A Monetary Theory of Public Finance

The New Fiscal Orthodoxy: From Plummeting Deficits to Planned Fiscal Surpluses

Historians will remember the beginning of the twenty-first century as the time when governments of rich countries praised themselves for having exacted amazing fiscal surpluses. No one dared doubt the positive impact of fiscal surpluses. Indeed, since the debate over deficit fighting was over, it was now important to find the best way to spend the “fiscal dividend.” Some wished to hoard the surplus so as to be used in the future, others advocated paying back the public debt to reach some ideal state of zero public debt, while still others lobbied for surplus assets to be allocated to the reduction of taxes. Some were even bold enough to demand that a share of the surplus be recycled for funding social programs or infrastructure. Regardless of the expected use of the surplus, the overwhelming majority of economists, either neoclassical mainstreamers or heterodox dissidents, agreed on the two postulates of the fiscal orthodoxy. According to the first postulate, an increasing fiscal surplus was the existence condition of sustainable growth, the proof of a shrewd...
and cautious management of the economy. The second postulate was the cornerstone of the new economics: the surplus provided the state with enough sound money to fund the long-run equilibrium needs of society. Fiscal surpluses had become the “golden eggs’ goose” of the responsible or cautious society!

Put in retrospect, the new orthodoxy was the ultimate achievement of what had been the fiscal counterrevolution unleashed in the late 1960s against the earlier post–World War II macroeconomic policies. Phase one of the fiscal counterrevolution targeted balanced budgets and implemented procyclical fiscal policies so as to suppress the impact of automatic stabilizers. The second phase began in the mid-1990s. Macroeconomic policy now targeted rising surpluses independently of the state of the economy. According to the prevailing ideology, rising surpluses were the sole source of funds for the cash-strapped state.

In this paper, I intend first to show that the ubiquitous faith in the surplus doctrine results from a fundamental belief, the budget constraint postulate, which is rooted deep in the psyche of neoclassical economics and of the overwhelming majority of heterodox economists. In the second section, a rigorous proof of the fallacy of the state budget constraint will be presented within the context of the theory of the monetary circuit. The major propositions of the neo-chartalist school (Bell 2001; Wray 1998) can therefore be integrated within a general theory of money (Parguez 1999; Parguez and Seccareccia 2000). Indeed, the postulate of state budget constraint is enshrined in the myth of a moneyless or real command economy. It is thus the ultimate generalization of the real loanable funds principle that permeates classical and neoclassical economics. In the third part of the paper, it will be shown that the surplus merely impoverishes the private sector and jeopardizes future sustainable growth.

The Underlying Economics of the Surplus Doctrine: The State Budget Constraint

A crucial principle of neoclassical economics is that, for any economic agent, there are three sources of funds out of which one can
finance expenditures. One can raise money by earning an income generated by the expenditures of other agents. One can borrow savings by selling debt titles to other agents. Also, the excess of expenditures over income and borrowing can be financed by bank loans, thereby entailing money creation.

However, if any agent were to finance a share of its outlays by money creation, this would generate a situation of aggregate excess demand in markets for commodities, services, and securities. The increase in the stock of money would account for an excess of expenditures (demand) over supply. The third source of finance, bank loans, is therefore presumed to be inconsistent with the existence of general equilibrium. From the “budget constraint” principle, there ensues the view that economic agents must finance their expenditures either from their income or from the savings of other agents. The budget constraint principle postulates that, for any kind of agent, expenditures are financed out of a preexisting stock of money raised by earning an income or borrowing other agents’ savings. Logically, expenditures are assumed to have no impact on the amount of money out of which they are financed.

Since what is true for individual economic units is also presumed true when economic units are aggregated, the budget constraint holds for firms as a whole. Firms must finance their aggregate outlays out of their receipts or the savings they borrow from households. Receipts and savings must therefore exist prior to firms’ outlays and they are logically independent of those outlays. Outlays include investment that is financed by preexisting profits and preexisting household savings. The neoclassical budget constraint explains why investment is the outcome of a predetermined saving fund generated by undistributed profits and household savings arising from their preexisting income. Aggregate savings determine investment, and their amount is logically independent of investment expenditures.

