Deficit Myth

Summary

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Monetary sovereignty

- A government has full monetarily sovereign if:
  - It is the monopoly issuers of an unconvertible currency: floating exchange rate regime
  - It issues debt only denominated in that currency
  - It taxes only in the denominated currency
  - It spends only in the domestic currency

- MMT describes how that monetary sovereignty is implemented by looking at the ***heavy*** and ***routine*** coordination between the Treasury and the Central bank to make public finances work smoothly.

Public finances are *not* the same thing as private finances

Public finances are usually assumed to be similar to private finances:

- Thatcher: “One of the great debates of our time is about how much of your money should be spent by the State and how much you should keep to spend on your family. Let us never forget this fundamental truth: the State has no source of money other than money which people earn themselves. If the State wishes to spend more it can do so only by borrowing your savings or by taxing you more. It is no good thinking that someone else will pay—that ‘someone else’ is you. There is no such thing as public money; there is only taxpayers' money.”
- Obama*: “*The hard truth is that getting that deficit under control will require some broad sacrifices. That sacrifice must be shared by the employees of the federal government. After all, small businesses and families are tightening their belts. The government should too.”
- Clinton (link is close enough): “For 29 years, the last day of the fiscal year was not a day of celebration, but a day we were handed a powerful reminder of our government's inability to live within its means. In the 12 years before this administration took office, the debt quadrupled, partisan gridlock intensified, and a crushing debt was being imposed upon our children. These deficits hobbled economic growth, spiked interest rates, robbed too many people of their chance at the American dream.”

- A household:
  - Uses income to spend
  - Must borrow or run down its savings if it runs a deficit
  - Can run out of money and so be unable to make payments
  - Deficit spending is dangerous so it is best to limit it and to focus on earning income before spending. Creditworthiness is crucial determinant of ability to borrow
- Following this logic a common view is that:
  - Taxes finance spending
  - Government that deficit spends must borrow funds
  - Government can run out of money and be insolvent if it can’t borrow funds
  - Deficit spending is dangerous and negatively impacts the economy (crowding out effect)
  - Government could cheat by printing its own money but it is an unusual source of finance and it is unsound source of finance because it is inflationary.

- Problem with previous view: Government is the issuer of the currency used by the private sector so government does not need to look for currency in the private sector, government just needs the private sector to accept that currency: creating acceptance of the government currency is the tricky part, not finding it.

- Greenspan: “I wouldn’t say the pay-as-you-go benefits are insecure in the sense that there is nothing to prevent the Federal Government from creating as much money as it wants and paying it to somebody. The question is, how do you set up a system which assures that the real assets are created which those benefits are employed to purchase?”
- Buffet: “We’ve got the right to print our own money so our credit is good.”
- Rep. Yarmuth: “We can afford it because we determine how much money is in the system. The federal government is not like any other user of currency, not any local or state government. We issue our own currency and we can spend enough to meet the needs of the American people. The only constraint being that we do have to worry about inflation […] Historically, what we have done is said what can we afford to do? The right question is, what do the American people need us to do? That becomes the first question. Once you answer that, you say how do you resource that need? […] I understand why most people don't understand this concept. They think of it in their own framework which is within their household which is you can't borrow so much money you can't pay back. That is not the position the government is in.”

- Public finances are quite different from private finances when monetary sovereignty prevails:
  - There is such thing a public money: A government *routinely* spends by creating the currency; that is *the only way* a government can spend. It makes no sense to say that a government borrows its own currency or taxes to get its own currency.
  - There is no such thing as taxpayers' money: Taxes and issuance of public debt destroys the currency, they are not financing tools for the government.
  - There is no such thing as deficit financing: financing of all spending is done by monetary creation from the get go so a deficit does not represent a lack of money to finance spending. A deficit represents the extra currency leftover in circulation after taxes destroyed some of what was injected through spending. Issuance of public debt allows currency holders to exchange currency for interest-earning government securities.
  - Given that gov spending injects the currency and taxes and public debt issuance destroys the currency, spending must occur before taxation and debt issuance.
  - Monetary creation, taxes and debt issuances are not substitutes, they are complementary tools of public finances.

