

# The Innocent Fraud of Fiscal Policy

# Govt. Deficit = 'Private' Savings!!!

- Govt. Deficits ADD to non govt. savings.
- Govt. Surpluses SUBTRACT from non govt. savings.
- This is Accounting, NOT Theory!
- A Case of 'Innocent Fraud'
- The Myth of 'Ricardian Equivalence'

# How Does Govt. Spend?

- Actual Cash
- Checks
- Crediting Bank Accounts
- Operationally, these are not 'Revenue Constrained'
- There are NO Operational Constraints on Govt. Spending
- There are ONLY Self Imposed Constraints

# Taxation

- Reduces balances in private sector accounts.
- Govt. doesn't 'get anything.'
- Govt. 'savings' in its own currency has no application whatsoever!
- If payment is made for taxes in actual cash it is shredded.
- If payment is made for govt. bonds in actual cash it is shredded.

# So, Why Does Govt. Tax?

- Taxation functions to cause individuals to offer goods and services in return for the needed funds to pay taxes.
- Taxation functions to create unemployment-defined as people looking for paid work.
- The funds to pay taxes comes from govt. spending.
- Govt. spending provides the paid work to eliminate the unemployment created by taxes.

# Why Does Govt. Borrow?

- Spending is independent of borrowing.
- Borrowing is best thought of as coming after spending.
- **The 'Penalty' for Not 'Borrowing' is a 0% Interest Rate, Not a Bounced Check!**
- Japan, for example, easily maintains a 0% interest rate policy, with record budget deficits, simply by spending more than it borrows.
- The interest rate is set by the Central Bank, NOT market forces!

# How Much Does Govt. Need to Spend?

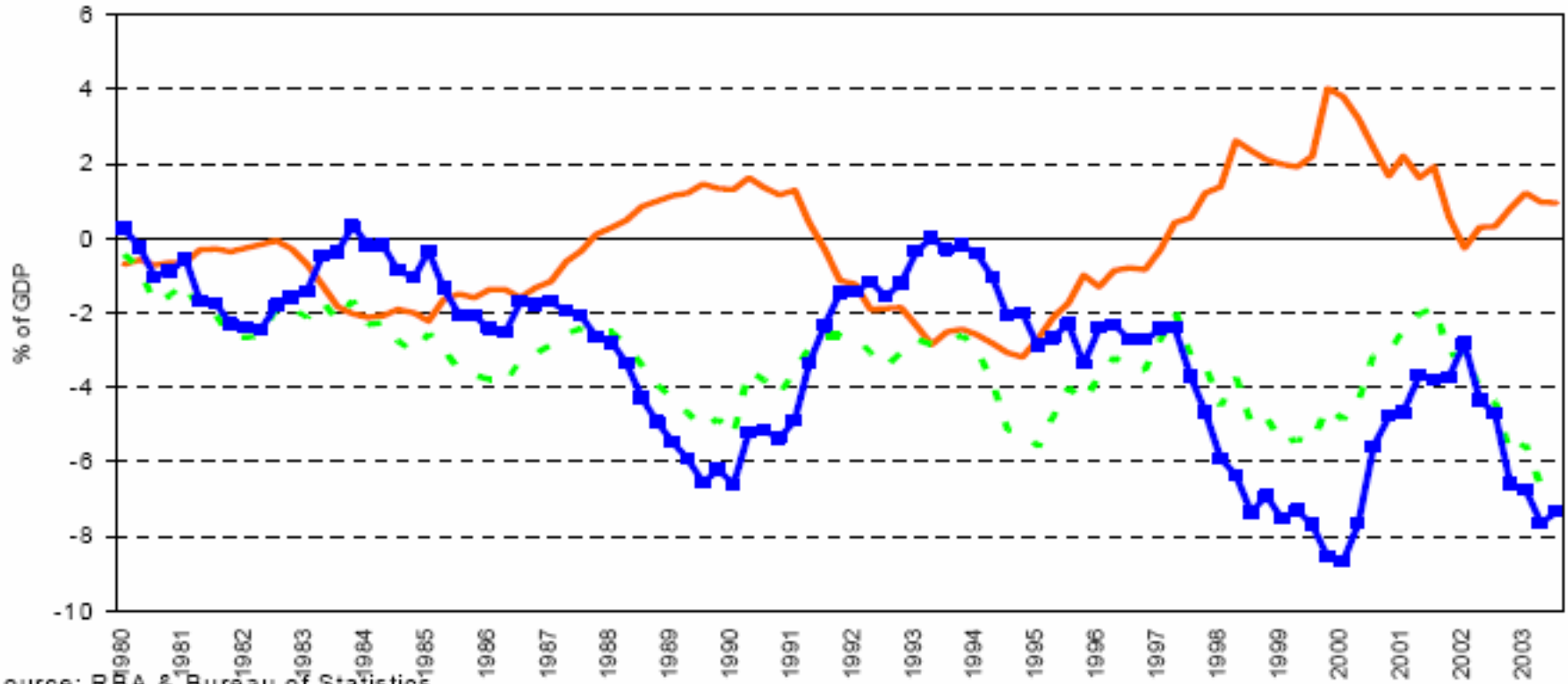
- Enough to allow for tax payment
- Plus enough for any savings
- If Govt. doesn't spend enough for the rest of us to pay our taxes and save as much as we want to the evidence is unemployment.

