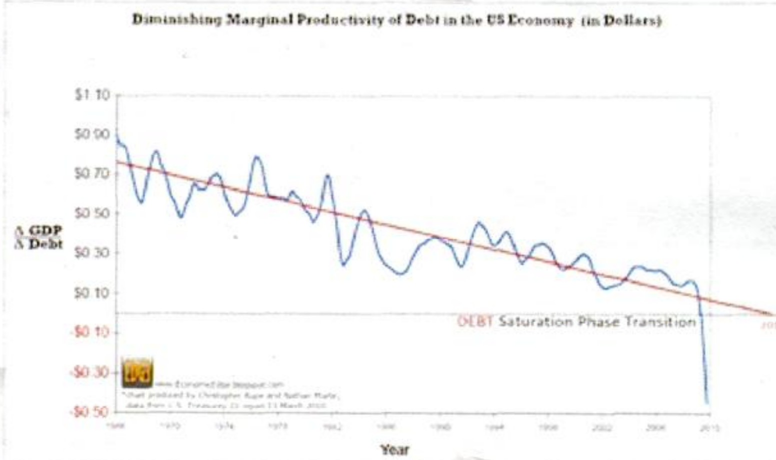
ARMSTRONG ECONOMICS™ 4-11-10

DIMINISHING PRODUCTIVITY OF DEBT



A chart that has created a heated debate is taking the GDP and dividing it by the debt yielding the image that there is a diminishing return for every new dollar in debt created insofar as creating economic growth. there are those who see the end times in this chart and others claim it is a lot of bunk. So is it valid or another trick of financial alchemists? to begin with, the velocity of money is the Money Supply divided into the GDP reflecting the number of times money is changing hands to produce that level of GDP. But the definition of money traditionally excludes public debt. the Gov't believed that if you could not use Gov't bonds as collateral for borrowing (ie Savings Bonds), then gov't spending was NOT inflationary as long as they borrowed to cover the deficit. this chart takes debt rather than money supply and showing there is a diminishing growth rate in GDP compared to the exponential growth rate in debt. But to create a more accurate picture, you should combine the Money Supply and the debt and divide that into GDP.

the amount of money invested in debt relative to stocks is 10:1. So the more money consumed by debt issues, the lower the economic growth in general when viewing public debt. Lending money to the private sector reveals a use of that money that creates jobs and in fact contributes to GDP growth. Public debt funds "public servants" that consumes wealth and contributes nothing to GDP growth. If you hire a maid to live in and do all the cleaning, she is a "servant" that consumes your income reducing your savings and wealth. If that money consumed by public debt were invested in the private sector, there would be no unemployment (but for those who do not want to work). GDP would explode and the standard of living would rise. Since public debt removes money 10:1 from private investment, it is logical you get diminishing returns the higher the debt rises.

Now enters "Practical Economics"™, and the reality of our global economy. Because we have reached the saturation level of prospective debt buyers domestically, we need foreign investors to float the debt. thus, the interest is paid out of the country exporting Keynesian stimulation theory so we help China at the expense of domestic growth. Clearly, as debt rises exponentially, GDP contracts due to the vast amount of exported capital in the form of interest payments.

At Princeton Economics we ALWAYS included debt as money because it is (1) reserves among nations, and (2) when a money market fund buys debt and sells shares in its collective investment, debt becomes money regardless of what the official definition may be. So the chart is valid but it reflects a broader spectrum of cause and effect trends than may be otherwise discussed. Each nation goes through a bell curve where at first public borrowing produces direct GDP in expanding the infrastructure (roads etc) that expands GDP. Borrowing to support gov't has the opposite effect - the prelude to the fall.

America's #1 Political Prisoner
Martin A. Armstrong