, few understand its true essence. The term can mean anything from jewels, natural resources to over-valued baseball card collections and high-flying financial investments. While these things indeed can be very expensive, are they sources of real wealth?

Centuries ago riches were perceived much differently. Then, it tended to be considered as the direct ownership of material things (*gold, land, flocks, stores of food, slaves ... etc*). Wealth had little to do with amounts of money (*coins mostly*) but rather was counted in the number of possessions ... livestock, for example. Today, wealth is most likely to be defined in financial terms.

Yet, whatever the changes in perception and form of riches down through the ages, real wealth

hasn't really changed at all. At its core, wealth is nothing more than the totality of the physical creation and the collective productive capacity of mankind's labor — past, present and future. We can define these types of wealth as either created or of human origin. Both of these forms are finite at any given point in time. The earth already exists with its minerals, oceans and landmasses. As well, the labor supply is static at any one time. After all, there are only so many people of potential working age on earth at any any one time. And each of us are bound by the same 24 hours each day.

We see that the world's wealth has a maximal physical or productive potential. It is fixed at any one moment. Yet, the volume of real wealth can change over time. It can do so mainly in two ways. The most important and sustainable means is through an increase in the earth's population. The more people there are, the greater the capacity for labor, the more hours of human labor that are available in the world. The greater the potential amount of labor, the greater the opportunity to create or hoard wealth. After all, without labor, there can be no prospect of human income; and without savings in some form, there can be no human wealth. This is an important concept to understand. For only a correct definition of wealth can protect against the deceptions behind modern day financial and wealth trends.

### **A Simple Example of how Real Wealth Takes Form**

Let's briefly examine the basic underpinnings of wealth with a basic illustration. Let's suppose that we are wandering Bedouins roaming the Judean desert. In our random travels, we happen to come upon some wild vines. It is late summer and these vines are loaded with grapes. We're

hungry, so we reach for one cluster and eat them. In doing so, what have we done? We have expended our labor and then consumed it. We worked — admittedly not very hard — by picking the naturally-created grapes from the vine and then ate them.

The created wealth — the naturally growing grapes that were preserved on the vine — no longer exist. We saved nothing. What if we picked all of the grapes on the vine, ate only a portion, and then brought the rest back to our village? We have now worked harder, picking all the grapes and transporting them home. Wealth has been created since we've picked more grapes than we have eaten. Why? Simply because our labor has been saved in some form — in this case, grapes transported to a village. We are now in a position to exchange our harvest for some other product or service. Or, we might choose to consume these savings (*eat the remaining grapes*) ourselves at some later time. Whatever the case, wealth was created by translating our labor into something that has potential value in excess of our present consumption requirements.

But what is the “potential” value of what we have saved? Value is a nebulous concept. Prices can fluctuate independent of real wealth. Like beauty, value exists in the “*eye of the beholder.*” Since we have picked these grapes, we may keep them for our own use unless or until we find someone who offers to buy them in exchange for something that we might want more. If we decide to do so, we will have chosen to receive something of value (*to us*) that the other party will have saved or promised. Perhaps the buyer of our grapes will offer us an exchange for a chicken he has raised. Or, what if our buyer has nothing saved — whether in the form of raised chickens, silver

coins, or something else — with which to buy our product? He could instead offer us a promise for a service he will perform in the future. Let's say that a buyer makes us an offer that he will repair our tent the next time it is damaged in a sandstorm in return for our grapes. If we accept his offer, we have chosen to allow our buyer to take ownership of our grapes in return for his promise to perform a service for us in the future. He is now indebted to us. We still have our savings, only now it is transformed into a claim upon our buyer. We have chosen to buy an income — the output of someone's labor — in the future. Having made the deal, our buyer eats the grapes. The real wealth — fresh grapes picked and delivered to the village — now no longer exists. Yet, wealth hasn't vanished entirely. It now takes the form of a promise of future labor ... a future production of wealth. It is a little riskier form of wealth than our grapes. Our buyer may renege on his promise or perhaps because of sickness be unable to deliver on his promise.

Of course, the above example is very simplistic. I have used a consumable item as the product. Had we sold something like a machine, quite a number of other wealth-creating concepts would need to be explored as well. However, these will not add anything to a basic grounding and understanding of real wealth and hoarding.

### **Three Important Truths About Wealth**

Our grape-picking exercise highlights three important truths about human wealth. First, it is inextricably tied to human labor. Ultimately, the value of all wealth rests on the foundation of income — someone's labors somewhere on earth, past, present or future. Second, wealth can only be accumulated when we consume less than our labor

produces. Third, if we exchange our savings for a promise of payment in the future, the underlying support for that liability ultimately depends on the labors of another human sometime in the future.

