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GOVERNMENTS' "DEFICITS" AND THE NEGATIVE CASH BALANCES OF FIRMS AND GOVERNMENTS

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Abstract: We recall that the non-financial agents taken together can only have negative net cash balances, i.e. the sum of their money holdings is smaller than their borrowings to banks. In applying this principle to public expenditure, we see that, except when there is a net entrance of foreign currencies, the only way to get a fiscal surplus is that private agents borrow central money instead of government. But that is only substituting public indebtedness by private one and has no macroeconomic effect. So the search of fiscal surplus is absolutely vain and useless.

We put the word deficit between quotation marks, because it does not have the same meaning in public and business accounts.

In business accounts the word deficit means negative profit.

In public accounts, the term of profit does not exist already, since the profit of an organization is the increase of its net assets, and that these assets begin only to be measured in public accounts. Thus in these accounts, "deficit" cannot mean negative profit, but means the excess of the cash outflows upon the cash inflows which can be covered only by loans. In fact the public "deficit" is only cash deficit and is the equivalent of the net borrowing of the national accounts.

In private accountancy it is normal for a firm to carry out a positive profit and to be involved in debt. We have even shown, by generalizing the principles of the French theory of circuit, (cf.our master's course, chapters III and IV) that in a closed economy, when we consider all the non-financial agents, and singularly the firms, they must be in their whole indebted and that the firms have normally a negative net cash balance (i.e. their cash holdings are lower than their debts towards the banks).

We are going to show that, for the same reasons, government in a closed can only, in normal conditions, be involved in debt, therefore be in "deficit", and that it has normally, like the firms, a negative net cash balance. But whereas these last ones have accounts in commercial banks, and that consequently their negative net cash balance is in currency created by these banks (or second-rank currency), the government has an account only at the central bank and its negative net cash balance is in central currency, its cash holdings in central currency being lower than its loans to the central bank. This demonstration will be the object of our first section. It has be inspired by the economists of the "Center of Full Employment and Price Stability" (C.F.E.P.S.)[1]

In a second section we will recall that the firms too have a negative net cash balance, although the term of deficit is not used with the same meaning. So the analyses of the C.F.E.P.S. and of the circuit school meet together: they both show that the non-financial agents have a negative cash balance, the first school has applied this principle to the circuit of the central money and to government, the second one has applied it to the circuit of the private money and to the firm.

In a third section we will give up the hypothesis of the closed economy and we will analyse the effects of the foreign trade.

I THE CIRCUIT OF THE CENTRAL CURRENCY IMPLIES THAT IN A CLOSED ECONOMY THE GOVERNMENT HAS NORMALLY A NEGATIVE NET CASH BALANCE AND THUS IS IN "DEFICIT".

In the majority of the countries of the world there is a central bank, which fulfils two functions: 1° it is the bank of the banks;

2° it is the bank of the government.

Ex: the United States with the "Fed".

European countries, not only the United Kingdom with the Bank of England, but still countries of the euro zone as France with the Bank of the same name (even if BoF is no more

[1] This centre belongs to the University of Missouri - Kansas City and includes L. Randall Wray cited bibliography.

the only creator of the central currency, it is always the bank of the banks and the one of government).

The payments made by the French government (the "Treasury") are made through its account at BoF, which means that government always pays in central currency. So the government expenses [2] feed the accounts of the commercial banks in central currency i.e. they increase their account at BoF (in crediting their accounts in the ledgers of the BoF, while the the account of the Treasury is debited).

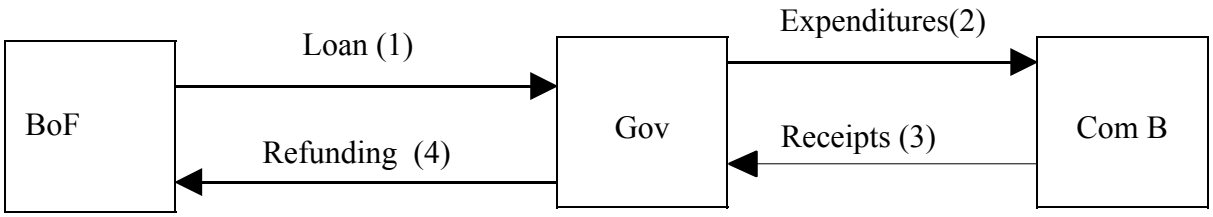
At the opposite the receipts [3] of the government go always to the credit of its account in BoF. These payments are done either in notes (i.e. directly in central currency) or through the mediation of the commercial banks. Thus the latter must pay the taxes (or the subscriptions of loans or any other payments) for the account of their customers through a transfer to the account of the Treasury at BoF (their own accounts in the ledgers of BoF being credited, while the one of the Treasury being debited).

