Re: Aggregate debt

Source: http://sci.tech−archive.net/Archive/sci.econ/2004−06/0706.html

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From: William F Hummel (*wfhummel_at_comcast.net*)
Date: 06/13/04

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Date: Sun, 13 Jun 2004 21:04:14 GMT
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On 13 Jun 2004 11:49:10 −0700, mikevilkin@mail.com (Michael Vilkin)
wrote:

<snip>

>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.

As I explained earlier, credit money is endogenous which means the amount ultimately depends on the demand for bank credit. The amount will increase or decrease as economic conditions change, and thus vary the demand for credit. There is nothing unusual about a decrease in credit money in the short term. However on average over the long term, the amount will increase because the real economy has a growth bias.

Banks need to grow their capital in order to back the ever−increasing demand for credit money. They return most of their earnings to the non−bank sector in operating costs, dividends, and bad loan writeoffs. A typical return on equity is about 10% if the bank is well−managed. They need about half of that just to stay even with the growing demand for credit.

You are arguing that interest on bank loans is a positive feedback which _forces_ banks to lend still more so the borrowers can pay the interest on those loans. I claim that applies only to a decaying economy, in which banks themselves would fail. If borrowers can't service their loans, including payi