Appendix 2 - The (fiat) modern monetary system

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Introduction

It is inconceivable to try to find a solution to the problem of inflation in the modern monetary system without understanding the nature of this monetary system itself and the Central Banking system that is considered the mechanism designed and employed to put the monetary system into action. . It is also important to study the network of financial markets as a basic tool of finance capitalism.
In the light of the materialistic foundation of contemporary Western civilization and the dominant American empire, the understanding of this usury based, shrewd and strange system

(including its characteristics, basis of finance capitalism, central banking system, financial markets, and financial and monetary war tactics) become imperative.
In this regard, some contentions are contemplated:

- How to understand the bases, mechanisms, methods and determinants of issuing modern fiat money? Who issues it? What are the institutions and operational mechanisms serving and protecting the US dollar as the world's largest reserve currency (and also the Euro for that matter) as the main instrument of imperial attrition?
- How to explain that all the countries of the world are in debt including rich countries, especially America? To whom the whole planet earth is indebted?
- Why that when governments issue national currency that they monopolize, they follow procedures that make them seem as if they borrow that currency? A procedure that causes the emergence of most of the so-called internal public debt? And if the state pays its internal debt, would the national currency disappear?

Money issued by decrees (fiat money) has been the subject of many academic studies. Although it is now the basic tool of exploitation and modern Anglo-American Empire, yet the present global economy is based on it. The best way to devise a way to rectify this unfair system is to spread the public knowledge of its basics among the students, academics and professionals, hoping that this will induce bright people to wisely navigate humanity through the process of righting its wrong.
Modern money is debt receipts, "trust receipts" or "accounts money" (dollars, pounds, euros…etc.). It is just a measure, like a meter, a kilo and a hectare. The government issues money first by spending it in the society (i.e., through deficit spending) to employ people and increase productivity. Then it absorbs what is in excess of the society needs through imposing taxes, fees and fines, in order to control inflation (so they claim). People have to look for jobs paid in the local currency to settle their tax liabilities thus creating demand for this currency.
Modern money may be defined as:

"An information system used to spread human effort."

Money is then an information system that contains the values of people's commitment to each other and their commitments to society and society's commitment to them, analogous to bookkeeping. Most of the money circulated today in modern societies has become figures on computer screens, with a small percentage in the form of paper notes or coins.
The percentage of paper and metal money in the United States is less than 1% of the USA total monetary content.

The central banking system

During the days of the empire, Britain established about 80 central banks in its domain of influence that are still running according to the rules that are (original & revised) set in periodic meetings in the headquarter of the Bank of international settlements in Basel, Switzerland that is controlled by the American, British and western central banks.
The central banks control the process of issuing money from nothing into the economy (in a way that make it look as if the government is borrowing it against treasury bonds against interest), decide on the interest rate and on the total money content (supply) in the economy. In turn, the public and private commercial banks relend (rent!) it to public and private companies and individuals against interest as long as they retain it.
Central banks are key institutions responsible for issuing currency, monitoring private banks and carrying out monetary policy. In terms of their influence on a country’s economy, central banks

may surpass all the economic agencies of the executive branch, including ministries of finance (treasuries). Central banks are not a part of the three branches of government (legislative, executive and judicial). Their special status, which makes them independent from the state, is set out in constitutions and special laws. It is claimed and believed that such independence is necessary to pursue a balanced monetary policy and prevent the government from abusing money.
Central banks may have the status of public sector, private or mixed (public-private) organizations. The form of ownership has absolutely no effect on their 'independence'. The US Federal Reserve System, for example, is a closed corporation. The Bank of England and the Bank of France used to be privately owned, but were later nationalized. The central banks of Japan and Italy are organizations with mixed ownership. Many of them are becoming 'financial mega-regulators' that are usurping control over the economy. Some of the events taking place in the world can only be understood in light of the fact that central banks have immunity that protects them from any attempts by the state or the national authorities to control their activities or encroach upon their 'special' status.

