LETTERS TO THE EDITOR: Consumers cash in from trade gap

By Warren Mosler
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From Mr. Warren Mosler.

Sir, Your story "Asian debt withdrawal threat to US deficit" (September 7) is helping to perpetuate the notion that, in general, America is dependent on foreign finance, and specifically to fund its current account deficit. While this alleged dependency may be the case under a gold standard or other fixed exchange rate regime, it is not the case with a floating exchange rate in the nation's currency of issue.

The US trade gap is the direct result of the non-resident desire to net save US dollar financial assets. If there were no desire to increase these assets any dollar earned by exporting to the US would, at the end of the day, be spent on US goods and services and there would be no trade gap. Yes, the adjustment process could mean a lower dollar - but not because of lack of external finance.

The non-resident desire to save dollars is fuelled by many forces, including the desire of governments to support exporters (albeit at the expense of their macro economies) by keeping their currencies weak to suppress domestic costs, particularly (real) wages. John Snow, the US Treasury secretary, is in fact attempting to negotiate a real wage increase for workers in China and Japan, thereby raising prices for US consumers as a means of "improving" the US economy.

The recent sharp fall in the price of US government debt is the result of changes in expectations of future Federal Reserve policy, as documented elsewhere, as have the related convexity hedging and rebalancing of mortgage portfolios. Volatility owing to dynamic hedging in general is a force to be respected and a significant concern of regulators. In support of the notion that a government with a floating exchange rate is not, in general, revenue dependent, note that Japan has had near zero rates for nearly a decade and term funding continues at ultra-low levels despite the largest absolute budget deficit in history and credit ratings below that of Botswana. Willingness of buyers of government debt is not the issue. The interbank rate is set by the central bank and the term structure of rates reflects expectations of the same.

The trade gap is a boon to the US consumer (who ultimately is the point of national economic policy) and it does not introduce a national finance risk. Government, unconstrained by revenue, always has the fiscal options to sustain domestic demand for the consumption of all of its own output *and* net imports.

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