To be able to make these payments in central currency, it is necessary that the commercial banks hold central currency before.

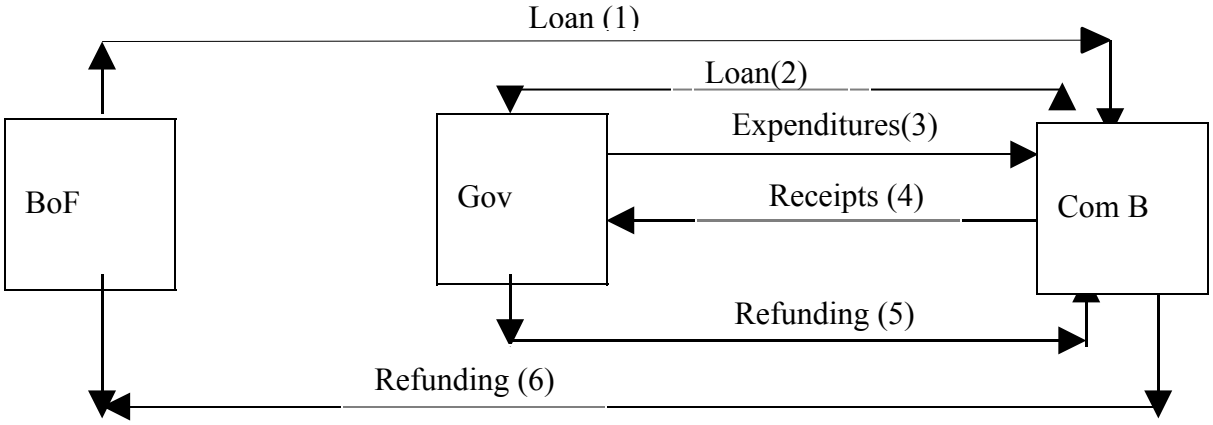
In other words we are in a system with three agents, BoF, gov (government) and the Com. B. (commercial banks) which act in their proper name or like representatives of all the other private agents. Between these three agents payments are done only in central currency (just like between the Com. B., the second-rank currency being used only between the non financial private agents). The central currency coming from BoF (or from Eurosystem, whose BoF is an agent), one can have only the following situations, which are the three types of circuit of central currency:

[2] Let us notice that by expenditure (or payments) of the government it is necessary to hear the final expenditure of any nature as well as provisional (loans of the government).

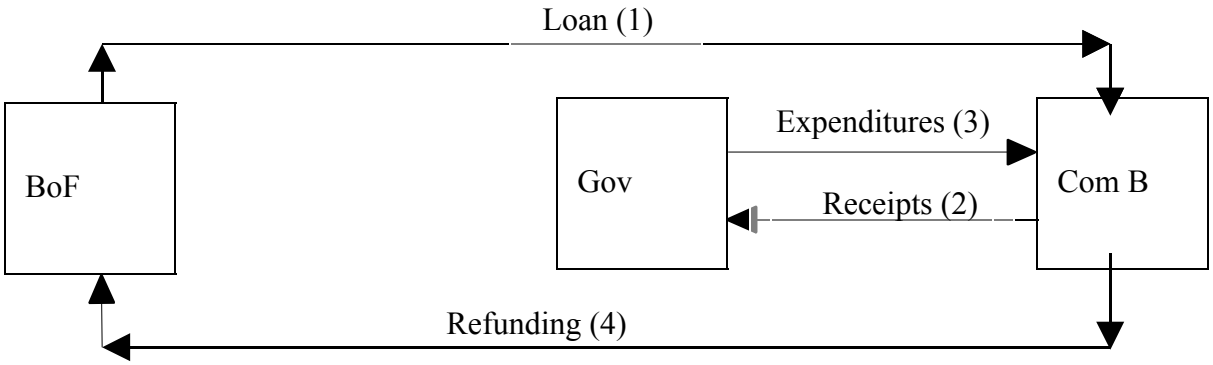
[3] Just as for the expenditure or payments, the receipts are of any nature and include the provisional receipts (public loans)