The banks and banking system (banks/borrowers/interest)

The banks are institutions to give authorizations or licenses to some individuals (borrowers) to be entrusted by members of the community with goods and services within the limits of the credit value allowed. The Borrower manages the process of directing and using certain assets, goods, efforts and services from the community to establish a specific project, under the bank's mandate and within the value of his loan or credit against payment checks issued by this borrower.
The Bank is responsible for collecting this credit from the borrower, as cash payments or in the form of asset collaterals allocated by the borrower to ensure compliance with the credit payments to the members of the community, in addition to the interest of the bank.
The bank acts as an accountant and a debt collector. It is supported by all the laws that impose respect of money, checks and credit, as well as the authority of the state represented by law enforcement institutions such as the police, the prosecutor and the courts.
To obtain a bank credit (loan). The Bank assesses the financial solvency of the applicant and the collateral he has to pledge to the bank to obtain the loan (home, farm, factory ...).
The borrower becomes a holder of a legal mandate to write checks within the loan's value and use it to obtain goods and services from the community. Once a seller of a commodity accepts the new money (checks), new money appears in the market, and is traded to complete an unlimited number of transactions until it is recovered by the borrower who first issued it, when he becomes a seller who offers a commodity or service produced in the market, then he pays his loan to the bank, and this money disappears.
If the borrower succeeds in retrieving the money he has issued by exchanging goods and services with the same value plus the interest, he will be able to retain his encumbered property. If he fails, the bank will seize it.

Bank interest

Interest is a "fixed or variable" time rent against temporary borrowing for the means of exchange of goods and services in the community (bank money).
Banks only create borrowed amounts, not enough to pay interest as well. Money for interests comes from other borrowers. For some to pay their interests, others will not even be able to pay off their principle loans and will go bankrupt and lose their collaterals to banks.

There is a continuous need to find more borrowers and bank money, otherwise bankruptcy rates and collateral confiscation will increase. But more bank money means more loans and debt to service the old debt. Only the time interval between loans and interest payment prevent interests from devouring all wealth in the community.
Those who escape bankruptcy are those who are active in marketable commodities, and those capable of achieving capital accumulation without any ethical considerations, and those who are competent in managing their business. The bankrupts are those who deal in unmarketable goods no matter how important, and who do not have the ability to achieve capital accumulation and who are inefficient in managing their business.
The interests raise the cost of everything (which is one of the main causes of inflation), and prevent society from devoting some of its members to deal with vital tasks that cannot be sold as commodities, such as fine culture, education, literature and other humanities.

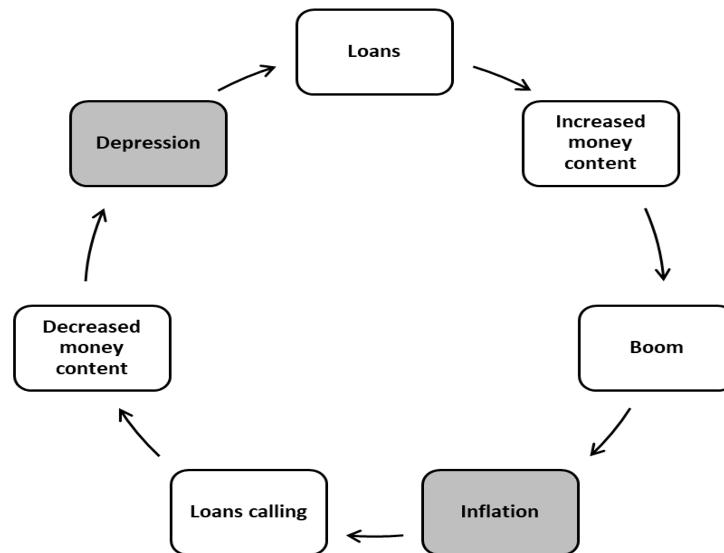
Highlights:

- People deal together using a means of exchange (bank money) issued by the financial institutions.
- This money must be borrowed and then returned to the source as if it its owner, i.e. people borrow the means to enable them to deal together.
- Financial institutions can encourage, direct, expand or restrict human labor.
- Everyone pays a percentage of their wealth and effort in exchange for the temporal use of this means of exchange.
- All bank money was borrowed by someone, so that if the loans were repaid or recovered by the banks, the bank money would disappear and the ability of the people to deal with each other would be reduced (to using only the basic government money as will be shown).