The inviolable fact of God's creation is this: There can be no human wealth without human labor whether past, present or future — either accumulated as savings in the past or an exchange for the promise of savings in the future.

The reality is that the accumulation of real wealth is a slow-moving process. Viewed simplistically, human wealth in the world expands as the working population grows, and our incomes and labor exceed our consumption. Many financial institutions — mutual fund management companies, for example — like to convince their clients that financial markets create limitless wealth. They would have us believe that stock and bond markets supposedly build wealth all on their own, independent of incomes, savings and human labors. And of course, each mutual fund company likes to claim that it can extract more of this wealth out of financial markets for its clients and its own profit than any other mutual fund company.

While these may be attractive concepts that sell billions in mutual funds, it is a total fallacy that financial markets create wealth. Neither do the financial and wealth management industries. By and large, their businesses are more concerned with the transfer of wealth. That's not to say that financial services do not have value or are unimportant. But to the extent that these industries promote the perception of "value" as wealth, or their ability to create wealth apart from human labor, they are mostly bamboozling us.

### **Real Wealth Really Growing Only Slowly**

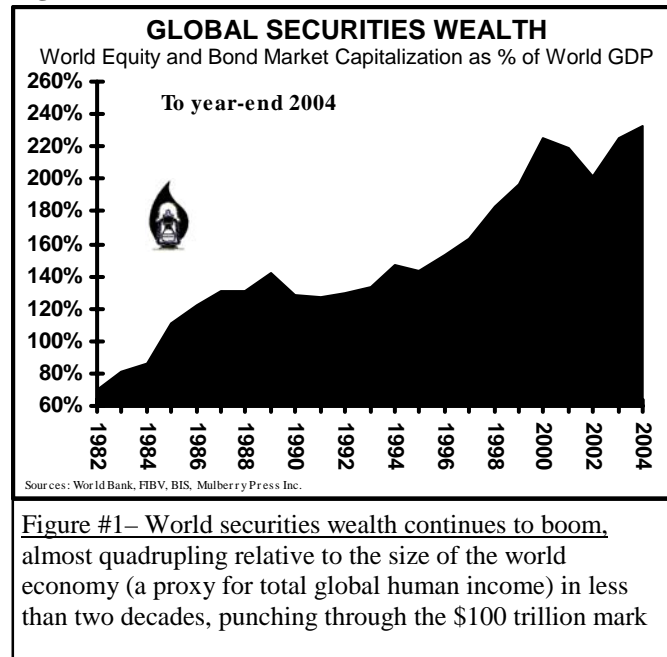
In recent years, the value of financial assets has risen by leaps and bounds. Financial securities in particular (*stocks, bonds and related instruments, a major component of financial wealth*) have virtually exploded in value in recent decades, recording rates of increase of 15% to 25% per annum and more. Figure #1 documents this trend relative to the size of total world income.

There's no denying that some people have been accumulating an incredible amount of financial wealth during this period. But how do these gains compare to the growth of *real* wealth? Just how fast has real wealth expanded these days? We can calculate this trend quite easily.

To begin, the world's population is growing at a rate slightly above 1.1%.<sup>1</sup> Though that is less half the rate of the mid-1960s, it is still growing much faster than the average growth rate of the world's population since the dawn of time. The higher the population growth rate, eventually the greater will be the working age population in the future. As a result, the higher the available pool of income producing labor hours, the greater the potential for wealth. By this measure, potential human wealth must also be growing at a rate of 1.1% per annum.<sup>2</sup>

There are other factors at work that we have overlooked thus far. For example, we have not considered the impact of productivity growth. This concept captures the idea that by working harder or smarter, the efficiency of human labor is increased. Higher productivity means that we are producing more potential wealth for each hour that we work. For instance, had we used an automatic grape-picking machine in our earlier example, we could have picked 20 times more grapes than we did by picking them by hand. We would have

**Figure # 1**



greatly improved the productivity of an hour of labor by using a machine.

World productivity growth can be estimated, though its measures are not precise. Presently, economists believe that it is expanding at a rate of approximately between 2%-3% per year. In other words, for a given amount of labor hours, 3% more output is being produced than the year before. Knowing this, we can now determine how fast real wealth is expanding. By combining both population and productivity growth we know that real wealth can grow no faster than 3.1% - 4.1% per year on a sustainable basis. This rate may be faster or slower in any one year for various reasons. In the context of human history, a sustainable rate of growth in wealth as we have estimated is a fast pace. For centuries and millennia, wealth increases crawled along at rates

of only a little above zero. All the same, a 4.1% growth rate in real wealth pales in comparison to the pie-eyed expectations of gain in financial markets these days.

