I

The contention of this essay is that the merits of Supply Side Economics, so called, are obvious, and historically easily demonstrated. As should be the case in all position statements, I will be applying logic to what I contend are facts to generate support for my claim. My aim is clarity of exposition, such that any errors in either logic or fact will be obvious; and that, conversely, if anyone wishing to refute me is unable to offer concrete examples of such error, that the discussion is not happening within the realm of reason.

To begin, let us begin at the beginning: a definition and discussion of the use of reason. The point of reason is reconciling desired outcome with chosen methods. It is to find beliefs and behaviors which are inconsistent with the desired outcome. It is illogical to eat more and exercise less if the desired outcome is weight loss. It is logical to eat more and exercise less if the desired outcome is weight gain. We make both of these claims based upon the twin assumptions that both caloric intake and exercise have measurable effects upon body weight. If either assumption were to be proven inaccurate, it would no longer properly belong within that logical structure.

Logic, then, consists in three elements: a stated outcome, stated postulates, and a process of developing consistent further necessary conclusions given the outcome and postulates. Postulates in a realm such as economics are necessarily reconcilable to empirical data, or what we tend to refer to as "facts".

To the task here, I will state the desired outcome of economic activity: ***increasing ability on the part of all members of society to provide both necessary and desired objects with less and less unchosen work.***

This should be clear enough, but I will note that by unchosen work my intention is to point to what I perceive as an obvious fact that some sort of work would be needed even if we could get everything delivered to us on silver platters. We grow or die, and work is how we grow. This is a moral question, though, best left for elsewhere.

With this definition I posit that growth (which is more stuff and/or less unchosen work) is better than stasis or regression, both of which are goals tacitly sought even now by members of our political elites. I will not seek here to defend this basic postulate.

I will further posit that if all people within a given order are improving economically, that is the salient fact, not the relative rate at which members are improving. All boats rise on a rising tide, and if all members of an economic order are able to get more with less work, that is an improvement.

If one looks at global economic history, the pace of wealth creation over the last several centuries—measured by the generalized provision of material goods, including housing, access to medical care, and food—is unprecedented in world history. This growth has happened as a result primarily of technical innovation. Such innovation, in turn, plainly happened because knowledge was democratized, and economic incentives provided to invent. I will posit this, and not seek to defend it here.

The salient question, I think, among those who understand the benefits of free markets, is how and why we sometimes reverse; how sometimes it becomes harder to provide for oneself relative to a state in which it was relatively easier; why, in other words, downturns happen, and how best to prevent them, and if unable to prevent them, to make them as short as possible. A further consideration of course would be explaining how and why some localized areas fail to participate fully in economic progress around them.

II

I will begin with a few basics. First: supply and demand. Basic economic theory stipulates that given a fixed supply, increased demand will cause price increases in a free market. Given fixed demand, an increasing supply will cause price decreases in a free market, etc.

In free markets, price is a signal which indicates relative demand and supply. If more and more people want something, then more and more will be produced, since price—and potential profit—will increase, and thus incent production. At some point, when the market is saturated, the price will drop, and production of that product will decrease.

Throughout economic history, this has been the case. When people are allowed to buy and sell at their discretion, prices will rise and fall. The cost of various spices were very high in Renaissance Europe, which is what incented the Spanish to pay Columbus to seek a route to the West to India. Had some ignorant bureaucrat decided the prices were too high and fixed them, then there would have been no reason for Columbus to make his voyage, and in point of fact the spices would have either been unavailable at any price (since people would have ceased making the voyages, since they would have been unable to make any money), or, more likely, a black market in spices would have arisen that would have factored in their illegality, and caused the prices to increase yet more. The desired outcome: plentiful, affordable spices, would not have been achieved.

All business owners/traders necessarily make guesses about market demand. Throughout history, some have guessed right, and some wrong. When they guess right, quite often they can create markets no one knew were possible. For example, when Apple launched the personal computer, there was no existing market for personal computers. It was assumed that computers were for large corporations, and that large (generally IBM) mainframes were the future of computing. Steve Jobs guessed right, and created DEMAND for a market which previously had not had ANY supply.