# Review- It's ALL about private savings!

- Govt. Surplus means Reduced Non Govt. Savings.
- Govt. Doesn't Gain Wealth
- Govt. Deficit means Increased Non Govt. Savings.
- Govt. Doesn't Lose Wealth



## Australia Sector Analysis



Source: RBA & Bureau of Statistics

— Government Balance    - - - Current Account Balance (Non-domestic Savings)    — Private Balance

Paradox of Thrift- and  
The Govt. Says We Aren't Trying  
Hard Enough to Save!

Decisions to 'Save' (Not Spend  
Income) Lead to LESS 'Savings'

# Extreme Example

- No One Spends Any of their Income
- Nothing gets sold
- Everyone loses their job
- There is no income
- There is no saving
- The universal decision to save caused savings to go to 0!

# Institutional Structure Encourages People not to Spend!

- Tax advantaged personal savings accounts
- Tax advantaged Private Superannuation funds
- Government Superannuation Schemes
- Life Insurance Funds
- Needs to hold actual cash for transactions
- International portfolio diversification
- ALL THIS CONTRIBUTES TO THE NEED FOR GOVT. DEFICIT SPENDING!!!

The Gap is Filled by  
Private Sector  
Debt

or

Govt. Spending

# Can Private Debt Expansion Drive the Economy?

- Yes, within limits, as in Australia for the last few years.
- The key is debt service levels, not absolute quantities of debt.
- When debt service hits a max % of income debt growth slows and the economy falters.

For a given tax structure, if people want to work, but not buy anything, and not go further into debt...

- The Government can buy the output (increase spending)
- Or there can be unemployment and a faltering economy

# Review

- Budget surpluses reduce private savings (increase private debt)
- Budget surpluses do not add to govt. wealth or ability to spend.
- Budget surpluses can be achieved only via decreases in non govt. savings (increases in non govt. debt)
- Budget surpluses reduce aggregate demand.