As soon as the state is integrated within this framework, it is enslaved to the budget constraint principle, which is the prerequisite for reconciling the state with general equilibrium requirements. State outlays are always adjusted to the amount of money that the state has raised by taxes or borrowed from households (their sav-
ings). Financial resources must exist before expenditures and their amount is logically independent of current outlays.

The postulate of a state budget constraint entails four major consequences:

1. Much like private sector revenues, taxes play the part of firms’ receipts. They provide the state with money that it can spend to finance its outlays. The more the state raises taxes, the more its resources are increased, and the greater its expenditures can be. Taxes are thus levied before the state undertakes its expenditures. Aggregate income, upon which taxes are levied, therefore both precedes government expenditures and is independent of their level.

2. The fiscal deficit is the discrepancy between expenditures and taxes. It reflects the amount of money borrowed by the state by selling new bonds. These bonds are acquired by households as a share of their desired savings. The selling of bonds provides the state with preexisting savings that are recycled into government outlays. According to the budget constraint postulate, the state must adjust its supply of bonds to the desired deficit. It should not finance a share of its desired deficit by money creation undertaken by the central bank or commercial banks.

3. Let us assume a budget deficit. Since the state’s desired deficit is exogenous relative to private agents’ rational choices, it accounts for an exogenous increase in the supply of bonds, leading to an automatic rise in interest rates, thereby engineering the “crowding-out” of private expenditures. In essence, the neoclassical “crowding-out” theorem is a mere corollary of the budget constraint postulate. Since both aggregate savings and their rational allocation between money balances, private securities, and bonds are assumed to be determined, the deficit imposes an excess demand for loanable funds. Equilibrium is restored by a fall in the private demand for funds (lower investment) and, for a given income, by a fall in consumption that generates higher savings. The conclusion is that the state must never run a deficit: desired expenditures cannot exceed the predetermined amount of money that the state can raise in tax revenues.

4. When the state runs a surplus, it is spending less than its predetermined tax revenue. It is presumed to be hoarding the
unspent tax revenue to finance its future increased expenditures or the reimbursement of a share of the public debt. The fiscal surplus plays the same macroeconomic role that firms’ retained earnings or profits do. Retained earnings account for that share of predetermined revenue, which is available to provide funds for increased capital spending. The fiscal surplus reflects the state retained earnings that can fund a desired growth of outlays, usually capital outlays.

Generating a surplus has no crowding-out effect in the short run. Any planned increase in the retained surplus generates an excess demand for bonds because there is an equal fall in the supply of bonds relative to the predetermined demand for bonds. The rate of interest on loanable funds plummets, and hence the surplus boosts private expenditures that are crowded-in! A policy targeting fiscal surpluses is conceived as reconciling the growth of state outlays with the increase in private expenditures, without any rise in the quantity of money. Here lies the paradox of the fiscal surplus: the fiscal surplus is the ultimate achievement of the neoclassical postulate of the budget constraint.

**Heterodox Economists Either Endorse the Neoclassical Postulate of the State Budget Constraint or Have Never Explicitly Rejected It**

One of the most misleading interpretations of Keynes’s economics is that he advocated “Keynesian policies” of increased deficit spending. Keynes never had been a “Keynesian” in terms of macroeconomic policy. Perhaps, the furthest that he distanced himself from the “principle of sound finance” was to support a policy distinguishing the capital budget from the current operating budget. Capital expenditures should be financed by surpluses generated in the current budget (Parguez 1998; Seccareccia 1995). However, this proposal was still compatible with the budget constraint postulate. A predetermined tax income was split between current expenditures and capital outlays. The role of taxes was to provide the state with funds before outlays could be undertaken. In Keynes’s macroeconomics, state outlays have no impact on the quantity of
money, just as firms outlays have no impact on the existing supply of money. Since the budget constraint postulate implies a strong exogeneity of the stock of money and endogeneity of interest rates, it is therefore perfectly consistent with the hard core of Keynes’s theory of money in the General Theory, which relies on an exogenous quantity of money and endogenous interest rates (Parguez 2000). Following Keynes, many post-Keynesians endorsed the postulate.