When Wang Computer declared bankruptcy in 1992, it was a result of business mistakes, which amounted to failure to provide a product the market wanted at a price it was willing to pay. It liquidated its debts, went through some restructuring, then reemerged as a new enterprise.

In free markets, both profit and failure act as incentives. Profit is pursued, and failure is avoided. The possibility of failure is essential, since it amounts to truth telling about the viability of an enterprise.

If we define failure as pain, however, there are clearly grades of pain. It is one thing to save up every penny for 20 years to start a business, and another entirely to make a call to a banker/golfing buddy for a line of credit to jump into whatever the currently hot market is.

What most students of economics fail to grasp is that money creation affects price structures, and thus the rationality of the connection between supply and demand. We assume that businessmen do not want to fail, which is true enough, but we seriously underestimate the flexibility that credit gives them.

I will repeat myself briefly, adding a new nuance. Prices are a signal that indicate relative supply and demand. As demand for something increases, prices go up and/or supply increases--usually both. Given finite humans on the planet, logically demand is finite, which means there is a finite supply which can be created and sold. Suppliers KNOW this, and further realize that if they incur production costs for things or services which cannot be sold, they lose all their money. You can't have a yogurt shop on all four corners of an intersection and expect all four to stay in business.

Yet, one must measure this in terms of risk and reward. In conditions of easy money, it costs the entrepreneur none of his own money to open a business, and it costs the bank none of ITS own money, either, since it is in the end creating the money from scratch (I deal with this at some length in my treatise on our financial system, here). Both entities can just invest the money, and if they go belly up, the entrepreneur just files bankruptcy for the corporation he created, and the bank writes the loan off, goes into receivership, or gets bailed out. The individuals involved are never made to suffer any serious consequences, as for example they would if they had had to save up the money involved through long effort (which is how most people envision our system.)

The lack of penalty has serious consequences, as it incents overproduction. We are conditioned to consider inflation as something that can be accurately measured, and which affects economies as a whole. This is not the case. Localized inflation is so common in the modern world as to be almost the rule.

Inflation, to be clear, is in my definition any increase in the money that COULD be circulated. It is not tied directly to price inflation, although of course the two are related.

In the 1920's inflation happened almost exclusively in the stock market. Prices for homes, cars, and other essentials increased only slowly. This inflation was facilitated by margin buying, which is to say money creation which was a result of fractional reserve banking, and which was supported for a time by low rates at the Federal Reserve's Discount Window.

This led of course to "irrational exuberance", and overinvestment. It led to investment which WOULD NOT HAVE TAKEN PLACE absent the ability to borrow the money in question. And the crash happened as a direct result of a credit tightening that the Federal Reserve initiated.

The point I want to make is this: overinvestment, which leads to a need for steep discounting, cannot happen absent what I am going to call dumb money entering the economy; and there is no fundamental difference between money which enters the economy as a result of being created as what amounts to fake Monopoly money, and money which enters the economy via government spending projects.

In 2008, the market that had been inflated then deflated was housing. Boiled down to its most basic element, the problem was that too much housing had been created at the prices they were charging, and they only got away with it because of easy credit. The foreclosures were the result of risks taken that would not have been taken if failure meant personal suffering on the part of the bankers.

In the case of the housing market, the risk profile was distorted by the policy of Fannie Mae and Freddie Mac of buying up substantially all mortgages offered them, regardless of their quality. These policies bankrupted both agencies, and resulted in their renationalization, tens of thousands of foreclosures (the last number I saw was that between them they held the titles to 63,000 foreclosed homes), and the American people being billed for the cost, which at this point is at least in the hundreds of billions.

To be clear, local banks would make loans they KNEW were not good risks, then flip them at a discount to Fannie Mae or Freddie Mac. They got their money right away, and walked away from the risk.

Alternatively, they would sell them to Wall Street banking houses, who would bundle them as mortgage backed securities. Fannie Mae and Freddie Mac would then guarantee those securities. Those guarantees are what are costing the American taxpayers hundreds of billions of dollars.

Our system depends upon both the profit motive and the desire to avoid failure. When the price of failure is set too low, then a moral hazard is created, in which mass failures become inevitable. It is my contention that such failures create and indeed constitute downturns.

