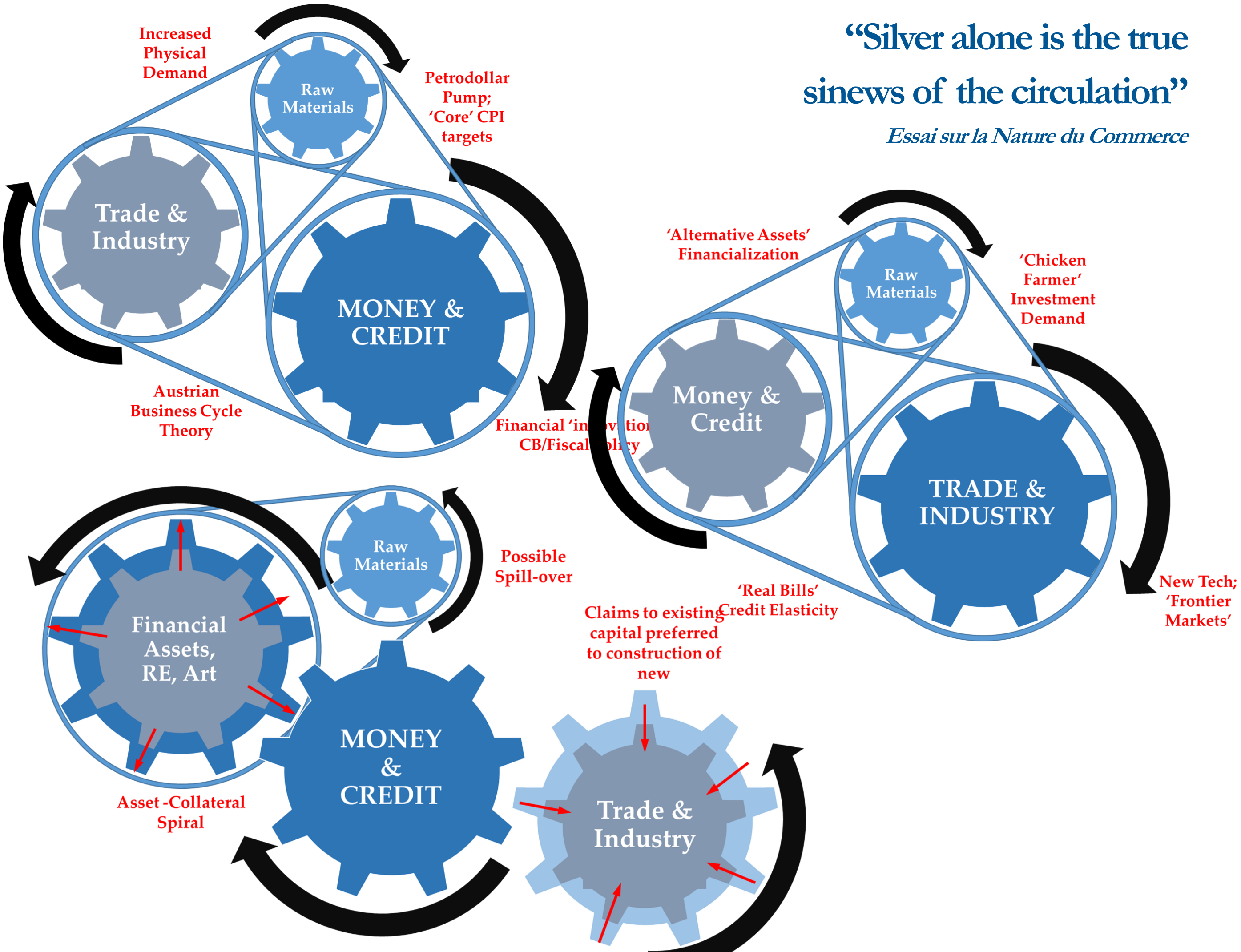
Unconventional Wisdom, Original Thinking September 2020

Cantillon Effects

The Course of the Exchange

CANTILLON CONSULTING



"Silver alone is the true sinews of the circulation"

Essai sur la Nature du Commerce

Volume I, Issue Ia

Fiscal Free Lunch

US government finances are in a mess that will surely only worsen as the two main parties compete to buy votes. For now, no-one cares—but should they?