There has been such a widespread faith in the logical necessity of the neoclassical budget constraint that it has not even been jeopardized by Kalecki and early circuitist writers. Although rejecting the crowding-out doctrine and proving clearly that the state deficit generates profits through its impact on aggregate demand, Kalecki never explicitly rejected the state budget constraint. Indeed, like Domar (1957), Kalecki believed that the deficit is entirely funded by the issuing of bonds and, therefore, by already existing savings (the capitalists-rentier savings). As a result, Kalecki still endorsed the proposition that state outlays can be undertaken without an increase in the supply of money. The major source of funds in Kalecki’s model is taxes, which are conceived as a predetermined supply of money for the state.

**The Paradox of Redistribution Through Taxes**

This could be deemed the “Robin Hood” paradox! Belief in the budget constraint leads to the conclusion that taxes are merely recycling income within the private sector. The state could finance its social expenditures, including social security, by raising taxes on rich households. Taxes should transfer income from those who are deemed “too rich” to the deserving poor. The whole redistribution theory is rooted in the neoclassical postulate that taxes are the main source of revenue, with taxes being used to engineer a society characterized by a more equal distribution of income and wealth. Taxes are the foundation of a “social capitalism” since they could fund all welfare outlays out of a preexisting unequal “primary” distribution. The higher the taxes, the more the state could spend on welfare programs. This mythology of
taxes explains why most left-wing economists and policymakers have embraced the budget constraint postulate and have remained so strongly supportive of balanced budgets. Here lies the core of the Swedish social democratic welfare state of the 1950s and 1960s (Parguez 2000). All who had been committed to the Robin Hood welfare state were poised to abide by the fiscal counterrevolution. It was not a straightforward counterrevolution against a revolutionary agenda scorning the orthodox theory of taxes. The new fiscal orthodoxy was just spelling out the logical consequences of the state budget constraint. No one could abide by the neoclassical postulate that taxes are the source of income without ultimately subscribing to the crowding-out effect of deficits and the crowding-in impact of surpluses. The neoconservative agenda wrote off the old welfare Robin Hood state because it succeeded in spelling out the blatant inconsistencies of “Keynesian fiscal policies.”

A Positive Theory of Public Finance Invalidating the State Budget Constraint

Since the budget constraint doctrine postulates that the state can undertake its outlays without any creation of money, it assumes a pure real economy in which the state, through its direct orders, exacts a tribute out of the given real income. Taxes are the source of outlays because the state is conceived as analogous to the despot ruling over a nonmonetary command economy. In such an economy, the Robin Hood paradox is true. The state can redistribute the real income it has previously levied by use of sheer force on private agents. The state is assumed to behave much like the feudal lords who forced the bondsmen to deliver them a share of their preexisting crop. The classical Smith-Ricardo doctrine of the real surplus is deeply rooted in this vision of a nonmonetary pure command economy. Money plays no part at all in the generation of the surplus that is raised as a tribute or tax on a predetermined real income by the class of proprietors or capitalists (Parguez 1998). A legacy of the real surplus model is the post-Keynesian notion of retained earnings. Like the Smith-Ricardo surplus, retained earn-
ings are levied as a tax on predetermined income by charging a markup on wage costs. Retained earnings are thus a mere redistribution of a given income. They are independent of investment outlays since they are funding them.

The twin aspects of the real neoclassical economics are the role of taxes and the role of retained earnings. Taxes are assumed to fund state outlays much like retained earnings must fund private investment. The budget constraint doctrine is founded on nothing more than a superficial monetization of the classical real surplus. It is therefore obvious that the state budget constraint is intertwined with a nonmonetary vision of private firms that could undertake their spending decisions without the creation of money. As soon as we reject the pure command model for the private sector, we must reject it for the state. A monetary economy is an economy in which money is substituted for despotic power and direct orders. No monetary economy can exist if there is no full monetization of the state, which implies that the state gets resources out of money creation instead of exacting a real tribute.