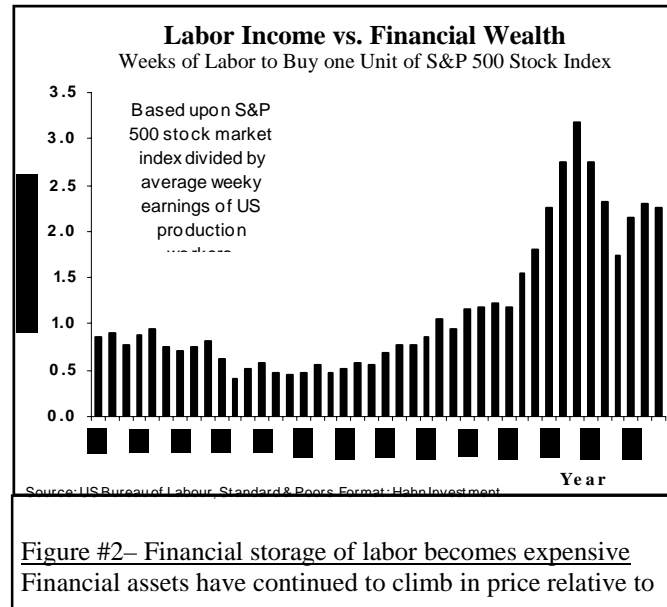
**Foundations of Modern Financial Wealth are False**

As already mentioned, financial wealth has been booming during our generation. How can this be when real wealth is creeping along at a fraction of that rate? Here we see that a main driver behind this apparently huge rise in wealth has been a rising perception of value. *(There are a number of other significant global developments that contribute to the rise of financial wealth not explained in this booklet. Ask a representative of our firm for publications explaining this phenomenon in greater detail.)*

The value of any financial asset — stock or bond *(or any asset or collectible for that matter)* — depends on the willingness of someone else to buy it. In the human economy, it only follows that for every seller there must be a buyer. If no one wants to buy something, then theoretically, it has no value. The highest priced stock or bond would be worth nothing if no one was willing to buy it — a truth that has recently again been discovered as financial markets have fallen in value. Yet, if that stock or bond continues to deliver income in the form of dividends or interest income it still represents real wealth. It will continue to transmit income to its owner.

But isn't it possible to sell an appreciated asset and then live off the proceeds? Yes, that is possible of course. But that can only apply to an individual, not to the world overall. We remember that for every buyer there must be a seller. Our proceeds from a sale are paid by someone else.

Figure # 2



The transaction has produce no new net income for the world, only an ownership change.

Capital gains when realized *(price gains on assets)* can lead to higher real wealth for individuals so long as these gains are eventually converted to investments that have claim upon current or future income. It is key to see that this cannot be possible for everyone at the same time. *(Economists call this paradox the “fallacy of composition.”)*

We see, therefore, that financial values associated with booming financial markets and real wealth are not necessarily the one and the same. Even if there was no financial value, there can still be real wealth. In a sense, real wealth is a little like truth. It can exist even though it is misconstrued or perceived to be of little value. Real wealth like truth is independent of perceptions and relative evaluation. Financial

wealth, on the other hand, is not.

A key point to see is that perceptions of wealth cannot feed the world any more than the world can buy its groceries on love. Yes, financial assets can of course generate income with which to sustain lifestyle needs. Crucially, all of this income is by definition based upon human labor. Over time, in order to live, the world as a whole (*in the aggregate*) can only buy its food and necessary amenities out of income. Only the output of labor and the accumulation of real wealth can provide sustainable sustenance over the long-term.

If apparent wealth (*perceived financial wealth, for example*) is rising much faster than underlying income growth and savings, then something potentially very dangerous is occurring. It gives rise to a very deceitful environment, one in which claims on true wealth — the ownership of human labor; past, present and future — is being misrepresented. It leads to a world that is deceived and may fall for an enormous bondage to fictitious financial wealth. At the same time, a fixation with the pursuit of gain in financial markets provides a greater facility for the hoarding of wealth by a select few. (*Other publications of Hahn Investment Stewards & Company Inc. deal more fully with this topic, explaining the means and mechanisms and documenting a widening wealth gap around the world.*)

No matter what happens to financial market wealth, what matters in the end is who owns claims to income. In other words, who owns the fruit of other people's labor.

