Re: Debtor Nation, another view

Source: http://sci.tech−archive.net/Archive/sci.econ/2005−10/msg00147.html

- *From*: William F Hummel <wfhummel@xxxxxxxxxxx>
- *Date*: Wed, 12 Oct 2005 08:04:15 −0700

On Tue, 11 Oct 2005 22:07:34 −0400, "Dan in Philly" <djr8@xxxxxxx>
wrote:

>"William F Hummel" <wfhummel@xxxxxxxxxxx> wrote in message ...
>
>> Debtor Nation, Without Rhetoric
>> By Thomas Nugent
>
>Any relation to Ted?
>
>> it is fact − not theory − that
>> government budget deficits add exactly that amount to the savings of
>> financial assets that the rest of us hold.
>
>Budget deficits are matched by issuing financial assets (eg. T−bonds); that
>doesn't mean that savings are unchanged.

Apparently you mis−read. Nugent is saying that the aggregate savings
of the private sector (the rest of us) increase when the government
runs a budget deficit.
>
>> When the consumer borrows to buy (a German) car rather than using cash in
>> his
>> bank account (a more likely option), the bank makes a loan to the
>> consumer, creating a loan on the asset side of the bank's balance
>> sheet and a new deposit on the liability side. (Loans create
>> deposits.) After the car is paid for, the German car company has the
>> new bank deposit. Note that consumer borrowing increased total bank
>> deposits and funded foreign deposits (savings) of U.S. dollars. The
>> widely held causal myth is that foreigners are funding U.S. consumers.
>
>yuck. Where did the bank's loanable funds come from?

Loans create deposits. Thus "loanable funds" automatically exist if
banks have the capital to back them. There is no finite pool of
so−called loanable funds.

>If the consumer hadn't
>bought the foreign car, what would those funds have been used for?

Those funds are created by the loan, and thus would not exist if the
consumer hadn't bought the foreign car.
>
>> That's what the trade gap is all about −− the desire of foreigners to
>> net save U.S. dollars and to sell goods and services to the U.S. to
>> obtain those assets. If foreigners did not desire to save U.S.
>> dollars, they would instead [use their dollars to] buy goods and
>> services from the U.S. and there would be no trade deficit.
>
>Or, if they didn't want dollars, they would convert them to yen, euros, etc.
>and cause the dollar to depreciate. Which is what began happening a couple
>years ago.
>
Correct. The forex value of the dollar will drop if there is a
preference for other currencies.

Against the major foreign currencies, the dollar has depreciated a
wopping 4% since Oct 2003. Today it is at the same level that it was
in Sept 1995. At one point during that period it was 29% higher than
it is today.
>
>> When foreigners hold Treasury securities, the U.S. government is said
>> to have foreign creditors, and the U.S. is said to be a debtor nation.
>> While this is true by definition, a look past the rhetoric at what the
>> U.S. government actually owes the holder of Treasury securities is
>> revealing. The government promises that, at maturity, the foreigner's
>> security account at the Fed will be debited, and his bank's reserve
>> account at the Fed will be credited for the balance due. In other
>> words, the U.S. government's promise is only that, at maturity of the
>> Treasury security, a non−interest bearing reserve balance will be
>> substituted for an interest bearing Treasury security. This
>> transaction is not a potential source of financial stress for the
>> government. Remember, the U.S. is no longer on a gold standard meaning
>> that the dollar is not redeemable at the government for gold or any
>> other good or service.
>
>So: using money creation to pay our foreign debts?

That's one way of looking at it. A more realistic way is that in the
aggregate foreigners want dollar credits, which can be created in
unlimited amounts. Note that the more dollar credits they acquire,
the more dependent they are on a strong dollar for their own financial
welfare.
>
>* * * *
>The only relevant question about budget deficits (arising, presumably from
>tax cuts or spending increases) or trade deficits is: does it change our
>consumption (C and G in the gdp equation Y = C + G + I + NX)? If not, then
>the article is basically right.
>

At present, our trade deficit is vital to the rest of the world's
major economies. Imagine what would happen if Japan, China, and
Euroland suddenly lost their net export advantage vis−a−vis the US.
Until those economies build domestic demand capable of absorbing their
own outputs, they are dependent on net exports.
.

- ***Follow−Ups***:
  - ***Re: Debtor Nation, another view***
    - *From:* royls
- ***References***:
  - ***Debtor Nation, another view***
    - *From:* William F Hummel
  - ***Re: Debtor Nation, another view***
    - *From:* Dan in Philly
- Prev by Date: ***Re: China's growth trumps ours due to neoeconomics***
- Next by Date: ***Re: Debtor Nation, another view***
- Previous by thread: ***Re: Debtor Nation, another view***
- Next by thread: ***Re: Debtor Nation, another view***
- Index(es):
  - ***Date***
  - ***Thread***