Deficits and debts in the U.S. economy: a critique to Godley's imbalances approach to macroeconomics

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Abstract: in this paper we try to critically evaluate the macroeconomic imbalance approach to U.S. economy, originally proposed by Wynne Godley at the end of the 1990's. When applied to Great-Britain during the 1970's this methodology was known as "New Cambridge Economics" and nowadays it is called "stock-flow consistent approach" by its supporters. In this paper we will denominate it as "imbalances macroeconomics". This methodology basically consists in making inferences about the sustainability of some expenditures and indebtedness patterns of the macro-sectors of U.S. economy (usually private, external and public sectors) from its *ex-post* financial balance (the difference between each sector savings and investment), derived from the national accounts. Specifically, in the medium run it is assumed that the growth path of private sector consumption and investment expenditures would be regulated by a financial balance norm or goal for this sector. First of all, we present a brief exposition of the imbalances macroeconomics basic analytical framework. After that, we will present a threefold critical evaluation. First, we criticize some conceptual issues, which aim to show some stock flow inconsistencies in this approach caused by not taking into account the capital gains or losses. Also, we will asses the relevance of analyzing the private net borrowing to the others macro-sectors, since banks are included in the private sector. Then, we will point out some general deficiencies of this approach in comparison with an effective demand analysis based on the levels and growth rates of each expenditure type. Finally, we will call attention to the inadequacy of the debt sustainability analysis when applied to the American economy in the last two decades, because in the current international monetary system (the floating dollar standard, Serrano, 2003) this country issues the key-currency, accepted as the international mean of payment. Even more, all U.S. external liabilities are denominated in its own currency, implying that is impossible to this economy to become insolvent. After the theoretical critique, we will highlight that this deficiencies induce to questionable interpretations of the trends and issues facing the U.S. economy during the 1990's and 2000's and to some inappropriate economic policy proposals.