There are… measures which if not taken, we are undone: to cease borrowing money and to pay off the National debt. If this cannot be done without dismissing the army and putting the ships out of commission, haul them up high and dry, and reduce the army to the lowest point at which it was ever established. There does not exist an engine so corruptive of the government and so demoralising of the nation as a public debt. it will bring on us more ruin at home than all the enemies from abroad against whom this army and navy are to protect us.

Thomas Jefferson, Letter to Nathaniel Macon, 19 August 1821

With the latest CBO estimates for the US Federal budget for August just in, we are again in a position to take stock of the scale of the burden which the COVID-19 lockdowns and more general restrictions have imposed upon the nation's finances.

Perhaps the best way to do this is to compare the change in the first five, pre-crisis months of this fiscal year from the comparable period in FY18/19 and then to repeat the exercise with the subsequent six, *post*-crisis months.

Oct'19-Feb'20 showed that things were largely on track, if with the grip on the public purse a little less rigorous than the year before. Revenues were up by 6.9% - a few percentage points ahead of overall nominal growth in the economy. Outlays were running ahead at a slightly brisker 9.2% pace, the combination leaving the deficit almost 15% - or $80 billion – wider.

In theory, it would then have taken simultaneous tax rises and expenditure cuts of 18.6% to balance the budget – an admittedly unfeasible task, but one only 1% more onerous than in the corresponding months, the year before.

However, as one might only expect, the picture rapidly worsens when we compare March through August.

Revenues here fell $130 billion short of their previous level: a drop of 7.2% which, one might feel, was surprisingly modest, given the circumstances. But it was on the expenditure front that the fiscal abyss truly yawned beneath our feet.

Outlays of just over $4 trillion in those six short months – a sum greater than was the entire national debt as recently as 1992 when Bill Clinton was on the verge of entering the White House – meant they towered 74% higher, $1.7 trillion larger, than during the innocent days of Spring-Summer 2019. As a consequence, the deficit was 4 ½ TIMES what it had been the year before – a gaping $1.86 trillion difference which was more than the total of all obligations accumulated, all through the two centuries which passed from Alexander Hamilton's infamous *démarche* to the middle of Ronald Reagan's second term.

Should the administration now wish to raise monies and limit hand-outs in order to close the gap, it would need to boost the first and shrink the second by all of 41.5% (versus 12.6% in 2018/19) – a steepling requirement only previously surmounted during the course of the two World Wars and at the height of the Great Depression.

Fortunately or otherwise, that added $1.8 trillion has been largely swallowed up and monetized by the banking system and its adjuncts. The Fed itself has bought $700 billion net of simultaneous additions to the Treasury's idle cash balance; commercial bank holdings have risen by $200 billion (augmented by a similar sum of newly-extended reverse repos); and, finally, government money market funds are presently groaning under the weight of a 33%, $900 billion inflow since the beginning of March.

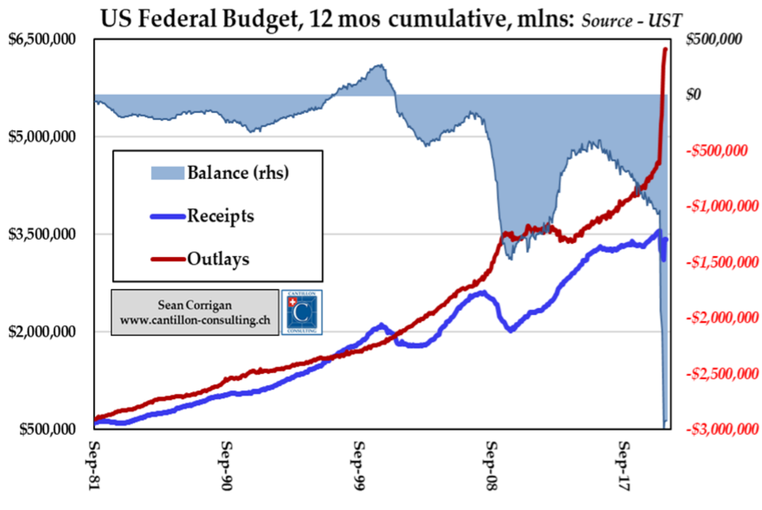
Happily, then, none of this has much impaired others' appetites for government debt, as demonstrated by the fact that 10-year yields are oscillating at levels around 1% lower than before the virus hit and, indeed, have been making record lows in the process.