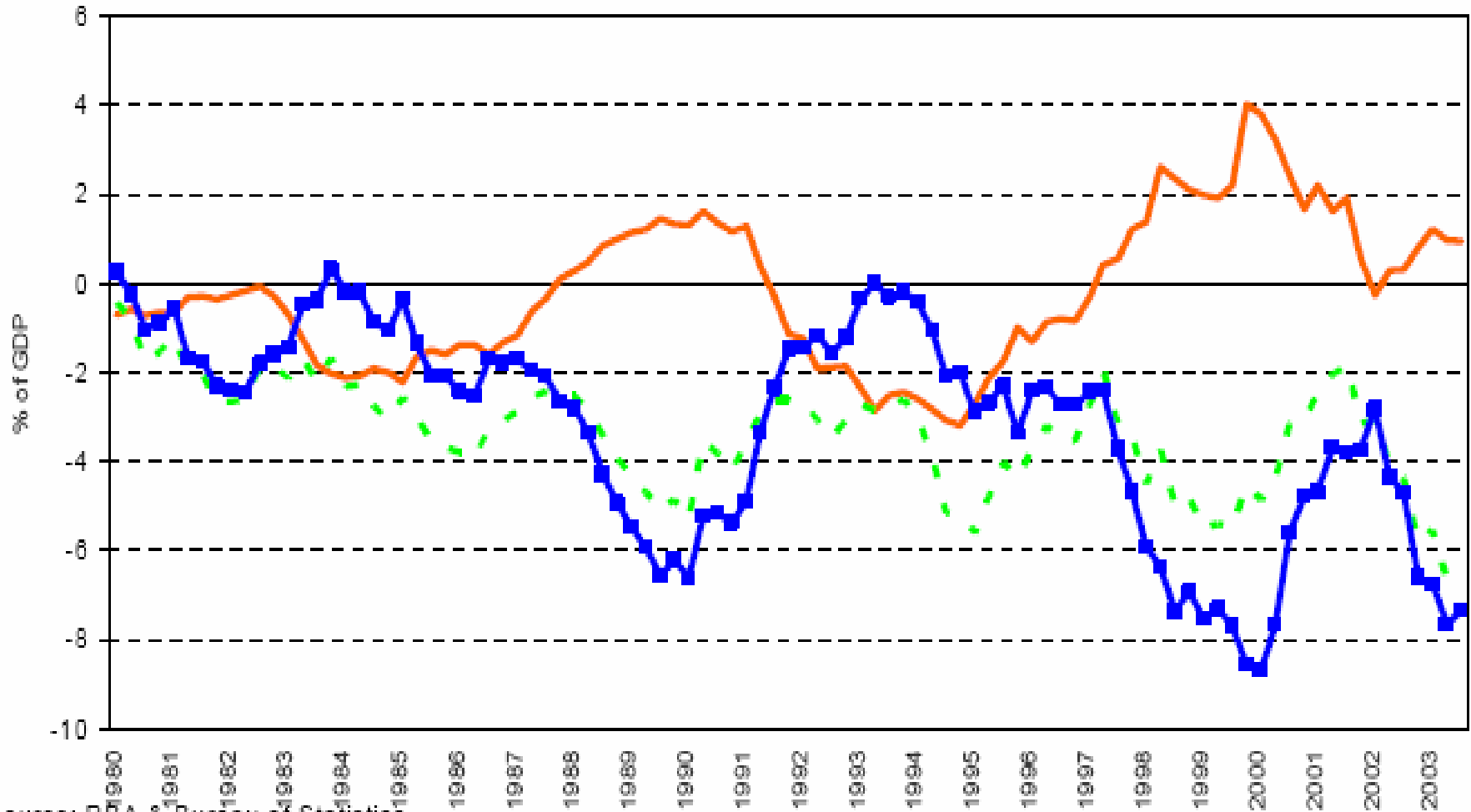


# Functional Finance

- Govt runs surpluses in order to reduce private savings and reduce consumer demand.
- Govt. runs deficits to increase private savings and increase private demand.
- Govt. 'finance' is not an issue.

