Re: Refuting supply−side economics

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From: William F Hummel (*wfhummel_at_comcast.net*)
Date: 09/18/04

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Date: Sat, 18 Sep 2004 04:19:12 GMT
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On Sat, 18 Sep 2004 01:40:22 GMT, William P.F
<catastrophic_success@wh.con> wrote:

>On Fri, 17 Sep 2004 18:20:12 GMT, William F Hummel
><wfhummel@comcast.net> wrote:
>
>>On Fri, 17 Sep 2004 15:53:48 GMT, William P.F
>><catastrophic_success@wh.con> wrote:
>>
>>>On Tue, 14 Sep 2004 03:58:16 GMT, William F Hummel
>>><wfhummel@comcast.net> wrote:
>>>
>>>>Since the Treasury sells securities in small amounts frequently in
>>>>order to avoid a temporary shortage of loanable funds, how can there
>>>>be any significant effect on dollars available for private sector
>>>>investment?
>>>
>>>Because due to the increasing level of debt the cumulative effect of
>>>all the sales will be that eventually the treasury will drain the
>>>market off of investable dollars.
>>
>>Except for a brief on−budget surplus in 1999 and 2000, Treasury debt
>>has been growing steadily for over 40 years. In 1962 the debt held by
>>the public was $248 billion. Today it is over $4,000 billion. How
>>long will it take to drain the market of investable dollars?
>>
>
>We should see the first effects of that in the next few years. The
>growth of the debt will exceed the that of GDP and when the size of
>the debt will get to a point that investors will not be willing to
>accomodate the extra demand with these lower rates. There are a lot of
>things that will pile on more debt in the next few years; the baby
>boomers will start to retire, more entitlements coming online in the
>next couple of years like the prescription drug for seniors, the
>effects of the tax cuts are not fully reflected in the numbers as many
>of those tax cuts have still not kicked in and last but not least the
>cost of the war. Not to mention that currently short term rates are
>below inflation an anomaly that cannot last forever unless economic

>theory is fundamentaly flawed and every interest rate increase also
>increases the cost of servicing the debt.
>As the amount of money needed to service the debt grows faster than
>GDP interest rates will have to rise even more. It's either that or
>Greenspan keeps printing money in which case the dollar becomes trash.

Over the last 15 years the annualized growth rate in the interest paid
to service the debt has been about 2.7% compared to a GDP growth rate
of about 6.5%. The actual interest payments on the outstanding debt
reached of peak in 1998 and has since dropped every year except in
1999. That doesn't seem too bad.

Greenspan "prints money" for only two reasons: (1) to meet the demand
of the public for currency (Federal Reserve notes), and (2) to provide
reserves to banks as needed to meet their reserve ratio requirements
in order to maintain control of the Fed funds rate. Item (1) accounts
for over 90%. So how does meeting the demand for currency fit into
your hypothesis?
>
>>>Hence the higher interest rates.
>>
>>While the debt quadrupled in the twelve−year period 1981 to 1992,
>>interest rates trended downward.
>
>Any meaningful comparison in this regard will have to be done with the
>real interest rate not the nominal one.
>Anyway, are you saying that high deficits and debt levels do not
>affect interest rates?

The real interest rate also trended down in those years.
>
>>Interest rates are lower today than
>>they were when Dubya blew the lid off. Where are the higher interest
>>rates you are talking about?
>>
>Again check the real rate of return. I am sure if you do your
>conclusions will not be as clear.

See above.
>>
>>>First Greenspan has been expanding the money supply aggressively, and
>>>second our trade partners are willing to reinvest their trade
>>>surpluses in treasury bonds.
>>
>>Our trading partners love to accumulate US Treasury bonds because they
>>are denominated in the world's reserve currency.
>
>Well yes, so far.

All of our trading partners have been fighting to sell goods to the
US, and erecting barriers to our exports. They must think investing

in the US is a pretty good deal.
>
>> And they will
>>continue accumulating those bonds as long as they succeed in
>>maintaining their trade surpluses with the US.
>>
>If that premise was right then the world would have jumped at the
>chance to accumulate Argentine peso denominated debt since it ran a
>huge surplus with that country and therefore Argentina would have
>never defaulted on their debt. All it would have to do would be to
>just print more pesos.

A US trade deficit inevitably results in an increasing amount of
dollar−denominated assets held by other countries. Some of those
assets are held in Treasury bonds by their central banks.
>
>>>It's only a matter of time before market
>>>fundamentals put an end on these, forcefully probably.
>>>
>>What "market fundamentals" do you have in mind?
>Supply and demand. Is that fundamental enough for you?

It sounds pretty fundamental, but what does it actually mean?