The Rennie Quarterly Return

Rennie & Associates
Financial/Investment Planning
Volume 9, Issue 3
March 31, 2017

Deficit Spending - Warning: Don't Try This At Home!

A CFP® licensee has a duty to stay current. Therefore, I attend periodic continuing education classes. Most of the time they showcase new theoretical research or regulatory changes. However, once in a while they upset my apple cart.

It was long ago engrained that all spending deficits are bad. Spending more than household income leads to a decline in family wealth. Business expenses that exceed revenues lead, eventually, to a bankruptcy filing. Fiscal imbalances cause sovereign countries [Greece] to default on debt.

Naturally, when the US Government routinely runs a deficit, a similar fate should await, right? A presentation by Stephanie Kelton, Professor of Economics at the University of Missouri, dumped my apples.

To wrap one's head around the inconsistency, imagine the US economy in its first year of existence. In "Y-1," the Treasury began by printing 100 crisp US Dollars. To get those Dollars into the hands of the US population, the Government had to spend, they couldn't just give the money away! They spent on bridges, military supplies, roads, education, welfare, etc. and paid the workers and suppliers in new Dollars. Total spending = $100.

Fiscal responsibility dictated that the Government maintain a balanced budget. Therefore, total taxes collected in Y-1 was also $100 and a balance budget was achieved! Yeah!

But wait a minute, if in Y-1 the Government ran a balanced budget, meaning they matched spending and tax collection, then what was left over for the little guy (US private sector?) The answer: Zero.

Behold the applesauce: Without running a budget deficit in Y-1, no private sector, personal wealth could have been created. A budget deficit in Y-1 was an absolute necessity.

Naturally, things have changed since Y-1, right? Not really. The truism remains. Private wealth creation must come from US Government spending (dollars added to the economy) exceeding taxes collected. Private wealth changing hands doesn't create more private wealth.

Trade Balances

In the global economy, there are three proxy account holders of US Dollars that theoretically, in aggregate, represent all dollars in circulation: The US Government, the domestic public and private sector (you and me,) and dollars held offshore by foreign entities.

In a year when the US Government achieves a balanced budget, by definition no new Dollars are added to the US economy. If during this year private sector wealth is expected to grow, the dollars must come from overseas, i.e. foreign Dollar holders paying more for US goods and services than the value of US imports. A net foreign trade surplus must exist. There is no other account from which the marginal domestic wealth Dollars can come.

Conversely, if the US runs a trade deficit (more dollars out than in) in a balanced-budget year, domestic private sector wealth must contract.

The US has been running a trade deficit for the last three decades or so. Dollars have left the US. Without simultaneous government deficit spending, private wealth would have declined over the same period. It has not, on average.

A decline in domestic private wealth, according to the data presented, was observed late in the second Bush administration, due to a large trade deficit coupled with reduced Government deficit spending. The Clinton-era budget surpluses were also periods of declining domestic private wealth. Unprecedented deficit spending during the post-recession Obama years was very accretive to private wealth, despite a sizable foreign trade deficit. However, this new wealth was highly concentrated.

Can deficit spending, which has been the facilitator of US private wealth expansion, persist into perpetuity? Each dollar spent by the Government is a dollar borrowed by issuing Treasury securities. Won't the US default, like Greece, eventually? According to sound bites from Warren Buffett, Bill Gates and Alan Greenspan; no. The US will never default as long as it has the authority to issue its own currency. It can print whatever it needs to pay debts. Greece surrendered that authority when it joined the EU.

However, the growing Federal debt combined with rising rates will increasingly burden the US economy as it becomes more costly to service. Unfortunately, either a budget surplus or a trade surplus is required to reduce US debt over time.

Gary B. Rennie, CFP®, AWMA®
Chief Executive Officer
Phone/Fax: (949) 679-4775
Cell: (949) 769-1343
Email: gary@rennieandassociatesfp.com

www.rennieandassociatesfp.com

My Two 

"I remember – I remember campaigning in Chicago, and one of the reporters said, would you ever deficit spend? I said only – only in times of war, in times of economic insecurity as a result of a recession, or in times of national emergency. Never did I dream we'd have a trifecta. "

George W. Bush

Quarterly Trivia:

What is each citizen's share of the US debt?

Roughly $61,150