Who's Afraid of the Big Bad Debt?

By Kerry Pechter *Tue, May 31, 2011*

Not Warren Mosler, bond trader, racecar dabbler, Senatorial candidate and recent author of "The Seven Deadly Innocent Frauds."

Ronald Reagan, maestro of the homespun quip, famously said that if he found a pile of manure in the barn, "there must be a pony in there somewhere." In the debate over the country's supposedly looming debt crisis, Reagan's earthy expression seems apt.

On the one hand, the country can't ignore its large and growing manure piles: the budget deficit, trade deficit and national debt. Woe R Us. But every debt is also an asset, and every government outlay is money in someone's pocket. So, in discussions about debt and entitlement spending, I wonder, where are the 'ponies'? Where are the assets?

Turns out, there's a herd of them. Obviously, when the government mails out Social Security checks or Medicare reimbursements or orders a fleet of stealth aircraft, the money doesn't go to Mars. It cycles through the economy (until or unless the government collects it as a tax). More to the point, the Chinese probably don't see their hoard of T-bonds as a shaky pyramid of worthless debt. They call it savings.

I'm not claiming that all is right with the financial world. Not at all. But when I read about our fiscal crisis I feel that I'm only getting half the story. It just doesn't add up. So I've been looking for the other half of the equation. That's when I discovered the writings of Warren Mosler.

At 61, Mosler has been a banker, bond trader, racecar builder (see photo below), and Senate candidate in Connecticut (he ran in 2010 as a "populist Tea Party independent"). He now lives in and blogs from St. Croix (Paul Krugman is a neighbor). Last year he wrote a little book called "The Seven Deadly Innocent Frauds." In it, he claims that our most cherished concepts about money are wrong.

The federal government, unlike a household or a state like California or even a small country like Greece, never needs to balance its books, he believes. It can't run out of money any more than, as he put it, a scoreboard can run out of points. The government can create inflation, which isn't good, but its checks will never bounce. Deficits don't ruin our grandchildren, he says, they create savings. To him, it's no coincidence that our public debt plus our household debt (manure) about equals our savings (ponies): in the neighborhood of $16 trillion.

"We're afraid of the financial aspects of the deficit spending, but we have to realize that that's entirely inapplicable to the U.S. government," Mosler told *RIJ* in a recent interview. (His book's title intentionally echoes the title of "The Economics of Innocent Fraud—Truth for Our Time," a 2004 book by the late John Kenneth Galbraith. It also channels the ideas of the late Keynesian economist Abba P. Lerner, developer of "functional finance.")

"A state like California or Illinois can get into trouble and need a bailout the same way Greece or Ireland. Greece is like our states, not our federal government. It's a false analogy that the US is like Greece. If we were still required to maintain a certain amount of gold and a convertible currency, then it would make sense to balance the budget. But we haven't been on the gold standard since 1933."

When people are out of work and demand is low, Mosler believes, the government should cut taxes or spend. When the economy recovers and private investment returns, the government should prevent inflation by raising taxes or cutting spending. The Fed's job (and in this Mosler agrees with the statements of Fed chairman Ben Bernanke) is to keep Americans employed and prevent inflation. Its job isn't to help balance the budget or ensure that the dollar buys a fixed amount of gold or euros or pounds or yuan.

"When someone buys a Treasury security, it's like they're opening up a bank account at the Fed," Mosler said. "When China gets dollars by sending hair-driers to Wal-Mart, those dollars go into the Fed. China's money can either go into a checking account at the Fed, in which case it's cash, or it can go into a securities account, in which case it's U.S. debt.

"Why should we care whether China's money is in a savings account or checking account? As long as China wants to sell us things, the process is not unsustainable. But when people say we're going bankrupt, they're just making a mistake. It's negatively affecting policy and threatening our freedom."

By "negative policy," Mosler means suggestions to cut the budget deficit suddenly and dramatically. Demand is still too low. He would prefer to see a FICA tax holiday to boost demand and help Americans pay down personal debt. He'd also like to see large-scale investment in infrastructure and education, plus an $8-an-hour federal job with free health benefits to help "transition the unemployed to private sector jobs." He wouldn't raise taxes or interest rates until the economy recovers.

Regarding the future of Social Security and the rising dependency ratio, Mosler thinks Baby Boomer aging poses a productivity problem, not a fiscal problem.

“If you only have one guy left working, how will you take care of all those retirees? It’s not physically possible without higher productivity, and for that we need better technology and education,” he said. “Instead, people decide to cut education so that we’ll have more taxes to divert to Social Security. That’s the ultimate irony here. The thing we want to cut first is the thing we need the most. All because people don’t understand the monetary system.”

As we enter the next election cycle, you’ll hear ad nauseum about our fiscal manure piles. It will all seem quite scary and apocalyptic—until you consider the ponies.