Inflation caused by interest bearing money

- Increasing monetary content while not increasing production of sellable goods necessarily leads to the so-called inflation and lower purchasing power of money.
- As banks finance more service activities (such as sports, tourism, art, entertainment, media, security, armed forces, etc.) compared to productive activities (such as mining, agriculture, industry, fishing, livestock and sheep … etc.), inflation increases and money purchasing power declines; as the same goods are chased by more money in circulation.
- The interests raise the cost of everything and thus cause inflation.
- Financing the big businessmen activities (who are usually of older age and usually prefer trade in goods, real estate and assets rather than engaging in productive activities) through bank loans is inflationary.
- The confusion in the economy due to inflation is caused by using the same name to the currency unit of account during the stages of its decay in value .
- If we continue to assign the variable and depreciating currency unit its nominal value, despite the decrease in its purchasing power (say 1% per month), this spoils the exchange process, and obliges the seller to reduce the grace period between the sale and the actual receipt of the price. Which may lead to the cancellation of credit completely and avoiding installments and forward sales and spoil long-term contractual relations. This in practice will paralyze the economy.

The bank money and inflation/deflation (so called economic cycles) cycles



Monopoly creation by fiat money and the banking system

Bank credit is a tool to:

- Launch, increase or restrict the process of production and exchange of wealth and goods.
- Distribute and direct national product to favor some (elite) by providing credit to them.
- Stimulate work in specific areas in relation to other areas by providing credit.
- Exploit the majority in favor of the elite.
- Transfer wealth from the public to the elite.
- Increase monetary content without increasing production which results in lower purchasing power of money, equivalent to levying a tax (inflation).
- Reduce interest rates to stimulate business and borrowing, or increase it to reduce business activity.
- Monopolize specific assets and activities.
- Concentrate wealth and pump it continuously from the majority to the elite minority and from the poor to the rich.
- Create an artificial scarcity of money. Even though money is just a tool to unleash human energy and a means of exchanging goods and services!
- Interest (usury) encourages fierce competition among members of the community to collect money to pay back the loan and interest.
- Not injecting money in the right place when issued, as it does not reach the hands of those who need it or those who would put it to best use, but goes to the rich elite and big companies who are trained to use and deal with banks.
- Create a need for endless growth, so that the continuous stream of installments of loans and accrued interest are paid.

The monetary base or vertical money

- The government/central bank (monopolizing issuing "basic capital" or basic money) issue the monetary base in the form of government checks to feed different accounts against treasury bonds (government debt securities) deposited with the central bank.
- This is why the government money is actually debts, but debts that no one intends to repay, because repaying means the disappearance of the currency (or the monetary base) of economy/society.

- The monetary base consists of bank reserves and cash currency (circulated). The banks' reserves are bank deposits (from the monetary base) in their accounts at the central bank in addition to the reserve liquidity in their coffers.
- The monetary base is the "actual" money in the economy, i.e. the net monetary assets in the economy, or monetary content in the economy.
- Government spending only is what increases net monetary assets, or basic money in the economy. The issuance of this money is called "vertical activity."
- Tax collection from the non-government sector is also a "vertical" process leading to a decrease in non-government net monetary assets.
- Only taxes and government spending change net monetary assets in the economy.
- The amount of money printed and coined should be in line with the development of society and should be sufficient to meet the need for cash circulation, not more.

