

Re: Paying for Katrina, another view

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- *From:* "The Trucker" <mikcob@xxxxxxxxxxxx>
 - *Date:* Wed, 12 Oct 2005 10:33:10 -0700
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"William F Hummel" <wfhummel@xxxxxxxxxxxx> wrote in message
news:vl0lk195ojhi7a5i527bhipkfq40cqd8u@xxxxxxxxxxxx

> How Will America Pay for Katrina?

> (Why are we even asking this question?)

>

> by Tom Nugent

> NRO Financial, Contributing Editor

> September 27, 2005

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> In rapid-fire succession, mainstream economists, pundits, and freshman

> politicians have offered various solutions to paying the costs of

> Katrina. President Bush has proposed spending \$200 billion to rebuild

> the ravaged Gulf Coast, while the president's detractors hold that the

> resulting larger budget deficit will penalize future generations and

> drive interest rates higher. Budget conservatives, meanwhile, have

> offered the Hooveresque prescription of spending cuts, postponed tax

> cuts, and higher taxes to pay for hurricane damage.

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> We've been here before. Only a couple of years have passed since

> similar arguments were put forth about the budget impact of tax cuts

> while we're spending on the Iraq war. Following these warnings of

> too-much-government-deficit spending, the economy rebounded, there was

> no "crowding out," and longer-term interest rates held steady (even as

> the Federal Reserve removed accommodation by raising short rates). The

> concerns of the budget-deficit hawks didn't pan out.

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> Let's take another look at the current concerns voiced by both

> Democrats and Republicans regarding deficit spending and put them into

> the proper perspective.

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> The budget deficit will be too large with both the Katrina spending

> and the tax cuts; interest rates will rise dramatically. Budget

> deficits are only too large if they usurp the private economy's need

> for physical capital and labor, thereby precipitating an inflationary

> surge. In previous recessions, the deficit reached 5 percent of GDP

> before the economy improved, as it did towards the end of 2003. Today

> it is about 2.5 percent of GDP. Using history as a guide, until the

> deficit gets to 5 percent of GDP, the economy will have too much

> fiscal drag to maintain its potential growth path. We need a bigger

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- > budget deficit, especially when economic and monetary forces are
- > acting to restrict economic growth.
- >
- > Short-term interest rates, meanwhile, are controlled by the Fed and
- > the market's anticipation of what the Fed will do down the road. While
- > the Fed has control over the federal funds interest rate, the factors
- > influencing long-term interest rates are not directly connected to the
- > Fed's current policy. As the Fed has acted to drive up short-term
- > interest rates over the past two years, long-term interest rates have
- > remained relatively stable. The recent swing from a huge budget
- > surplus to a rising federal budget deficit has had no impact on
- > interest rates. Rates went lower, and then higher, to exactly where
- > the Fed voted them to be. Arguments that interest rates are going
- > higher because of deficits are misplaced; interest rates are going
- > higher because of Fed policy.
- >
- > How does the federal government pay for the damages caused by Katrina?
- > Does anyone asking that question actually know how the government pays
- > for anything? Essentially, the federal government pays for things in
- > just one way – it credits a member bank account. Let's review the
- > process: The federal government writes a check to a construction
- > company to pay for a bridge. The construction company deposits the
- > check at a bank. When that check clears, the Fed credits the bank's
- > reserve account at the Fed, and then the bank credits the company's
- > bank account with "good funds." Bottom line: Operationally, virtually
- > all of the federal government's spending per se consists of the Fed
- > crediting an account – that's all. The federal government doesn't have
- > any "box of money" that gets "filled" from tax collections and the
- > proceeds from new Treasury securities and then gets "used up" by
- > spending or lending. This is an operational reality. In today's world
- > of non-convertible currencies, spending is necessarily nothing more
- > than "score keeping." (If one football team scores a touchdown, and 6
- > points are added to its score, does anyone ask where the scorekeeper
- > gets the points?)
- >
- > Likewise, tax payments simply reduce account balances in the private
- > sector. Nothing "goes" anywhere; the government doesn't "get
- > anything." To reinforce this point, if you pay your taxes in actual
- > cash, or buy Treasury securities (government bonds) with actual cash,
- > the Fed shreds the cash. Likewise, if you donate cash to the federal
- > government for Katrina, it shreds it. In fact, if you take a \$100 bill
- > and burn it, you've donated that \$100 to Katrina! Operationally, the
- > entire spending process is not constrained by government "revenue."
- > Whether or not the government has collected taxes or borrowed is not a
- > factor in the payment process. Any constraints on the process can only
- > be "self imposed."
- >
- > So, the actual "paying for Katrina" is not the issue. The issue is the
- > real economic ramifications of the proposed spending or the proposed
- > tax increases – the impact on inflation, output, growth, employment,
- > distribution, etc. Let's take a look at some of these entities:

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- > Is higher inflation coming? Perhaps. Excess government spending leads
- > to higher prices, particularly with rising energy costs, excess
- > capacity in the rest of the system notwithstanding. But has anyone
- > actually expressed this concern? No. There have been no estimates as
- > to how much the additional (one time) Katrina spending will add to
- > inflation. While Fed Chairman Alan Greenspan has provided Congress
- > with detailed analysis of the relationship between interest rates and
- > budget deficits, he has not documented the inflationary impact of such
- > government deficits. The Japanese example of record budget deficits
- > and deflation may give him cause to pause.
- >
- > Will Katrina spending cause interest rates to rise? Hardly. The drama
- > surrounding last week's fed funds rate hike concerned the possibility
- > that Katrina would cause the Fed to pause in their current policy of
- > raising short rates. It's not a case of interest rates jumping up on
- > their own. Interest rates go up or down only when the Fed thinks it's
- > a good idea.
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- > Will private borrowers be crowded out? Impossible. The causation is
- > "loans create deposits," as taught on day one of every traditional
- > money and banking class. The act of borrowing itself creates exactly
- > that same amount of new liabilities (deposits). The process is "self
- > funding" and circular, as a matter of accounting. The concept of a
- > "pool of savings" that somehow gets "used up" by borrowers is a
- > throwback to the time of fixed exchange rates and gold standards, and
- > has no application in today's floating-exchange-rate world.
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- > The true economic cost of Katrina is the real, physical resources
- > committed to repairing the damage that otherwise could have been used
- > elsewhere to expand productivity or improve overall standards of
- > living. But with today's excess capacity in everything but energy,
- > there is not going to be much of an opportunity-cost to rebuilding,
- > apart from temporary dislocations of building materials and energy
- > production. In other words, shortages of goods and services due to
- > rebuilding should be temporary and modest.
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- > In fact, with today's modest expansion seemingly winding down
- > (pre-Katrina), the increase in federal government spending may very
- > well result in a net boost in domestic demand, enough to sustain the
- > current moderate recovery and help keep the real estate markets afloat
- > another year.
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- > Politicians who advocate the elimination of tax cuts and/or cutting
- > other federal spending mistakenly believe that a smaller federal
- > deficit will somehow "pay for Katrina." We need our leaders to get "in
- > paradigm" now.

Let's be sure we understand this: Katrina along with Iraq and tax cuts SHOULD decrease the value of the US dollar. As gold is currently \$470 per ounce where the price just 3

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months ago was \$426 we can see that the dollar has lost value. There is no big secret that the dollar has been declining in value ever since the latest incarnation of tax cut and spend Republicans came to town. We might argue as to whether that is good or bad, but I see no argument over the truth of the statement concerning the "value" of the dollar. The reason we have not had "inflation" as that term is defined by the neocons and the Keynesians alike is that wages have fallen dramatically here in the USA due to cheap foreign labor. As the price of land and gold and oil increase (these are land), the wages have decreased such that the cost of goods (the product of land and labor) has been only slightly rising. But I think we are nearing the end of that era. The apparent rise in the price of oil is more related to the decline in the value of the dollar than it is in the demand for oil outstripping the supply. To be sure, an interruption in the supply of oil and refined fuels caused by Katrina is causing what should be a short term blip. But the overall direction of the dollar is still down

The sale of treasuries acts to decrease the volume of highly liquid dollars in the world and thus gives us a short term stop gap that seems to control inflation even in the absence of taxation. But the liabilities incurred due to excess consumption and lack of production are still there and the only way to remove these liabilities is through taxation. If the Republicans are allowed to address this problem then wages will be taxed at even higher rates and so too will true interest income (that would be what later day neoeconomists and other defenders of aristocracy, plutocracy, autocracy, and theocracy currently call dividends). Land and other privilege which should be taxed, will not be. The Republican objective is to create a land of serfs and nobles and they will use Katrina to that end just as they use everything else to that end.

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"I know no safe depository of the ultimate powers of society but the people themselves; and if we think them not enlightened enough to exercise their control with a wholesome discretion, the remedy is not to take it from them, but to inform their discretion by education." – Thomas Jefferson
<http://GreaterVoice.org>

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- **Follow-Ups:**
 - ◆ **Re: Paying for Katrina, another view**
 - ◇ From: William F Hummel

- **References:**
 - ◆ **Paying for Katrina, another view**
 - ◇ From: William F Hummel

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