Postulate: price signals are accurate only when not acted upon by the government, or by money creation. When acted upon by the government or through money creation, actual underlying economic realities are masked, and poor decisions and economic downturns are inevitable.

III

"The lessons of history … show conclusively that continued dependence upon relief induces a spiritual disintegration fundamentally destructive to the national fiber. To dole our relief in this way is to administer a narcotic, a subtle destroyer of the human spirit. It is inimical to the dictates of a sound policy. It is in violation of the traditions of America. …"The Federal Government must and shall quit this business of relief."

When FDR said this, he was just repeating the received wisdom of the time. I would contend that nothing has changed. There is a fundamental qualitative difference between working to earn your living, and having it given to you with no effort on your part.

The goal, then, is logically full employment. We are told this will lead to inflation, that some small percentage of people must necessarily remain unemployed. This is ridiculous. Can you imagine a tribe of Sioux concluding that only 90% of those able to do so could go on a hunt, because otherwise they might get too much meat? No, what would happen is that all would go on a hunt, and get their needed food in LESS TIME.

I will readily grant that if people are temporarily unemployed due to changing jobs, or to being laid off, that is acceptable. I simply believe that finding new jobs should be easy. My contention is that inflation and job growth would not be related in a rational, just economy.

I will explain myself.

As we just saw, economic bubbles are financed by banks and/or the government. Absent interference from one or both, the pain of failure will lead to much smarter decision making, in which local failures are inevitable, but generalized, large scale ones are not. Only if one equates growth with structural overinvestment can employment be related to inflation. When economic analysts are speaking of this correlation they are looking at history. They are looking at patterns of credit-fueled expansion, in which unemployment plummets due to business growth, and in which the large scale growth in credit leads to large increases in the money supply and following price inflation. It has been a source of vague misery to me ever since I realized that Milton Friedman—otherwise an ardent champion of free markets—also fell prey to this delusion—again, because he studied history rather than asking fundamental questions about the system itself.

Logically, if we can make more stuff in less time, it should lead to increased leisure across the board. Let us say if the Sioux (back before the intervention of the American Empire; I will note here as well that only in North America can this nation properly be called imperialistic) invented a magic pipe to make the bison come to them, where they could be corralled for easy access, then they would have more time on their hands. What they did with it would be up to them, but less work would be forced on them as a result of hunger.

Why has this not happened? The answer should be obvious, but first I would like to offer up a quote from Oscar Wilde:

> *The fact is, that civilisation requires slaves. The Greeks were quite right there. Unless there are slaves to do the ugly, horrible, uninteresting work, culture and contemplation become almost impossible. Human slavery is wrong, insecure, and demoralizing. On mechanical slavery, on the slavery of the machine, the future of the world depends.*

Why have our mechanical slaves not served us better? Why do we work MORE now than we did 50 years ago? The average home owner fifty years ago was actually a home OWNER. Now, people routinely carry mortgages into their graves.

The answer is that inflation and government have stolen from us our purchasing power. I will deal with them one at a time.

Inflation, intrinsically, is wealth transfer. I will offer up an analogy I have used before, which clarified this to me. Imagine a table, on one side of which is a seller offering for sale a teacup. You sit on the other side, and offer up one dollar for that teacup. Before the transaction is complete, however, another person comes along, who has just taken out a large loan, who offers $1.50 for that cup. The price for that cup is now $1.50, which in essence is the definition of inflation. However, that person does not actually own that cup, as the bank holds title to it. He just feels as if he owns it. The core point, though, is that that $1.50 was manufactured. It did not exist prior to the bank making the loan.

This is the essence of fractional reserve banking: it makes a claim on wealth without producing anything except money. In the modern world, all a bank needs to make a loan is a computer. In making the loan, they literally just type in the numbers, and the money is there. That's all the Federal Reserve does, in its domain. The only limit is that at midnight, according to existing standards, they need to have 10% of the money they have lent out in either their vault, or an account at the Federal Reserve. It is very hard to get anyone to be honest about this, but that, as far as I can determine, is how it works. And it is not even clear to me that in conditions of economic growth—where they can loan out a lot of money—that the 10% does not in large measure consist in money borrowed from large banks, who themselves constitute the Federal Reserve.

