



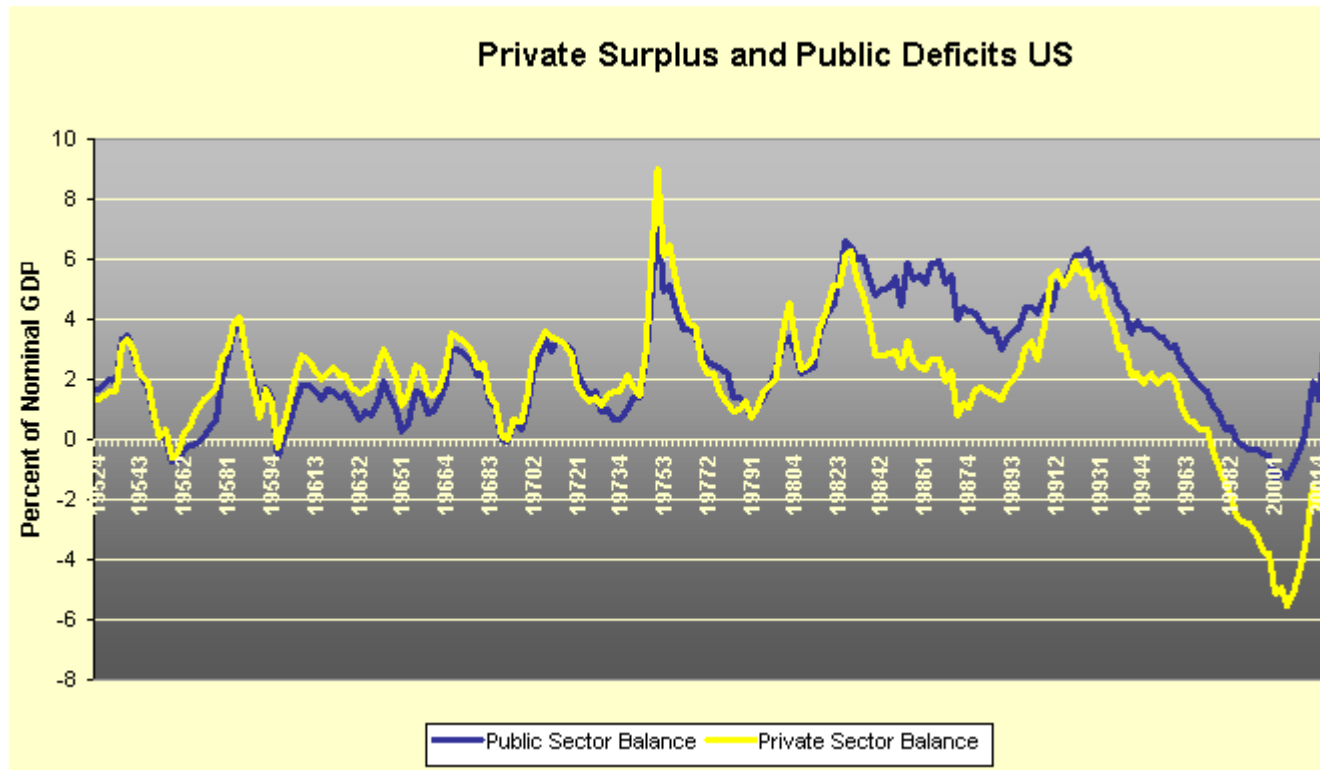
## Who is going broke - Uncle Sam or you?

### Government Deficits Improve the Private Sector's Balance Sheet

Zdravka Todorova Nov . 24 . 2003

Rather than crowding out private spending, government deficits improve balance sheets in the private sector, while government surpluses worsen them. This was the main message of the C-FEPS workshop "Is Uncle Sam Going Broke?" held at UMKC on Nov. 17.

Presenters demonstrated that there is a close relationship between public deficits (government injects more money into the economy than it collects in taxes) and the private sector surplus (firms and households revenues are less than their spending).



Source: Scott Fullwiler, Wartburg College - presenter at the workshop

Warren Mosler, C-FEPS co-founder and distinguished research associate, argued that when the government receives more income (taxes) than it spends (government expenditures), another sector such as the private sector, is spending more than it is earning. In this case the private sector is net borrowing (running a deficit), while the government sector is running a surplus.

"Every past successful attempt at significantly reducing the national debt has coincided with the onset of economic depression," said Scott Fullwiler, James A. Leach Chair in Monetary Economics at Wartburg College.

**Years                                      % of debt paid off                      Year Depression began**

1817-1821	29%	1819
1823-1836	100%	1837
1852-1857	59%	1857
1867-1873	27%	1873
1880-1893	50%	1893
1920-1930	33%	1929
1998-2001	13.6%	2001?

Source: Scott Fullwiler, Wartburg College

"During the post war era, the private sector surplus as a percent of GDP had almost never been below zero. However, during the 1990s expansion, record public sector surpluses and trade deficits meant that-by definition-the private surplus reached a record low," stated Fullwiler.

"Researchers from the Levy Economics Institute predicted that these public sector surpluses were not sustainable."

"The ensuing recession led to a reversal in the fiscal stance while record low interest rates failed to stimulate a private sector buried under record debt burdens and reduced income flows," argued Fullwiler.

The private sector balance equals the government sector balance minus the external sector balance. Thus, if the government sector runs a surplus (collects more taxes than it spends), and the external sector runs a deficit (imports more than exports), the private sector will have to run a deficit.

Dimitri Papadimitriou, President of the Levy Economics Institute, showed that currently the U.S. private sector balance is -1% of GDP (deficit), whereas the government balance is -5% of GDP (deficit), and the external sector's balance is -6% of GDP (deficit).

Presenters at the C-FEPS workshop emphasized that firms and households are users of the government currency, while the state is the monopoly issuer of the currency. Hence, the state cannot go "bankrupt" if it spends more than it receives in taxes. On the other hand, private sector can go bankrupt.

"Deficits incurred by a government issuing its own fiat currency do not threaten the government's solvency," said Randall Wray, UMKC Economics Professor. However, "continuously increasing debt burdens in the private sector are not sustainable," pointed out Fullwiler.

Workshop presenters explained that budget surpluses contribute to financial instability, while deficits improve private sector financial positions. A declining private sector financial position is an indicator of possible financial fragility in the economy.

"What is necessary are models to guide policy that recognize the unsustainability of a continuous negative financial position in the private sector. Such models do not currently exist," said Scott Fullwiler.

Current macroeconomic models used in policymaking, however, assume exactly the opposite: that a negative private sector balance can be sustained indefinitely.

**For more information about government deficits, money, and national debt, visit**

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Posted on: 11-24-2003

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