# Using Sector Analysis to Understand the World Economy

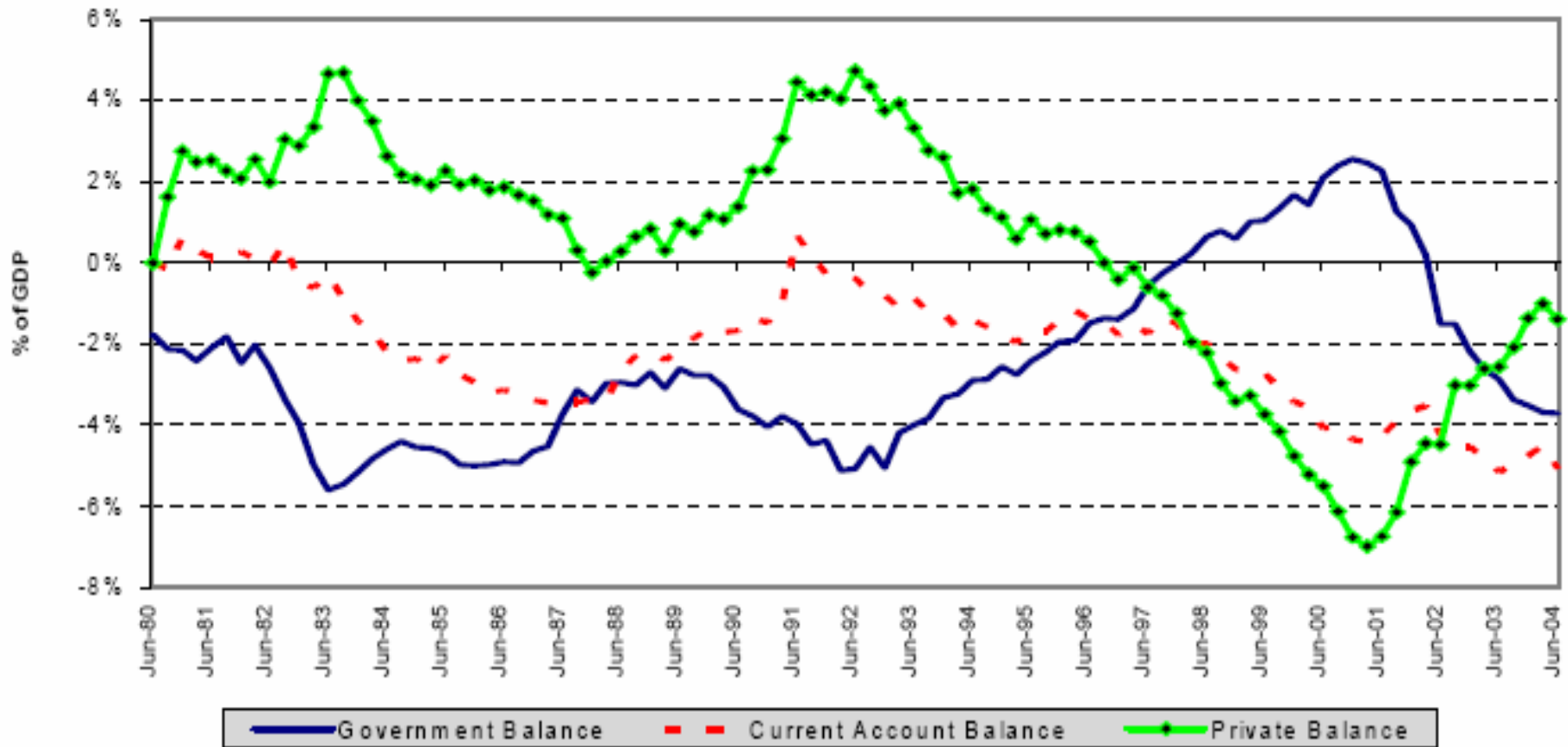
# Australia Sector Analysis



Source: RBA & Bureau of Statistics