The Theory of the Monetary Circuit as the General Theory of a Noncommand Economy

In the noncommand economy, both the state and firms have to spend money to undertake their decisions. State and firms outlays are the logical first phase of the monetary circuit by injecting money into the economy. Both the state and firms cannot finance their outlays out of their future receipts, which are the outcome of the initial injection and which account for the “reflux” phase of the monetary circuit. Both the state and firms are obliged to finance their expenditures by money creation. Money exists as a mere debt issued by banks on themselves (Parguez and Seccareccia 2000; Rochon 1999; 2000), which is accepted as a means of acquisition because all economic agents share the belief in the strong creditworthiness of banks. There cannot be a monetized private economy without the state because it is the state, as the supreme source of law, that bestows on banks debts their creditworthiness, and therefore their acquisition power, by endorsing them. State endorsement ensures the existence
of money as long as state and firms’ outlays are creating real wealth. State legal endorsement thus reflects a long-run bet on the ability of state and private firms to sustain the growth of real wealth by their outlays. Money is created out of credits granted by banks to allow firms to undertake all their decisions that entail outlays for the acquisition of the newly produced capital goods. The creation of money has a counterpart in firms’ liabilities. Firms have to pay back initial loans out of their receipts generated by sales of commodities and debt titles. This is the outcome of the reflux phase that leads to an automatic cancellation of both firms’ liabilities and money. Since the state is the prerequisite for the existence of banks’ power to create money, it logically has the power to create money for its own account.

In modern economies, having broken any link to the command economy, the “flux” phase entails the creation of money by the state through its banking branch, the central bank. The reflux phase, on the other hand, encompasses taxes by means of which the state recoups a share of the amount of money that had been injected in the flux phase. By their very nature, tax revenues must extinguish money by an equal amount. In a monetary economy, the outcome must therefore be the same for the state and firms. Taxes arise from the initial income expenditures undertaken by both the state and private firms. These taxes cannot logically be levied before the outlays upon whose existence they are based. There is no tax income that would exist before the flux outlays and the level of which would be predetermined relative to those outlays.

Temporal causality is inherent to the monetary economy. Outlays determine income and therefore outlays are undertaken while income does not yet exist. This temporal dimension of the monetary economy explains why neither the state nor private firms can finance these outlays out of revenues generated in the future by what must be spent now. Having the power to create money for its own account, the state, through its spending department, the treasury, asks for credits from its banking department, the central bank. The central bank issues debts on itself, which are lent to the treasury to finance the desired outlays. Since the central bank does not need to protect its own creditworthiness by generating profits, its
loans are interest free and the treasury does not face any creditworthiness constraints. State outlays are therefore reflected in the central bank balance sheet by an equal amount of liabilities, the counterpart of which is an equal amount of claims on the treasury on the asset side. Outlays transfer central bank liabilities to private agents, which determine an equal increase in the reserves of commercial banks.

The state has undertaken its outlays while imposing forward tax liabilities on the private sector units—firms, households, and banks alike. Those “tax debts” are the prerequisite for planned outlays. Private units will be discharged of their liabilities by paying taxes. The payment of taxes transfers an equal amount of banks liabilities to the treasury, which instantaneously requires their transformation into central bank liabilities. From the point of view of the treasury, tax liabilities are extinguished when it recoups an equal amount of state money or central bank liabilities. Private units can be discharged of their tax liabilities by payments in bank money because bank money is perfectly convertible into state money. In the flux phase, the state injects an amount of state money because it plans to recoup in the reflux phase a desired amount of state money when tax liabilities are extinguished, which determines an equal fall in bank reserves. Assuming that tax liabilities are greater than planned expenditures, banks fall short of reserves and therefore are obliged to sell bonds to the central bank to provide the treasury with the required amount of central banks liabilities. Ultimately, tax payments simultaneously extinguish tax liabilities and an equal amount of money from household balance sheets. This amount of money had been initially created via state outlays to provide households with enough money to meet their tax commitments in the reflux stage. In the central bank balance sheet, tax payments are reflected in an equal instantaneous decrease in liabilities and assets. When tax liabilities exceed outlays, tax payments are destroying both the whole amount of state money created in the flux stage and a share of bank money created to finance firms’ outlays. We can therefore spell out our basic tax theorem as follows: Taxes destroy an equivalent amount of money. Taxes, therefore, withdraw income from the private sector.
without generating revenue for the state that could be recycled into spending.

