WALSKY INVESTMENT MANAGEMENT

A Debate on Debt

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In September 1789, a 32-year-old Alexander Hamilton had a problem. As the newly appointed secretary of the treasury, Hamilton was responsible for overseeing the nation's finances and making sure that it could pay its bills. The Revolutionary War had left the country millions of dollars in debt, with little revenue. To address the problem, Hamilton negotiated to borrow $19,608.81 from the Bank of New York and the Bank of North America. Thus began the United States' national debt under the new Constitution.

Today, the national debt is over $27 trillion, which equates to about $82,000 per citizen. It is a staggering sum that would amount to a stack of dollar bills reaching the moon and back over three times! The only time the country became debt-free was in 1835, when President Andrew Jackson achieved his goal of paying off the national debt through westward expansion.

Jackson viewed the national debt as a curse to the republic. His viewpoint has been embraced by politicians around the world. In 1983, British Prime Minister Margaret Thatcher echoed Jackson's disdain for government debt, saying "the state has no source of money, other than the money people earn themselves." In other words, if the nation needed money, it would need to get it from the people. Her opinion has been shared throughout the decades by politicians who promote the idea that the government would need to tax and borrow first, before it could spend. In other words, a government must be run like a household. If it wants to spend money, it must first obtain it through higher taxes or increased borrowing.

While many economists share Thatcher's opinion that fiscal deficits and growing national debt are bad for long-term economic health, a smaller group contends that deficits are not a problem. They advocate a new way of looking at monetary policies, called Modern Monetary Theory (MMT). Conventional monetary theory focuses on the management of the nation's money supply as a tool to stimulate the economy or ward off inflation, along with how the federal government's borrowing affects economic growth. MMT, on the other hand, contends that the U.S. does not have to worry about its debt, as it has "all the money it needs."

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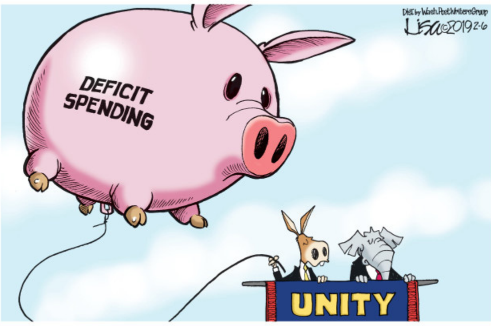

A cartoon illustrating that despite their differences, increasing the national debt has gained bi-partisan support.

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According to MMT, most people fail to realize that unlike a household, a business, or a state or local government, the U.S. has a monopoly on its currency. If it wanted to reduce its debt with China, it could do so immediately by simply issuing more money. And, since most financial transactions are conducted electronically, the transaction could actually be completed without ever printing a single dollar bill!

One might ask, if the government can print as much money as it needs (increasing the supply of money) then why not simply do so? The answer is that at some point, the additional supply of money in the economy would drive up prices and lower the value of the dollar. If the U.S. significantly reduced its debt by issuing more dollars in order to pay off bonds with China, China would find itself holding a tremendous amount of U.S. dollars. With dollars earning little to no interest, China would then want to reinvest these funds into other U.S. assets. This would cause inflation and potentially devalue the dollar.

While critics of MMT point to the prospect of inflation, advocates of MMT note the low inflation rates and disinflation that have occurred over the past twenty years as proof that the U.S. can increase the money supply and fund many new programs without causing inflation. These programs range from providing guaranteed work for the unemployed to environmental initiatives addressing global warming.

At the heart of MMT is the difference between currency issuers (the federal government) and currency users (households, businesses, and state or local governments). Only the federal government can issue U.S. currency, while all others need these monies to conduct daily transactions. By being the sole issuer of U.S. dollars and coinage, the federal government has not only a monopoly on its money, but also monetary sovereignty. As MMT advocates point out, to maintain monetary sovereignty, a nation cannot tie its currency to another asset (like gold), or "peg" it to another currency (as the British Virgin Islands and Latin American countries have done with the U.S. dollar).

The idea of MMT was originated by Warren Mosler, who in 2013 wrote a little book called *Soft Currency Economics*. In the book, Mosler outlines the difference between currency users and currency issuers. Mosler refers to the U.S. dollar as "simple public money" and believes that because the government is an issuer of dollars, it is silly to assume that it actually needs our money to pay its bills and fund new programs.

Mosler claims that instead of needing money from the public to pays its bills, the government needs something else. What does it want? According to Mosler, it wants to *provision* itself. Taxes are not intended to raise money. They serve to get people working to make things for the government and create a demand for the currency. To pay for our military and build bridges, public parks, etc., the government will pay in dollars; however, people will only perform the work and ask to be paid in dollars if they need them. To create a demand for the currency, Mosler contends, the government imposes taxes. Before anyone can pay the tax, they need to do the work and earn the currency. Thus, taxes create a demand for the currency.

A significant flaw of MMT is that if the government printed as much money as it wanted, the role of the Federal Reserve and banks would be diminished. This is why the United States has a separate and independent Federal Reserve, to prevent the government from manipulating the value of the currency in a manner that MMT would encourage.

This is not to say that MMT and its advocates should be ignored, for they raise a pertinent question. While no one in Washington is debating the need to reduce the federal debt, many Americans have been asking the very question that Hamilton recognized when he advocated for the nation to incur its first debt: what *level* of debt is excessive?

As Hamilton saw it, "a national debt, if not excessive, will be a national blessing." However, not everyone shared Hamilton's opinion. To garner support for this debt plan, Hamilton needed to compromise with two men who vehemently opposed him. As portrayed in the song "The Room Where it Happens" from the Broadway show, *Hamilton*, the three men met in private and struck a quid pro quo. Madison and Jefferson, both Virginians, offered to support Hamilton's plan to give the Treasury the ability to borrow, and Hamilton agreed to support moving the nation's capital to land located between Maryland and Virginia. With the national debt currently over $27 trillion, it is apparent that the debate over MMT has just begun, with the central question still being: what level of debt is excessive?