Feb 02 Letter to Bartley at the WSJ

Dear Mr. Bartley,

This is to comment on your recent editorial. I will focus on only one point of fact as I think it may influence your entire thought process. First, from 1st year macro: govt. surplus = non govt deficit and vice versa, of course. This is the accounting identity for all national income accounting. Much like balancing your check book. The left side must sum to the right or an accounting error has been made. Therefore, when govt. runs a surplus of, say, 250 billion, non govt net financial savings drops by the same amount, to the penny. Non govt includes residents, non residents, business, foreign govt. etc. Here's a quick view of how the debits and credits work in the above example: At the macro level, member bank reserve accounts are debited 250 billion as the tsy receives checks from the private sector. This puts the banking system 'short' 250 billion in reserves triggering some combination of either a) the purchase of purchase of 250 billion of tsy secs by the fed and/or tsy. Or b) the tsy allowing net 250 billion of secs to 'run off.' (mature without refinancing them). At the end of the day(year) the private (non govt) sector as a whole has reduced its holdings of tsy secs by 250 billion, and that 250 billion has gone to pay the net tax liability of the same amount. No $ have 'gone to investment,' etc. The govt. surplus has reduced non govt holdings of financial assets-aka 'savings' in national income accounting by the same amount. I realize that 'savings' has recently been augmented to include future payments from govt. which is an entirely separate, political, matter. Net financial ($US) assets of the non govt sector include tsy secs outstanding, cash in circulation, and reserves. All other financial assets net to '0' at the macro level, much like 'open interest' on the futures markets net to 0. So the question is, does this 'savings' of net financial assets matter? I would emphatically say 'yes!' In fact, it constitutes the notional 'equity' that supports total debt and credit. Reducing the equity, at the macro level by running a surplus, reduces credit quality of the non govt sector. Let me further state that with a floating exchange rate, the only reason for the govt to run a surplus is to reduce non govt savings, and vice versa. The 'credit worthiness' of an issuer of a currency with a floating exchange rate is not an applicable construct for its currency of issue. Note that Japan, after two down grades and perhaps the largest debt and debt ratio on the planet sells its t bills at a rate of .002%. This is because the issuer 'spends' by crediting member bank accounts. The 'money' doesn't actually 'come from' anywhere, though it is 'accounted for'. 'Spending' is not inherently constrained by 'revenue' as it is but a 'credit' to a member account. 'Overspending' may depreciate the currency, cause 'inflation,' etc, but is operationally unconstrained with a floating exchange rate. A bit of history. The 6 US depressions were all preceded by the only 6 periods of serious budget surpluses. The worst was after Jackson paid off the debt in 1836. Are we going to make it 7 for 7? It was just noted the US ended four years of surpluses, the longest since 1927-1930. Also note Japan let its budget go into surplus in 1987-1992. In sum, budget surpluses drain net financial assets and undermine the economy. Several articles appear at www.mosler.org on this topic. I suggest you begin with the piece on 'Financial Engineering.' I am available for discussion at your convenience at 561-818-4039 and can provide substantial academic support for the applicable principles.

Sincerely,

Warren Mosler

posted May 5, 2002