Look at this chart. Banking as a share of the GDP has climbed steadily throughout the 20th century. Consider this: they create nothing tangible, and yet have steadily carved out a large piece of our national pie. GDP itself has climbed steadily as well.

Let us take as a reference point 1953, at which point it seems to cross the 2% mark. GDP was roughly $250 billion in inflation-adjusted dollars (I will note in passing that measurement of inflation is very difficult, given the phenomenon I have noted of localized inflation; I am not even being very precise in using the term inflation, and here intend the traditional notion of price inflation). 2% of $250 billion is $5 billion, again in adjusted dollars. In 2012, GDP was $13.50 trillion, and the banking part of it was roughly 5.5%. That is $742 BILLION. $5 billion is roughly 6 tenths of one percent of that number.

But that is not even the most important number. These are REVENUES, not assets. They make profit off of interest on their assets. Let me offer up a few facts in this regards. Goldman Sachs has, according to their website, $714 billion in assets under management. This more or less means that they own $714 billion of the private sector, although of course much of that will be in government bonds. Bonds mean that we the taxpayers pay them interest with our taxes.

According to this link, household debt is about 84% of GDP, or about 11.34 trillion. This works out to $32,000 for every man, woman, and child in the country. If we figure an average household of 2 parents and 2.2 kids, this works out to $136,000 per home.

All of this debt was created ex nihilo. It was created through the leveraging of a privileged place in the system, a place which legally allows money to be created, and thus wealth claims. What could your family do with $136,000? At a minimum, you would more or less own your home, would you not, particularly if the cost has not been inflated at the outset? My claim here is simple: virtually all that money represents wealth transferred from producers—both business owners and workers—to banks. This is money we would have retained in a fair system, and REINVESTED, to our own profit, not that of a banker. It is virtually impossible to be precise how much wealth we have lost, but I would submit that we are close if consider that a dollar is worth roughly 5% what it was in 1913, the year the Fed was created to better support the institution of fractional reserve lending. That means we collectively are one twentieth as wealthy as we otherwise would have been.

And history backs me on this. The data is clear that in that latter half of the 19th century the purchasing power of our money—there were many currencies—increased steadily. You could buy more with the same amount of money. That stopped when the third and most pernicious central bank was created by bankers for bankers.

To this we must add the added impositions of various government agencies. I will only deal with the Federal Government for simplicities sake.

In dealing with the government, two sources of wealth dilution/seizure need to be factored in. One is the interest paid on our national debt, which is productive only for those who hold US Treasury bonds, and a waste for everyone else. I will deal with momentarily. First, I will deal with taxes.

In 1953, total receipts from income taxes and payroll taxes were $619 billion, again in dollars adjusted per some generally recognized formula to account for price inflation. In 2012, they were $2.089 trillion. The Federal government is more than 3 times larger than it was in 1953. However, this does not even tell the full story. In 1953 expenditures were $677 billion, which of course netted a budget deficit, of the sort that caused Barry Goldwater to rail against the RINO's of the 1950's (it is a less attractive acronym, but given the actual history of the Republican Party, perhaps CINO's—Conservatives in name only—might be more appropriate). In 2012 they are projected to be 3.2 trillion dollars

[I will note in passing that if you look forward, you will readily note both massive tax increases and spending increases—no doubt related to Obamacare--that Obama for some strange reason is not talking about; in 2014 they plan to set a new record for receipts, and they plan to continue a pattern of spending over $3 trillion a year, which has never happened before under any administration. If you want to understand why Obama keeps racking up huge deficits, what you need to do is subtract the receipts from the expenditures. The receipts are not unprecedented—Bush collected $2.4 trillion in 2007—but the scope of spending certainly is.]

Now, what you need to understand is that every Federal building you see, you paid for. Every so-called public servant (and I question neither that some are needed, or that many are in fact diligent) you meet, you are paying their salary, to the extent the money is not borrowed. When it is borrowed, your bill is in the mail, and will land in the mailbox of your children.

