Week 5 (April 29 2024): Introductory Remarks

- Chapter 5: “Winning at Trade”
- Chapter 6: “You’re Entitled”

We have just two sessions left in this course so in today’s session we will once again cover two chapters in Stephanie Kelton’s *The Deficit Myth*. Those chapters are #5, “Winning at Trade”, and #6, “You’re Entitled.”

The material that Kelton presents in these two chapters is more advanced than that found in earlier chapters but it particularly merits the attention of those of you who are in the United States and will be voting in elections in November. Kelton argues that U.S. politicians in both major political parties have misunderstood questions of international trade and social benefits and have often deliberately perpetuated myths about them for their own political advantage. We can expect such misunderstandings and mythologizing to continue in this election year.

A Three-Sector Model of the Economy

In Chapter 4 Kelton modeled the economy as a set of transactions where funds flowed between two buckets: one representing the government sector, the other the entire non-government sector. In this *sector balances* approach (derived from the thinking of British economist Wynne Godley), what appears to be a surplus for one sector must necessarily appear as a deficit for the other – but the sum of the sector balances must always add up to zero. Similarly, the accumulated net liabilities of the government sector – the national debt – are the accumulated net financial assets of the non-government sector. Hence, to reduce the national debt would necessarily entail reducing the net financial assets of the non-government sector.

In Chapter 5 Kelton extends this way of thinking by dividing the non-government sector into the U.S. private sector and the foreign sector – the ‘rest of the world’ (ROW). We now have three buckets instead of two. If one bucket is running a surplus, at least one of the two other buckets must be running a deficit. The sum of the balances across the three buckets must still add up to zero. The same reasoning applies to international trade in goods and services. All countries cannot be running trade surpluses at the same time. If some countries are running trade surpluses some other countries must be running trade deficits.

Reject Panic Over Social Security and Medicare

In Chapter 6 Kelton’s attention turns back from the international economy to the domestic political economy. She argues quite strongly against the notion that we ought to panic about the ability of the Federal government to sustain payments of Social Security and Medicare benefits. This is an area in which I have a strong personal investment, since Social Security forms the largest part of my income and I am on Medicare.

What’s important to understand is how drastically the analysis which Kelton presents of the problems facing Social Security and Medicare differs from conventional explanations provided by the Republican and Democratic parties in the United States. Kelton argues that decisions made by President Franklin D. Roosevelt in setting up Social Security in the 1930s now impede our understanding of the program and its problems. Kelton argues that Roosevelt understood that there would always be elements in American politics who would view an old-age income support system as a giveaway to the undeserving poor and would therefore seek to undermine the system. So Roosevelt chose to characterize Social Security as an *earned entitlement*, the amount of which would be determined by one's work history and not simply by one's age. He wanted people to be convinced that their payroll tax deductions during their working careers would inevitably result in benefit payments upon retirement. This, he felt, would ensure that the American electorate was politically and psychologically invested in the defense of the Social Security system.

Although the Social Security Act was signed into law in 1935, it did not originally include the Social Security trust funds. The first of those only came in the late 1930s. By placing payroll tax deductions into the trust fund, and by making payments only out of the trust fund, Roosevelt could remove the payment of benefits from the annual Congressional appropriations process. He could make it seem as if the Social Security program was entirely self-funding. In point of fact, Social Security has always been an inter-generational transfer of income from currently working young and middle-aged people to older, retired people. The problem comes, of course, when the number of retired people grows large in proportion to the number of retired people. If benefits are to be paid *only* from the Social Security trust fund, what happens when that fund's balance goes low? Does that mean that benefits need to be cut? Does that mean that America's promise of a certain level of financial security to its elderly needs to be revoked?

Panic over the financing of Social Security has been a recurring theme in U.S. politics since the 1980s. Some of you are old enough to remember when people qualfied for full Social Security benefits at age 65. Changes in the Social Security law during the Reagan administration meant that for me the full retirement age was 66 and for people a little bit younger than me that age will be 67. So the U.S. has, in fact, been reducing Social Security benefits for decades. Wall Street gazes upon the vast flow of payroll tax deductions and says, "Let's let Wall Street finance guys manage this money as they do private pension funds, and let them earn big fees for this work." The Democrats periodically get entranced by this and start to think, "We need a 'grand bargain' with the Republicans to 'save' Social Security." The Sanders wing of the Democratic party shares the general obsession with the balance of the Social Security trust fund and calls for raising the cap on payroll tax deductions. Everybody treats the Social Security trust fund as if it were an immutable fact of nature when, in fact, it's ultimately nothing more than an account entry on the Treasury's books.

Stephanie Kelton notes that one of Medicare's two trust funds does not tie the payment of benefits to the balance of that trust fund. I believe that she is arguing that the Social Security trust funds and Medicare's other fund ought to be changed to work similarly. This is consistent with Modern Money Theory's observation that in an economy with a fiat currency, the sovereign government is not financially constrained by the volume of tax revenues in making payments. Finding the money is never the real problem; finding the real resources is. For Kelton, what's important in Roosevelt's vision is maintaining the promise of financial security for America's elders and disabled is more important than the particular Treasury account out of which the Social Security checks are written.

Let’s get to our discussion questions for Chapters 5 and 6 in Stephanie Kelton’s *The Deficit Myth*.