The theory of the monetary circuit brings about the rigorous proof of the Lerner-Wray proposition (Bell 2001; Wray 1998), according to which, since taxes destroy money, they cannot be a source of funds. The state imposes tax liabilities to squeeze the private sector aggregate income and therefore ultimately consumption (a rigorous proof of this ultimate consumption squeeze is to be found in Parguez, 2003). Since taxes cannot generate revenues that fund outlays, the very redistribution doctrine, deemed the “Robin Hood” paradox, is at odds with the existence of money. There is no tax revenue to be redistributed because all the money collected through taxes is instantaneously destroyed. In a modern monetary economy, taxes cannot withdraw income from wealthy households to fund “transfers” to the deserving poor. Redistribution is a mere illusion based on a misunderstanding of the nature of the monetary circuit: taxes destroy income and slash aggregate demand. The deflationary effect of taxes explains why, in the long run, tax hikes have a destabilizing impact in a modern economy by generating a long-run decrease in consumption expenditures, which brings about a fall in expected profits and leads to a fall in private investment. This tax squeeze effect can be the underlying cause of the “crisis” of the old Robin Hood welfare state, which relied on the mythical model of a nonmonetary command economy. The tax squeeze effect was so strong and superseded the positive impact of state outlays that expected long-run profits plummeted. Unraveling the tax squeeze effect explains why the positive theory of money may support tax cuts to boost aggregate demand, growth, and employment. It gives credence to a macroeconomic policy agenda, which is not biased by the old ideological commitments of the “classical Keynesian” left inherited from the command economy. It is true that, by shifting the tax burden from households with a low propensity to save to households with a very high propensity to save, the state may alleviate the tax squeeze effect, but it cannot get rid of it because high taxes cannot be raised without also squeezing middle income households whose propensity to spend is very high.
The Role of Bond Issues in a Monetary Economy

The state deficit accounts for the discrepancy between initial outlays and future tax receipts. It is therefore equal to the difference between the amount of money created in the flux phase to undertake outlays and the amount of money ultimately destroyed by taxes. Bond issues cannot therefore fund a deficit, which is already financed (Bell 2001; Wray 1998). Why then does the state issue bonds entailing future interest payments to bondholders? The neo-chartalist school is right in raising this question, which has never been answered by heterodox economists even though they often loathe the rentier class (Bell 2001; Wray 1998).

To understand this, let us assume some ex post accounting deficit and a given very small targeted reserve ratio, which reflects the ratio of reserves banks desire to hold relative to their profit commitment. The deficit has two effects on a commercial bank’s balance sheet. On the asset side, it is reflected in an equal increase in reserves, which exactly matches the net increase in the private sector stock of bank liabilities. Assuming that the deficit has generated an equal increase in aggregate demand, the sum of state acquisition of commodities and of household net increase in consumption, the deficit is equal to firms’ accumulated retained earnings. Monetary retained earnings are equal to the discrepancy between aggregate profits and the debt incurred to finance investment that has been paid back out of gross profits. The whole increase in the stock of banks’ liabilities is therefore held by firms as their monetary retained earnings.

It is obvious that banks now find themselves holding excess reserves since firms hoard their retained earnings until they decide to recycle them into future investment outlays. Since commercial banks are committed to maximizing their profits, they must substitute income-earning assets for excess reserves. They, therefore, will seek to eliminate their excess reserves by acquiring treasury bills. Assuming that the state does not wish to issue new bonds, banks’ acquisition of bonds brings about a rise in bond prices that is reflected in an automatic fall in the effective bond yield. Without treasury intervention, the deficit engenders a collapse in the rate of interest.
on bonds, the latter being the anchor for the long-term rate of interest (Parguez 2000; 2001). New issues of bonds allow the treasury to absorb bank excess reserves and prevent the automatic fall in the long-term rate of interest. Since banks want to get rid of their excess reserves regardless of the bond rate of interest, the treasury can charge any rate of interest it wants on new bonds.