Situation 1



Situation 2



Situation 3

On these three diagrams the arrows represent the circulation of the central currency between the three principal agents (BoF, gov, Com. B.). The circulation of the central currency between the Com. B. (even between all the agents for banknotes) is not represented because it does not have any interest for our matter.

The arrows are numbered, the circulation of the central currency, taking place inevitably in the order of the numbers.

On the three diagrams the currency leaves BoF (loans (1)), after its creation and returns in BoF (refunding (4) or (6)) where it is destroyed.

For the countries of the euro zone the situation (1) is impossible, since the Treaty of Maastricht forbids the governments to borrow from the central banks, but the situation (2) makes possible to turn this prohibition because there the governments borrow from the central banks through the commercial banks.

In the situation (3) the receipts are collected before the government makes its expenditures, but the private agents must then borrow central currency from BoF in order to make it possible (they do it in fact through the commercial banks[4]).

In the three situations it is necessary to have public expenditure $\geq$ receipts. It is absolutely necessary in the situations (1) and (2), so that private agents hold enough central currency to pay the receipts, and it is necessary in the situation (3) so that they can refund their loans to the central bank (through the commercial banks). Of course it is possible to find situations in which the private agents remain continuously involved in debt, via their bank, at BoF. In such a situation the private agents would remain continuously involved in debt in central currency in order to be able to pay taxes or to subscribe to public loans. Then the entry of the central currency in the economy would be done through them and the governments would be in "surplus". If one excludes the effect of the foreign currencies, about which we will speak afterwards, it is the only situation in which the governments can be in “surplus”. Thus in a closed economy, so that a government be in "surplus", it is necessary that the private agents be continuously involved in debt in central currency. If the epigones of orthodoxy were followed, this situation would be preferable to the other ones.

But is it really? There are at least three reasons for which the orthodox economists condemn the public "deficit". Firstly the "deficit", because debt, would be a load for the future generations. Secondly the "deficit" would cause an effect of crowding out by decreasing the quantity of saving available for the private investment. Thirdly the "deficit", by creating a currency without productive counterpart would be inflationary.

However in the third situation, one did nothing but replace the debt of the government in central currency by an equal one of the private agents in the same currency, therefore the alleged load for the future generations is exactly the same, the alleged crowding out on the saving is exactly the same, and the alleged creation of currency without productive counterpart would be exactly the same.

Thus it is not the fact that the government is in "surplus" or "deficit" which is condemned by the supporters of the liberal orthodoxy, but the existence of any public expenditure, and so of any central currency (except the central currency necessary to the interbank compensation and banknotes).

In short, in a closed economy, when the private agents are not continuously involved in debt in central currency, the government is in "deficit" and has a negative net cash flow in central currency.

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[4] Let us suppose for example that private agents having their account with the Crédit Lyonnais must pay taxes or subscribe to a public loan, whereas government has not still made any expenditure, and that there is thus no central currency yet. These private agents give cheques on the Crédit Lyonnais to a public accountant, who requests the Bank of France to cash them and to carry their amount to the account of the Treasury. To honour these cheques the Crédit Lyonnais can only borrow central currency from the Bank of France through the various techniques offered by the money market. It thus had to borrow central currency for the account of its customers who in large majority of are not aware of it. The reasoning is identical within the framework of the euro zone. If the governments of this zone taken in their whole have not spent before collecting taxes, or if they have insufficiently, the Crédit Lyonnais will not find on the unified interbank market of the zone the central currency necessary and it will have to address itself to the Bank of France.