Role of taxes and role of public debt

- Taxes have several purposes:
  - Monetary: Create a demand for the currency
  - Behavioral: Discourage the “bads” and promote the “goods”
  - Accounting: Give a sense of cost of a program to participants
  - Macroeconomic: Price stability
  - None of the purposes is to finance the government (taxes destroy the currency they don’t provide currency to the government)
- Public debt has several purposes:
  - Monetary: helps target interest rates
  - Financial: Provides a safe assets to the nongovernment sector
  - Finance: Provides a proxy of the risk-free interest rate used to price financial assets
  - None of the purposes is to finance the government (issuing treasuries destroys the currency, it does not provide currency to the government)

The fiscal deficit myth

- The myth has three parts:
  - 1- fiscal deficits limit the future ability of government to help the economy (run out of money)
  - 2- fiscal deficits limit funds available to the private sector and so crowd out private investment (higher interest rates, low economic growth)
  - 3- removing the myth will lead politicians to spend carelessly and anarchically.
- The implication of the myth is: government should always balanced, or seek to balance, its budget. Policymakers should be bound by an austerity commitment.
- The myth is quite common and is pronounced by most politicians who fear that they would lose votes otherwise.
  - Kennedy: “That's right isn't it? The deficit can be any size, the debt can be any size, provided they don't cause inflation. Everything else is just talk.”
  - Cleaver: He understand it is a myth but stated “I can’t say that” See book.

Busting the myth: Fiscal deficits are normal and help the economy

- A government deficit is a non-government surplus: Fiscal deficits inject funds in the private and foreign sectors, which helps their solvency and liquidity by:
  - Raising income: government spends more into the economy than taxes away.
  - Raising net cash flow: government deficit is a net injection of currency in the economy
  - Injecting safe assets in the non-government sector: US treasuries are very safe and liquid
- There is no link between:
  - Fiscal deficits and interest rates: crowding out does not apply if a government is monetarily sovereign
  - Fiscal deficits and inflation: inflation occurs when aggregate spending (private, foreign or public) grows too fast or because of supply side problem (energy cost, supply chain disruption, etc.), or conflict over the distribution of income
  - Public debt and tax rate: The public debt will never be repaid and it should not be repaid (fiscal surpluses negatively impact the finances of the nongovernment sector)

Change of perspective and framing of policy debates

- Our public debt clock should be renamed our safe asset clock

Gasp! I owe $119,027!

Phew! I own $119,027!

- A fiscal deficit should be named a fiscal benefit: remember the buckets

Functional finance instead of sound finance

- CBO current methods of judging a policy proposal is based on sound finance: will the proposal add to the public debt? (if proposal is not "paid for" by lower government spending somewhere else or raising taxes then it is an unsound proposal)
- Functional finance: Public debt and fiscal deficit are improper points of reference for policymaking
- Focus on the *effect* of public debt and fiscal deficit: impact on interest rates, inflation, economic growth.
- What CBO should do: Judge an economic proposal based on its intended impact on the economy and society, not based on its impact on the fiscal position.
- Promote legal structures and budgetary procedures that embrace monetary sovereignty and promote broad participation in political life: remove debt ceiling, remove social security trust fund, remove PAYGO budgetary procedures, promote greater transparency in budgeting process, determine resource availability, etc.

Foreign-denominated debt and export-led growth are not proper tools of development

- Government should focus on leveraging its monetary system to move *domestic* resources for development.
- Government should not issue debt denominated in a foreign currency:
  - Locks a country in an export-led growth strategy (to earn the foreign currency needs to service the debt) -> domestic development becomes secondary (promote domestic austerity to ensure that most domestic production (GDP) goes to export instead of domestic uses)
  - Locks government in a debt trap and low-value economic strategy (tourism, etc.) that reinforces the problem of food and energy dependency.

MMT policymaking praxis: there are potential political and resource constraints, act accordingly

- MMT describes public finances: Government spends and provides credit by using keystrokes, this takes seconds and minimal effort. In that sense, many government already “do MMT”
- MMT goes beyond description to promote a specific way to do policymaking: Not followed by governments currently
- Decide what the public purpose is: What are the “goods”? What are the “bads”? What can/should the government do about them? How? (political constraint: define the political agenda and find the votes)
- Implementing the public purpose: Do we have the domestic physical, natural and human resources? At what pace can we proceed if we don’t? (economic constraint: find the resources)
- Fiscal deficit matters but not in the way you think: inflation barrier, ecological unsustainability, lack skill availability are *potential* constraints on the ability to spend, financing spending is never a problem

Deal with the deficits that matter not the fiscal deficit

- Environmental deficit
- Healthcare deficit
- Housing deficit
- Income deficit
- Job deficit

MMT proponents want to use monetary sovereignty to deal with the deficits that matters while following the policymaking praxis described earlier: focus on outcomes not numbers on an accounting ledger, be constrained by political will (finding the votes) and resource availability (determines the level and pace of spending) not by finance (fear of running out of money)