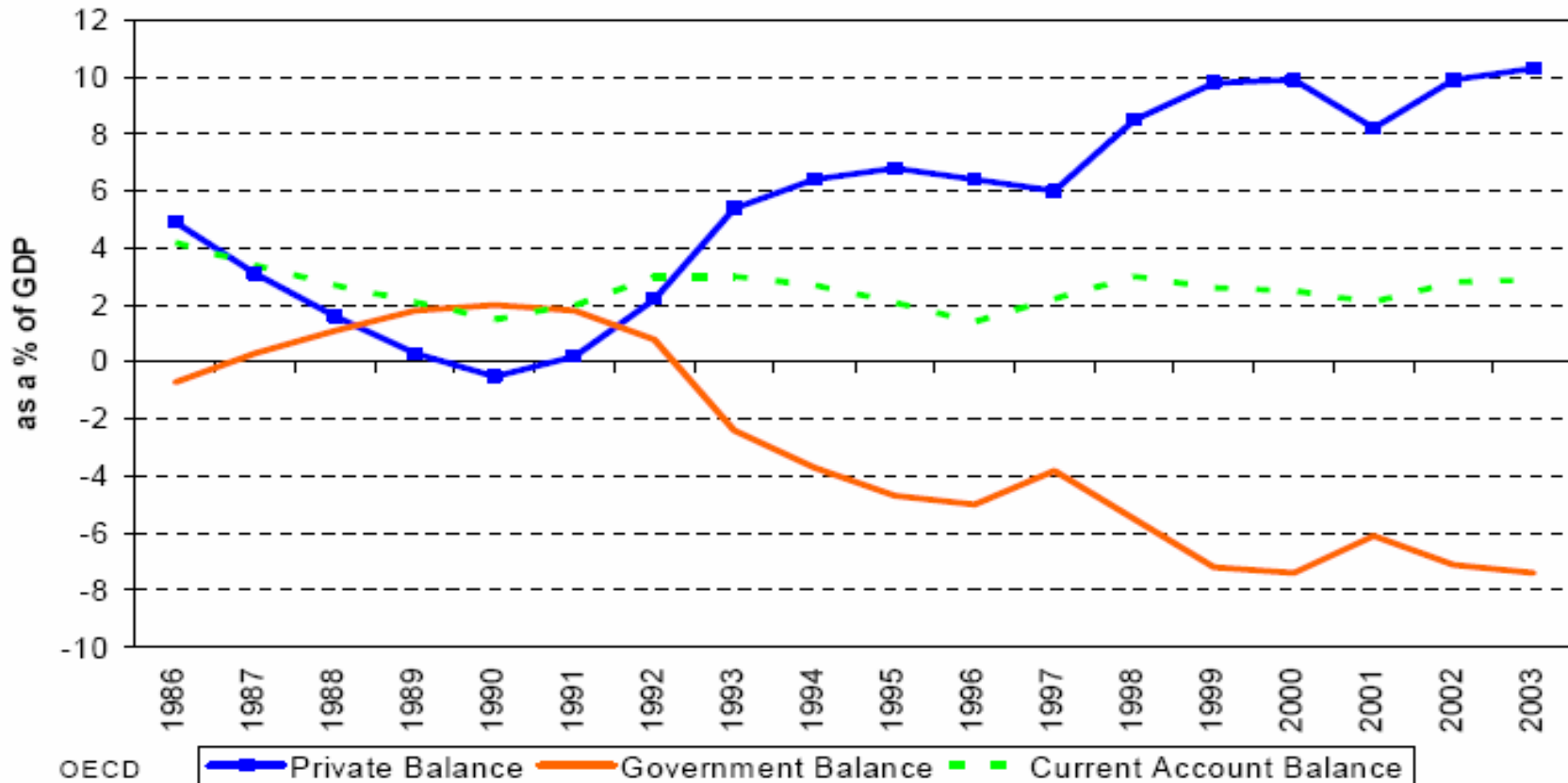
Government Balance    Current Account Balance (Non-domestic Savings)    Private Balance