Here lies the explanation of bond issues. The state issues bonds to impose the short-term rate of interest it has targeted in order to offset the impact of the deficit on interest rates. Were the treasury to refuse to issue new bonds, it would then have planned to impose the rate of interest resulting from the bank’s intervention in the “bond market.”

The impact of the deficit on bank reserves has been emphasized by the neo-chartalist school (Bell 2001; Wray 1998), but neo-chartalist writers do not explicitly draw on the conclusion that it supports the complete exogeneity of the long-term rate of interest (Parguez 2000; 2001). Like many post-Keynesian economists, the former put too much emphasis on the power of the central bank to control the overnight rate of interest, without proving that this central bank rate is the anchor for the whole set of interest rates. Ultimately, bond issues are a major tool of monetary policy. The state has no possible use for the excess reserves collected by bond sales. They are instantaneously written off by extinguishing an equal amount of central bank claims on the treasury.

The second pillar of the orthodox doctrine of public finance is therefore put into question: **Bond sales cannot raise money that could be recycled into new spending because, like taxes, they destroy money instead of redistributing it.**

A corollary is that the central bank cannot finance a share of the deficit by acquiring bonds, thereby allowing the state to run a deficit greater than the increase in the demand for bonds. Outlays having been already undertaken, there cannot be a creation of money in the reflux stage of the monetary circuit. Central bank balance sheets display the cancellation of claims and liabilities incurred in the flux stage. They cannot display a new increase in liabilities offsetting an equal increase in claims on the treasury resulting from outlays initially financed by money creation. The orthodox notion
of monetization of debt is a legacy of the neoclassical theory of the state budget constraint, and it contradicts the fundamental flux/reflux law, which is the core of the monetary economy. All the debates over the necessity of mandating the central bank to acquire a share of the new debt are thus irrelevant since they rely on the false assumption that a creation of money could be substituted for bonds issue.

**The Deficit “Crowds-In” Private Expenditures**

It has been argued that the counterpart of the state deficit (net spending) is a net surplus or saving of the private sector. The higher the desired net saving of the private sector, the greater must be the state deficit. This private net surplus accounts for a creation of profits by the state deficit. Aggregate profits are earned in the reflux phase. They account for the excess of aggregate sales over initial outlay that firms had to undertake to meet their production plans. Aggregate profits are therefore determined by the amount of autonomous demand minus the leakage resulting from household saving. Autonomous demand is generated by firms themselves (investment spending) and the state, the deficit reflects the state-generated autonomous demand. The deficit determines an equal increase in aggregate profits relative to profits generated by the private sector.

When the profit effect of the deficit is strong enough, aggregate profits can be greater than investment spending. Firms earn more profits than they have to pay back to banks to extinguish the debt incurred to finance investment. It is the existence condition of retained profits, which are recycled into future investment expenditures. Retained earnings allow firms to substitute internal finance for credit that lowers future interest payments. In a monetary economy, the deficit crowds-in private expenditures and it may be facetiously considered the “goose” that lays the golden eggs for firms, workers, and banks as well. Planning a long-run growth of the deficit, the state becomes the cornucopia of the private sector, generating enough growth to reach a full-employment state with real wages being high enough to sustain household consumption.
In a Monetary Economy, the Surplus Doctrine Is False

The monetary theory of public finance that we have put forth rejects the pillars of the budget surplus doctrine. The budget surplus cannot provide the state with revenue that can be recycled. Indeed, the proof is straightforward. The surplus accounts for the excess of taxes over outlays. Tax payments extinguish an equal amount of money. The surplus never exists as hoarded money, which could finance new spending. In essence, the state cannot even pay back its outstanding debt out of the surplus. When the state wants to pay back the debt, it has to include debt payment in its initial outlays that are financed by money creation. When the state runs a surplus to pay the debt, it is just substituting debt payment for other outlays. Since the surplus does not have material existence as a source of funds, all debates over its use are absolutely irrelevant. It must be henceforth proven that the surplus cannot fund a cut in taxes.