The monetary sovereign government

- The monetary sovereign government is not obligated to convert its currency into gold or any other currency at a predetermined price.
- Because the sovereign government monopolizes the local currency, the government's money never runs out. It does not even need to collect tax before spending, or borrow to meet the expenses in the currency it monopolizes.
- The government must first spend to transfer the currency that it monopolizes its issuance to the hands of the people to enable them to pay taxes and buy government bonds.
- Government spending is never constrained to the government's ability to collect revenue; revenue collection here loses its meaning.
- The relative values of national currencies are determined in the exchange market, which automatically adjusts the effect of any increase in local government spending (apart from the effect of currency manipulation and currency attack by speculators). If government spending increases, domestic monetary content increases, the local currency exchange rate declines, and vice versa, so that trade balance is maintained.

The features of the modern monetary system in a monetary sovereign government

Government funds can never be exhausted

- In the presence of a flexible exchange rate, government money can never be exhausted. The government's over-spending could cause prices to rise. But all the constraints on government spending (such as budget control ...etc.) are self-imposed by the government and can be eliminated.

Taxes do not provide liquid cash for the government’s treasury

- Taxes are tools to manage aggregate demand and control financial reserves in the economy by absorbing liquidity, not a means of generating cash receipts to finance government spending.

Government bonds do not fund government spending

- The monetary sovereign government does not need to tax or borrow or issue and sell government bonds to raise money and generate revenue for domestic spending. But the sale of bonds to banks maintains the stability of the interbank borrowing interest rate required to absorb the banks’ accumulated surpluses that are pushing to lower the interbank interest rates. (As will be seen below).

The hierarchy of money in a monetary sovereign state

- In every economy there is a hierarchy of money, which is not all of equal power.
- The money most acceptable in the economy sits at the top of this pyramid. They are government debt securities in "national currency" issued by a formal decree that everyone must accept, and it is used to settle transactions and debts.
- Debt receipts or personal trusts do not enjoy the same trust and acceptance as government debt or "state money" and cannot be widely used in society to settle transactions.
- The government spends and taxes in its own currency, which it controls.
- The government can always pay off any debt in the currency it monopolizes its issuance, and can never go bankrupt or run out of such money, and do not need to borrow in its currency. It also sets the interest rate against borrowing its currency.

The hierarchy of money in a country operating under the gold standard

- The Government undertakes to convert its currency into gold on demand.
- That is why the gold reserve in this case is at the top of the hierarchy, not the national currency.
- If the government spends much of its own currency, it may not be able to convert all that it may be required to convert from its currency to gold as promised.
- Hence, governments operating under the gold standard do not have a sovereign currency.

The hierarchy of money in a country whose currency is pegged to another currency

- The State that establishes the exchange rate of its currency as a percentage of the currency of another State shall protect its reserves of that other currency. It may go bankrupt if it fail to convert its currency to the other currency on demand. This requires the realization of trade surpluses to obtain the other currency and to keep adequate reserves of that currency.
- The monetary hierarchy here has that foreign currency at its apex.
- The member countries of the euro zone only use it and do not issue it. That is why they have to borrow it and pay any interest imposed by the bond markets, so their monetary wealth may run out. They therefore lack the political freedom enjoyed by monetary sovereign governments.
- If a sovereign government renounces its control of its national currency, it also abandons its ability to establish an independent national economic policy and concede that authority to the bond markets.

Commercial bank credit or horizontal money

- Central banks create government money. Commercial banks create credit.
- When central banks create money, they finance government spending, capital investment, and public infrastructure to stimulate economy, growth and new investment.
- When commercial banks create credit in the so-called horizontal activity, they lend it against mortgages, capital or assets that already exist, not necessarily to create new assets.
- Loans, bank deposits or bank money do not increase or decrease net non-governmental monetary assets (monetary base) - the net result is always zero. This bank money is always created along with a corresponding liability. Meaning that the result is neither an increase nor decrease in net cash assets.
- The activity in this credit market is based on the base money or the monetary base lever.

- Monetary assets in the non-government sector and bank deposit accounts are claims on the principal base capital. Where it is assumed that it can be converted into a principal capital at the due date. Sometimes referred to as "bank money", "credit money" or "cash deposit."