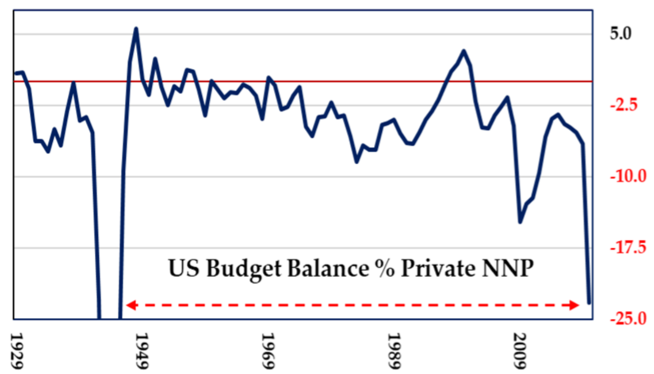
In effect, therefore, we have been living unbeknownst through a dry run of the dreadful policy of deliberate collectivism and partly-suppressed inflation which glories in the name of Modern Monetary Theory.

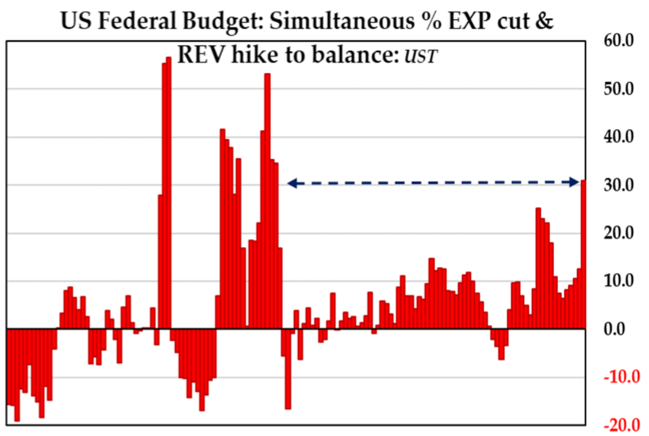
And, yes, Professor Kelton, I agree it has *not* led to a noticeable generalized increase in prices – not YET, while we are still limited in our lifestyle choices and still very much in fear of our jobs and businesses, at least.

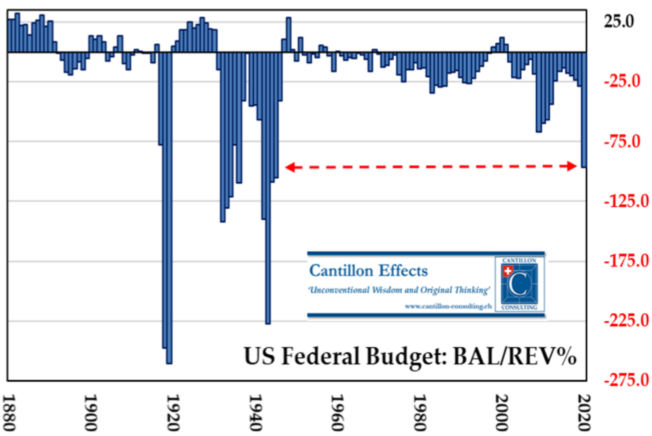
But it HAS already shifted far too much power and influence and transferred far too great a disposal over scarce economic resources *to* the dead hand of the State and *away* from the wealth-generating, liberty-preserving private sector.

For that, you can rest assured, the bill will be silently mounting up, even if none can say exactly when and how it will be presented.









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