### **Giving Away Labor for a Mess of Pottage**

Misunderstanding the nature of true wealth,

many people have been selling their birthright — their God-given years on earth and capacity for labor — for a mess of pottage. To help explain this point, consider US stock market prices relative to wage trends. At the end of the last century (1999), the S&P 500 (Standard and Poor) stock market index was at a level of 1,469 ... or \$1,469 for the sake of illustration. At that time the average weekly wage per employed private worker as calculated by the US Bureau of Labour was \$463.68. Taking these two figures, we could say that one index unit of the S&P 500 would cost 3.2 weeks of wages. When an investor chooses to buy one unit of the S&P stock market index, they have chosen to store 3.2 weeks of labor in the financial form of stocks. Is that a good trade? Ten years earlier (*at the end of 1989*) a unit of the S&P 500 index would have cost considerably less — only a little more than one week's labor of an average worker. Ten years earlier again (*year-end 1979*) a unit of the S&P 500 would have cost even less — only 0.48 weeks labor income or approximately a half week's work.

What we see is that over a period of two decades, US stock markets have become more expensive relative to labor by a factor of six times. Put another way, investors at the end of the last decade saw the stock market as a storehouse for their labor as six times better than 20 years earlier. Did investors actually believe that they are trading their labors for something that will return their 3.2 weeks of labor income (*the equivalent amount paid for an investment in one unit of the S&P*) or more in the future? Does one unit of the stock market yield better earnings and dividends than 20 years before? Hardly. While the stock market had risen 13.6 times over the two decades reviewed, earnings rose only 3.3 times, dividend income only

3 times. While it is true that the reported earnings represented by the S&P 500 stock index appeared to rise faster than labor income — 62% more — stewards still chose to store their labor in stocks for only a fraction of the value 20 years earlier. (*As it turned out, much of corporate earnings growth in the 1990s was fictitious.*)

Valuation swings of this magnitude are irrational. Knowledgeable investors wouldn't trade their valuable labors — a resource that each of us have only been given by God in a finite, unknowable quantity — so cheaply.

### **Conclusions and Consequences**

Fixation with financial wealth and appreciated perceptions of value — soaring stock markets, booming bond markets, huge house price gains ... etc. — are distracting many people from pursuit of real wealth. The proof? Indebtedness and the gap between the rich and poor continues to rise to unprecedented extremes.

The world, thinking that it is getting rich by virtue of soaring asset prices, is actually deceiving itself, as real income — the product of human labor and the true source of sustaining wealth — is growing only very slowly. The truth behind this relationship will be very evident in the next few decades as world population growth continues to slow sharply. Inevitably, the relative income needs of a rapidly aging population will clash with a declining labor force.

As mentioned, appreciating prices (*capital gains when realized*) can lead to higher real wealth for individuals so long as these gains are eventually converted to investments that have claim upon current or future income. This is an especially critical consideration for individuals

planning for retirement.

Here are some guidelines to keep in mind when seeking stores of value for your saved up labors.

1. Get a claim upon income: Make absolutely sure that you have a claim on investment earnings — quality interest and dividend income. Ultimately — especially so in a world of declining population growth — all financial values must rest on basic income. That's an aspect of the human economy that will always remain true, no matter how sizzling and futuristic the world may seem. Pay less attention to capital appreciation alone. Whenever opportunities avail, invest your savings in securities or ventures that have a strong prospect of continuing to deliver income (*hopefully income that is also rising*) — whether markets rise or collapse.
2. Avoid assets that can be manipulated: Choose investments that are least subject to volatile swings in value due to manipulation or fickle human emotions. Securities markets are notoriously easy to control by monetary authorities and owners or managers of large pools of financial wealth. For the long haul, minimize the type of investments whose value can fluctuate suddenly and wildly with supply and demand. As much as practicable, avoid over-valued securities markets (*relative to labor income*).
3. If at all possible or suitable, seek other types of stores for your savings in addition to financial securities. Invest savings in stores

### *Real Wealth:*

of value other than in financial securities markets. Direct ownership of businesses and real property with good income prospects would be recommended ways of diversifying future income potential.

The first objective of all investing and retirement planning is to at least ensure that our savings — excess labors in excess of consumption — are turned to us in the form of income sometime in the future. Hopefully, it will also be possible to generate an increase upon our original investments over and above the rate of inflation, in this way securing a secure and increasing real wealth.

Critical to the success of these endeavors is an understanding of real wealth and the avoidance of its false images.

### *Avoiding false images*

#### **End Notes**

1. Source: United Nations Population Division (UNPD).
2. For the sake of illustration, we assume that potential labor force growth is the same as population growth. While there is a strong relationship over long periods of time, in actuality, the two can vary quite sharply over shorter periods for various reasons. A key difference is due to the standard definition of potential labor force. Persons of 16 years of age or older are considered potential entrants to the labor force. As such, labour force growth lags population growth by at least 16 years.