# US Sector Analysis

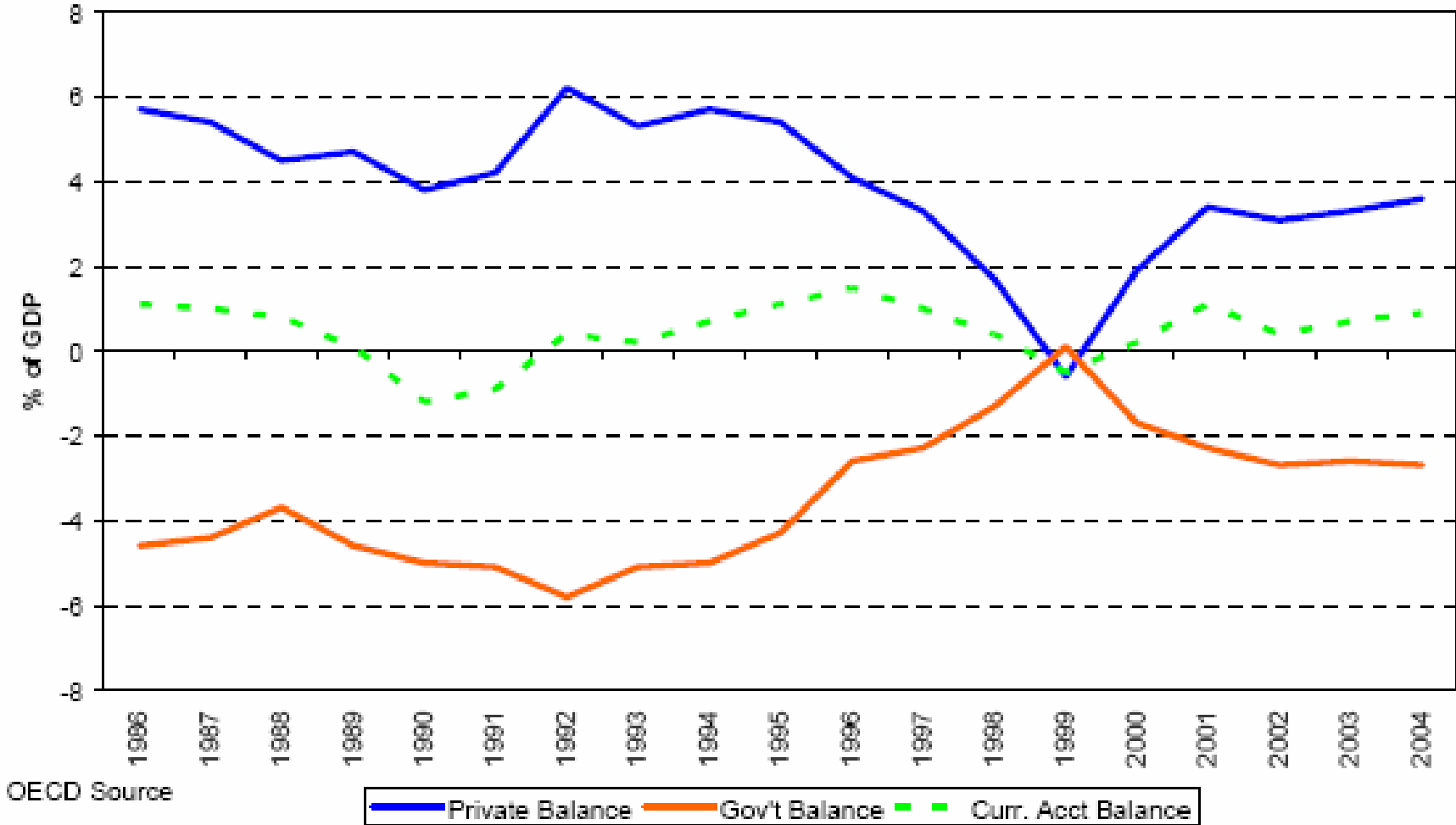


# Why Japan is doing Well Now

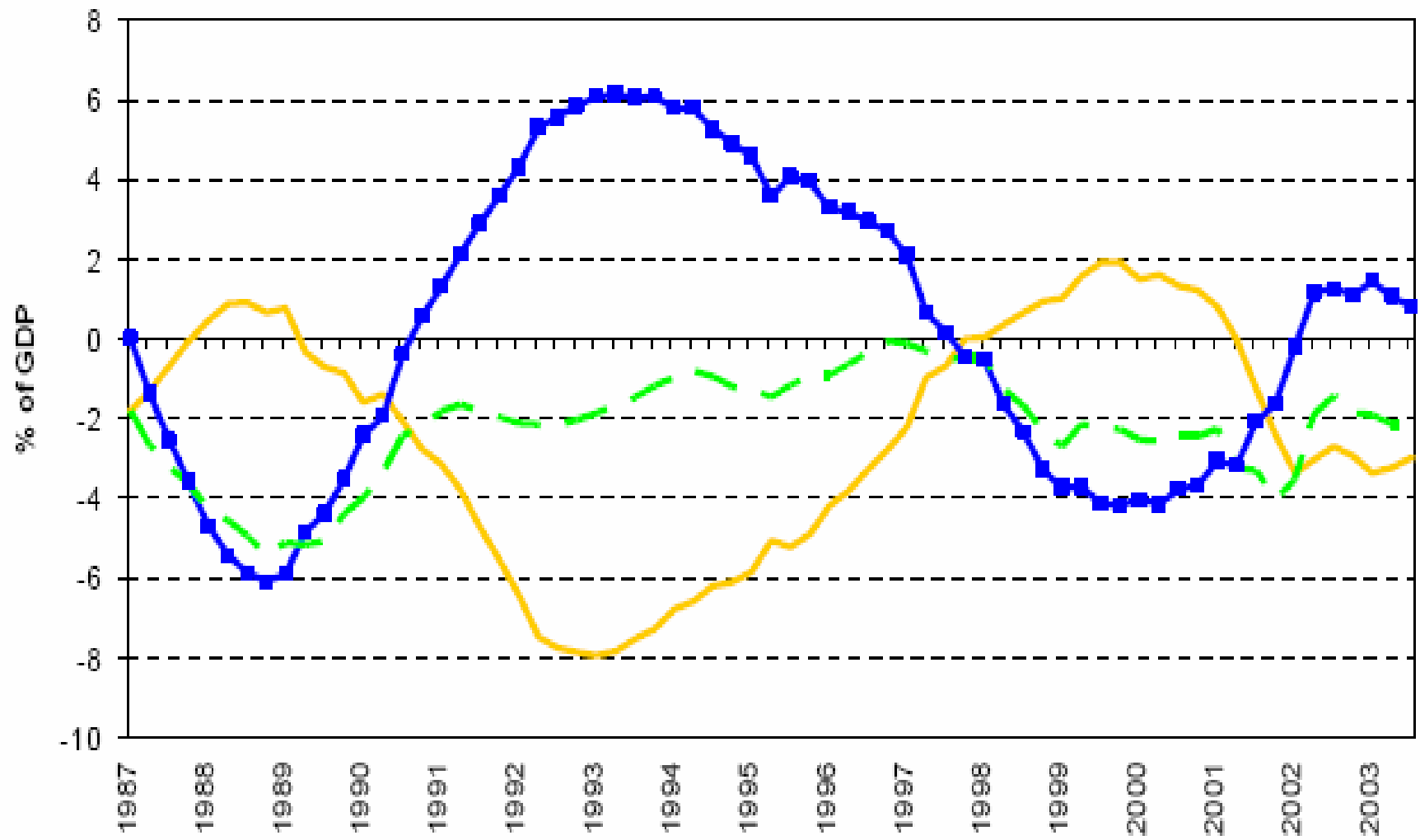
## Japan Sector Analysis



# Euro Area Sector Analysis



# UK Sector Analysis



ONS Source



# Conclusion

- In a floating exchange rate world, government is still acting as if it was supporting a fixed exchange rate regime.
- This 'innocent fraud' is undermining our current and future standard of living.
- The cost of today's mainstream notions of 'fiscal responsibility' are robbing the planet of universal economic prosperity.