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
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
Why Japan is doing Well Now
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.