

Re: Aggregate debt

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From: Michael Vilkin (mikevilkin_at_mail.com)

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William F Hummel <wfhummel@comcast.net> wrote in message
news:<16dnc0lua4ugc4pn77fdeedomj3mderhre@4ax.com>...

> On 12 Jun 2004 16:18:39 -0700, mikevilkin@mail.com (Michael Vilkin)
> wrote:
>
> <snip>
>
> > *This example illustrates the most fundamental principle of our
> > banking system. It's impossible to pay accumulated debt unless the
> > banking system continuously makes new loans.*
> > *We should note, however, that when our moneylender spends money that
> > he earned as interest, that money is returned to the economy.*
> > *The worst thing to happen is if and when aggregate debt is many times
> > bigger than the amount of money in circulation, and bankers slow down
> > creation of money.*
> > *That is a recipe for economic depression.*
>
> *There is nothing inherently unstable about money lending within the
> private sector. Banks provide the liquidity that firms need to manage
> their cash flows, including the means of payment in advance of revenue
> from sales. In return banks earn a fee for service or earn interest
> on loans, which amounts to the same thing. They do not share in the
> profits, but do share in the loss if the firm proves not to be viable
> or is poorly managed and unable to repay its loans.*
>
> *Bank credit has a major effect on economic growth. When banks get
> overly cautious and fail to provide sufficient liquidity to meet the
> demand, that's when the economy suffers. Banks need to at least break
> even to remain in business. But if that's all they could do, in the
> aggregate borrowers would be paying the interest on their loans from
> what the banks spend, not from new loans.*
>
> *Banks do increase their lending for the simple reason that there is
> continuing demand for credit expansion in a growing economy. It's
> myopic to argue that banks must continue to lend more and more just to
> enable borrowers to pay off their debts. Banks lend to grow their
> capital and pay dividends to their shareholders, not just cover their*

> *expenses.*

William, thanks for the explanation. We agree on most things, except a couple of points that I very much would like to discuss.

I have nothing against bank credit. I believe that banks should print money and create a lot of bank credit to make loans to build new cities and new communities. Housing is very important as you know. I believe there will be no inflation. If I borrow, say, \$100,000 to build a new house, \$100,000 of new money will be created with new debt. But in a few months a new house will be ready which has a market price close to \$100,000, plus or minus a little. In this case money supply increased by \$100,000. A new house represents real wealth. Credit may be productive. Credit can create new wealth, which is worth also \$100,000 in this case.

My point is this. Let me put it in numbers so that we don't confuse similar terms like money, credit and debt.

Here is a theoretical question.

Suppose, the banking system lends total of \$100 B at 20% interest per year and collects \$20 B in interest. So, \$20 B is taken out of the economy. Now \$20 B sits in banks' own accounts.

Banks have certain expenses, so banks return back to the economy \$10 B per year out of those \$20 B.

In this case \$10 B will be taken out of circulation, and money supply will fall by \$10 B.

I don't say that the banking system really does this every year. This is just an example.

Do we agree that money supply may increase or fall depending on the amount of interest earned – \$20 B in this case – and the amount of money banks return to the economy, which is \$10 B in this case?

To keep money supply from falling, the banking system has to create new money with new debt. If the banking system will not create \$10 B of new money, money supply will fall by \$10 B in this case.

William, if we agree on this, I will continue. Thanks.

—Michael Vilkin