By planning a surplus, the state seeks to withdraw an equal amount of money from the private sector that will be destroyed instantaneously. The existence of the surplus therefore entails an equal loss of wealth by the private sector. The bulk of the destruction of wealth is initially borne by firms that suffer from a collapse of their profits relative to their expected level. Profits could even become negative for large enough planned surpluses, which would bankrupt firms.

In any case, on the revenue side, banks are squeezed by the fall in the expected growth of income generated by the state-planned surpluses and, on the asset side, by the collapse of the value of their net wealth induced by the profit squeeze confronting firms. However, the worst-case scenario occurs when the state plans to reduce the size of its outstanding debt. Bank profits decline because of the fall in interest payments on the public debt. At the same time, they cannot acquire other income-generating assets because the initial increase in reserves resulting from state repayment outlays is entirely extinguished by the ex post loss of re-
serves induced by excessive tax payments. In this case, banks strive to exact more profits from firms by raising the rate of interest on loans and, therefore, will impose higher net revenues (or bank markup) to compensate for the decrease in asset values. Having to cope with losses, banks are led to rely on more demanding credit-worthiness norms.

Both the expected rise in interest payments and the increase in bank markups entail higher prices. Assuming an unchanged policy rule, the state imposes higher rates of interest on bonds, which induces more losses of wealth for firms and banks. Ultimately, planned surpluses generate a spiraling process of wealth destruction, which induces a cumulative fall in investment and consumption expenditures, accompanied by growing unemployment and plummeting real growth.

The theory of the monetary circuit helps us to spell out the ultimate surplus theorem: By planning a surplus, the state is no longer the cornucopia of the private sector in a monetary economy. It plays the role of a whimsical “bad robber,” the contrary of the “good Robin Hood robber,” which cannot compensate for the private net wealth it has extracted.

Rejecting the New Fiscal Orthodoxy: A Sensible Fiscal Policy Agenda for the Economy of the Twenty-First Century

In the late twentieth century, the devastating impact of the new fiscal orthodoxy had been compensated by a tremendous increase in household net indebtedness. The ratio of after-tax household income to the outstanding household net debt to banks had reached historical records, essentially because the rate of growth of household net debt had been progressively higher than the rate of growth of personal disposable income. Household net indebtedness is a source of profits for firms, which is financed by the creation of money undertaken by banks. Household net debt is, for firms, the cornucopia that bails them out of state-induced bankruptcy. In the standard Kalecki-Robinson equation (Robinson 1956), household
net indebtedness accounts for negative household savings. When the state plans a surplus, aggregate profits are generated in the reflux by investment spending and the excess of household net indebtedness over the planned surplus.

Such a situation is not sustainable in the longer term because households do not earn sufficient income in the reflux process to allow them to repay their debt. They are poised to accumulate a stock of debt that they can only repay out of the future growth of their income. Since the state had engineered a long-run downward pressure on income by enforcing its fiscal agenda, households could not be bailed out of over-indebtedness via growth of their income. The alternatives would be either household bankruptcy, by inflicting losses on banks, or a future dramatic decrease in consumption to repay the debt that would lead to a collapse of aggregate profits. Here lies the ultimate proof of the inconsistency between the new fiscal orthodoxy and the existence of a monetary economy: Implementing the new fiscal orthodoxy is just substituting household net indebtedness for planned deficits, private deficits for public deficits.

A question remains unanswered by heterodox economists: Why has the state in Western countries indulged in such self-defeating policies? The planned surpluses could be explained by the un-daunted commitment to the budget constraint postulate and the underlying command economy model, which is the core of the ruling ideology of the political elite. The theory of the monetary circuit debunks the budget constraint postulate by putting forth the true nature of taxes. Taxes destroy income; they cannot be a source of funds. Here is perhaps the core of the monetary theory of public finance by supporting a minimum agenda that can help to bail the world economy out of its unsustainable path.

The whole mainstream theory of the state is false because it is completely inconsistent with the essentiality of money. The ultimate conclusion of this paper is that it is now the time to substitute a modern monetary view of the state for the questionable “tax-funded” state—the latter being a legacy of a remote past that rests on the imaginary world of an ideal command economy.
References


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