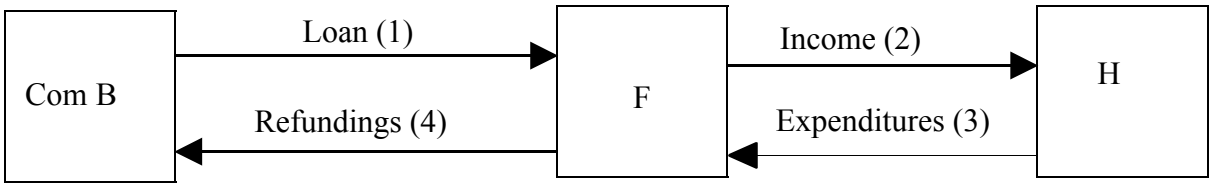
This situation is completely comparable with that of the firms, which, when the other agents are not continuously involved in debt, have a negative net cash flow.

II. THE CIRCUIT OF THE PRIVATE CURRENCY IN A CLOSED ECONOMY IMPLIES THAT THE FIRMS HAVE NORMALLY A NEGATIVE NET CASH FLOW

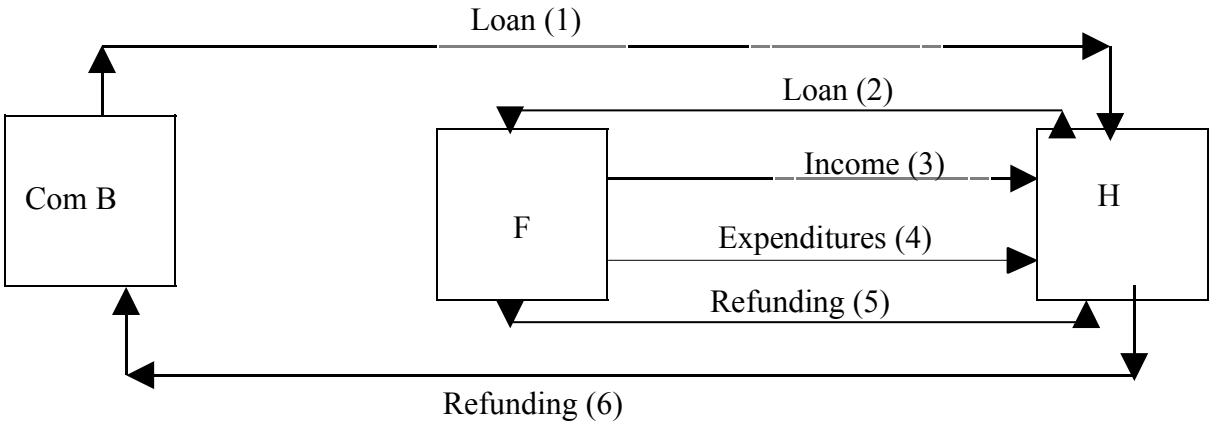
To understand the analogy between the situations of the government and of the firms, it is enough to take again the three situations evoked above, by making permutations between the agents and flows.

With regard to the agents, let us replace the Bank of France (BoF) by the commercial banks (Com. B.), the government (gov) by the firms (F) and the commercial banks (Com. B.) by the households (H).

With regard to flows we have only to replace the (public) expenditure by the incomes (paid by the firms) and the (public) receipts by the (households) expenditure, the 3 situations become:

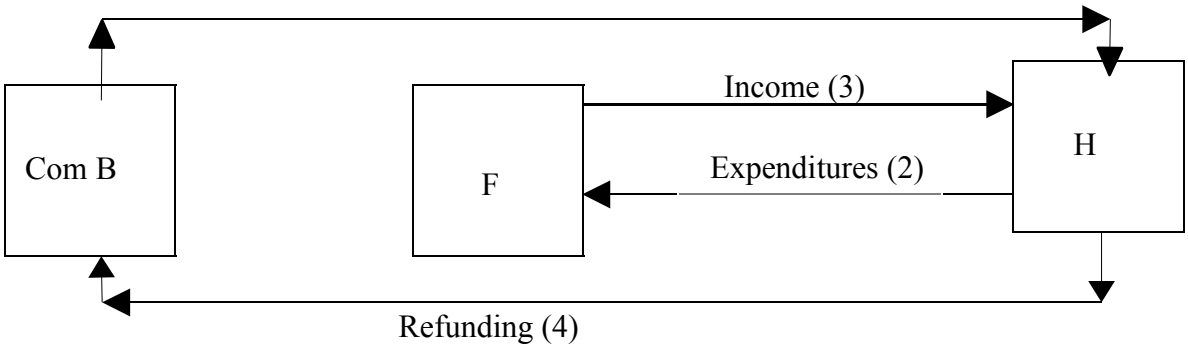


Situation 1'