We see the argument that the metric we need to look at is government spending as a percentage of GDP. Why? Let's take a few simple examples: if a community suddenly become twice as wealthy, does it need twice as many policeman? Firemen? Is it twice as hard to process a tax return for $100,000 as for $50,000? Does the need for spending on national defense increase as our economy grows? Of course not. If spending could rationally be tied to anything, it would be population growth.

In 1953 we had some 159 million people. In 2012, 311 million, which it not quite a doubling. What we would expect from that is a federal budget something on the order of $1.5 trillion, or half what is being spent today. We can I think then productively assume that roughly $1.5 trillion AT LEAST is being used unproductively, in ways which do not in fact make the lives of ordinary Americans better, and which will CERTAINLY remove money from the private sector. This works out to not quite $5,000 being taken out of the pockets of every person in the country, either now via taxation, or in the future via taxation which goes to make interest payments on our national debt.

Finally, interest: in 2011, the United States paid out some $227 billion in interest on our outstanding debt. However, we keep borrowing over a trillion dollars a year, and sooner or later our sterling credit rating is going to go out the window, and then we will be borrowing at higher interest rates, on larger dollar amounts. Remember: we pay interest on all $15 trillion (it will be $16 trillion before you take a nap and walk your dog) of that money, FOREVER (until it is paid, which it won't be without a drastic plan of the sort I have envisioned).

Look at this infographic, which projects what servicing the national debt will cost, at various interest rates. In the ROSY scenario we will be paying out nearly $600 billion just in interest in 2014. This works out to about $2,000 for every man, woman and child in the United States. By way of comparison, total expenditures for the Defense Department are about $700 billion. Self evidently, it will take far less than a decade to exceed that amount, considerably.

All of these factors diminish private capital available for investing. In a truly Capitalistic system, money would retain its value, savings would make sense, and people could self finance new businesses. The logical end of true Capitalism is that EVERYONE is a capitalist, and everyone determines their own financial destiny.

This is my jobs solution: steady increases in purchasing power via technological innovation, such that more can be bought with less labor. If less labor is needed, then more jobs open up, and a society can exist comfortably with both negative inflation and zero unemployment.

Postulate: the more the purchasing power of our labor is diluted by inflation and taxation, the harder it becomes to earn a living. The converse holds equally true. The goal is full employment, which will eradicate all economic hardships.

IV

I have not yet dealt with job creation. All public sector jobs depend upon private sector jobs, since all jobs which are actually paid for must be paid for out of taxes exacted from the private sector. This fact can be obscured by printing money or by borrowing the money, but the fact of the matter is that all three options, sooner or later, will be exacted as loss of wealth on the part of the public sector. <u>This outcome is necessary and cannot be avoided.</u>

In the first case inflation causes decreases in the value of all real owned property, all savings, and in the value of labor. In the second case, borrowing means that the money will be paid back, with interest. MORE will have been paid than otherwise would be the case, except in the case of default. Default is not necessarily painful for the government, although bond issues to fund debt become very expensive or impossible, but default is VERY painful for the private sector, since all investment in the country becomes suspect, and thus foreign capital flows dry up or become prohibitively expensive. To the extent a private sector depends on such investment, it is economically ruinous.

Thus, in all possible outcomes, money spent by the public sector for ANY outcome comes from the private sector, in something between a linear and contorted but real path.

This NECESSARILY means that <u>all real economic growth is a result of growth in the private sector</u>. This is a necessary point. This is the end goal, however it is reached.

I am not neglecting the real possibility of creating the ILLUSION of economic well being by large scale borrowing. If I gave you a credit card with a $1 million limit, you could live very well for 5 years or more, by spending what you wanted, and paying the monthly balance by taking more money out of credit. But sooner or later, the limit would be reached. The more you spend, the higher the interest, and thus the higher the monthly payment, and thus the quicker the full amount gets reached. It may in fact be that you reach the end of your life without maxing out the credit card. You would then leave that debt to your children, or perhaps your children's children.

The immutable fact remains that the credit on that card will not last forever. This point is ineluctable and necessary. You cannot borrow your way into prosperity. It has been tried many times. Argentina (and much of Latin America) is a good example. Usually, they wind up in hyperinflation or default, both of which are very economically damaging.