Situation 2'

Loan (1)



Situation 3’

These three situations are the three types of possible circuit of second-rank currency, the second-rank currency being the currency created by the Com. B. to distinguish from the central currency created by BoF.

The circuits of central and second-rank currencies are independent, which implies, among other things, that the volume of second-rank currency put in circulation by the loans from the commercial banks (flow 1 of situations 1 ', 2' or 3') is independent of the circulation of the central currency and that it is possible to imagine the circulation of the second-rank currency without considering government and the public expenditure and receipts. That has for only effect to limit the central currency to the notes in circulation between the firms and the households and to the central currency circulating between the commercial banks for allowing compensation between the commercial banks of the payments carried out in second-rank currency.

If we consider the situations 1' and 2', we see that we have inevitably income ≥ expenditure (just like we had for the circuit of the central currency in situations 1 and 2, public expenditure ≥ public receipts), and thus that the firms have a negative net cash flow.

If we consider the situation 3' we see that the firms can have a positive net cash flow if the households expenditures are higher than their income, i.e. if they remain continuously involved in debt. This situation is completely comparable with situation 3.

Let us examine now what occurs when we consider simultaneously circulations of central and second-rate currencies.

First of all let us notice that one can find any situation 1, 2 or 3 with any of the situations 1', 2' or 3'.

Then the firms and the households have, through the public expenditure, another source of second-rate currency that those which are reproduced on the diagrams 1', 2' and 3'.

Indeed the trade banks perceive for the account of their customers the excess of the public expenditure on the public receipts. This excess is perceived in the form of central currency, but it is transferred by the trade banks in the accounts of their customers and becomes consequently t second-rank currency.

This surplus of resources implies that the firms can have a positive net cash flow although in situation 1' or 2'. This positive net cash flow comes then from the negative net cash flow of government, while in situation 3', it comes from the negative cash flow of the households.

As we have showed it in our Financial analysis course, the net cash flow of the whole of the non-financial agents (households, government, firms) is null, the positive situation of the ones compensating the negative situation of the others.

Let us see now the effect of the entry of foreign currencies.

III EFFECT OF FOREIGN EXCHANGES

When an economic agent receives incomes in foreign currency (whatever is the cause, product of a sale, a work, a service...), it deposits the currencies received in its bank, which itself deposits them to BoF. In counterpart BoF creates central currency. The net entries of foreign currencies thus constitute an autonomous source of creation of central currency.

Then the central currency that the private agents hold can come from three sources:

1° the public expenditure;

2° loans of central currency by the private agents (loans done through the commercial banks);

3° net entries of foreign currencies.

As we have previously noted, the loans of central currency by the private agents allow, if they are not refunded, the government to have a positive net cash flow, therefore to be in "surplus". The net entries of foreign currencies also make possible to constitute a "surplus".

CONCLUSION

We have showed that if the only source of creation of central currency is the loan of the government to the central bank, the governments can be only in "deficit".

So for the governments being in “surplus” it is necessary either that the private agents borrow in a continuous way from the central bank, or that there are net entries of foreign currencies.

One cannot hope from net entries of foreign currencies an improvement of the budgetary situations for the whole of the governments of the world, since on a world level the net entries of the ones are the net exits of the others, and thus that the creation of central currency for the ones corresponds to a destruction of central currency for the others.

As for the continuous loan of central currency by private agents, although it allows the creation of "budget surpluses", one can doubt its utility, since it does not, in any manner decrease the total debt, neither the alleged effect of crowding out, nor the alleged creation of currency without productive counterpart.

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