If one looks at the history of the word "Supply Side" Economics, it is readily seen that it did not exist before Keynes invented the concept of "Demand Side" economics. In large measure, the phrase was intended as a pejorative means of referring to ideological others. Let us compare the core contentions of each:

In Supply Side economics, economic downturns are understood as self correcting, and best addressed by either doing nothing, or by liberating private capital for reinvestment in job creation through tax cuts.

In Demand Side economics, economic downturns are understood as possibly not self correcting; or self correcting at lower overall rates of employment such that long term structural problems are created. The solution is stimulating consumer demand through government spending.

Yet, as we have seen, governmental action works to dilute price signals, and thus further disrupts the economic life of a nation. There is no foundational difference between banks lending willy-nilly to anyone with a pulse and Keynes classic example of burying money to stimulate labor.

Who buys things? People with jobs. And who creates those things? Companies that were started by someone. Keynesian economic stimulus does not incent people to make rational buying or building decisions. It does not fund sound business plans, but rather whoever happens to be standing at the front of the line.

Take Solyndra, which got "Stimulus" funding. They did not have a sound business plan, and it appears everyone knew it, including the Obama officials who got them their money. They went bankrupt. And we the taxpayers still wound up paying out huge bonuses to these people. The executives at Solyndra were no different than the banking loan officers who knowingly made bad loans: they abused the system to personally enrich themselves at the public expense.

Government intervention facilitates moral hazards, and financial waste. It is stupid money. What is always needed is smart money that funds businesses that will be viable indefinitely, without help.

It warrants repeating that governments do not have money. It does not fall down like manna from the sky. What they have is what they are given, and thus they cannot GIVE something they did not TAKE. The question is who should be doing the granting: people with a personal interest in an outcome, or people with NO vested interest but the protection of power granted them as Cargo Cult czars, people with the power to make it rain on people they like?

Postulate: All sustainable jobs exist in the private sector. Public sector jobs can exist only as long as the private sector can pay for them. The private sector knows how to grow the private sector; the government does not. Since the money the government spends comes from the private sector in the first place, all it can do is deduct intelligence and motivation from the money.

V

Summary:

Postulate One: ***price signals are accurate only when not acted upon by the government, or by money creation. When acted upon by the government or through money creation, actual underlying economic realities are masked, and poor decisions and economic downturns are inevitable.***

Postulate Two: ***the more the purchasing power of our labor is diluted by inflation and taxation, the harder it becomes to earn a living. The converse holds equally true. The goal is full employment, which will eradicate all economic hardships.***

Postulate Three: ***All sustainable jobs exist in the private sector. Public sector jobs can exist only as long as the private sector can pay for them. The private sector knows how to grow the private sector; the government does not. Since the money the government spends comes from the private sector in the first place, all it can do is deduct intelligence and motivation from the money.***

Conclusion: decreases in the size of government, and of the role of the fractional reserve banking system are necessary in order to secure long term improvements in our standard of living, and the elimination of business cycles.

Afterward: I realize I have not dealt with the role of regulations. In my personal view, virtually everything that is intended could be dealt with through tort law and modifications in our legal system. If someone builds a shoddy house, and someone is hurt, then they should go to jail. The pain of doing something wrong needs to be increased. Most people, however, are honest most of the time, if for no other reason than that it is good for business**.**

When you look at Worldcoms, and Enrons what you are seeing is companies that used deception to make use of floods of available money in times of economic growth, aka monetary inflation. If we can just make people more careful because they are risking real money, most all of these problems will in my view get sorted out. Everybody knew at some point that Enron could not possibly be as good as it seemed, but they threw their money at it anyway.

At the same time, I would also vigorously support greatly enhanced prosecution of white collar criminals. In my view, the standards with regards to such thefts should be on par with those for armed robbery. That would make a large difference as well.

Further, I have not dealt with how to end the fractional reserve banking system, which is what we have been stuck with for hundreds of years. My provisional plan is linked again here.

With regard to the Federal Government, we need to cut it roughly in half, and balance the annual budget. Since this is unlikely, my plan assumes we fail, and are forced to contemplate national default on our debts. There are smarter and dumber ways to do it, with no nation to my knowledge having attempted anything quite like what I have proposed.