The mechanism of loans and deposits

- The process of creating this "horizontal" bank money is through the mechanism of loans/deposits within the commercial banking system, *without the direct participation of the Central Bank*. Horizontal activity can neither increase nor decrease net monetary assets (monetary base). The net is always zero.
- When a loan is issued on the basis of a newly deposited deposit, the borrower usually transfers money to another person (possibly for a purchase). The borrower's account is debited and the seller account is credited with the same amount. The deposit becomes a receivable for the recipient, and a liability or obligation to the borrower and his bank. To settle these transactions, the reserves are transferred between the banks, so that the borrower's bank loses some of its assets that goes to the recipient's bank. I.e., the net cash assets (monetary base) have neither increased nor decreased - the net result is still zero.
- When the payment of the loan is made in the deposit account of the borrower (the bank money "disappears"), and the loan contract is updated (possibly implicitly) to reflect that the remaining portion of the loan has also decreased. The net result is zero.
- When the borrower pays the interest of the bank, the value of his deposit decreases and the value of shareholders' equity in the bank increases accordingly. (The shareholders' equity of the Bank may be considered as a deposit in the Bank).
- When a borrower defaults for any reason, its loan contract (which was ultimately a liability to the borrower and assets of the Bank) is canceled. Both the corresponding assets and liabilities disappear. Here there has also been neither increase nor decrease in total net cash assets - that is, the net result is zero again.

Bank money can only be created through loans

- All existing bank money was initially issued as a loan from a bank. Money is created in the modern monetary system only when lending. The act of borrowing takes bank money into existence. The repayment of loans makes them vanish.
- Bank money has a lifetime in circulation and ends with repayment of loans, thus limiting the activity of exchange in the community.
- The real source of bank money is the borrower in the form of checks signed in his name.
- *Banks do not neither lend their capital, surpluses nor even deposits.*
- Banks can create any amount of money borrowed by clients, because they create it from nothing just through writing any value on the computer screen against the name of the borrower.
- The bank allows the client/borrower a right on the basic capital that can be liquidated immediately upon request, against the long term right of the bank (on the client/borrower) that also includes interest payments. The net accounting result is neither an increase nor a decrease in the net financial assets. Of course loans/deposits could be used to finance productive investment, which could increase the real assets.

Reserve and capital of banks

- Banks use "bank reserves" to settle their daily transactions. The bank can obtain reserves by attracting new deposits, or borrowing from the interbank lending market.
- The reserve does not affect the Bank's ability to lend. If the bank has clients with a good credit standing, the bank will consistently "create" the loan and the corresponding deposits independently of the current reserve position. The reserve shortfall is then resolved after it occurs from the interbank lending market at the end of the day.
- The central bank deals with the interbank lending market to maintain the target interest rate. If there is a shortage of reserves in the interbank lending market at the end of the day, the central bank must intervene and provide the necessary reserves, and act as a "lender of last resort", and if there is surplus it absorbs it to relieve pressure on interest rate to increase or decrease.
- Reserves requirements is a remnants of the old gold standard system, but are not relevant in the current monetary system because the reserves do not reduce the bank's risks and do not constitute a reserve that can be withdrawn if there is a run on the bank.
- Banks are prevented from over-lending by placing conditions on capital requirements, in accordance with the Basel Convention's regulatory framework! (Is this strictly observed?)
- The Bank's capital relates to the Bank's solvency, i.e. its ability to meet its obligations, while the Bank's reserves relate to its available liquidity, which changes on a daily basis. A bank with financial leverage can always get liquidity by borrowing more reserves from other banks.

Common misconceptions

- The wide spread belief that banks receive deposits, and hold part of them as reserves and lend the rest - "that is, loans are from deposits" is incorrect. The reality is that loans create deposits.
- Banks do not lend their reserves to clients. Reserves are used to settle interbank accounts. There are three things banks can do with surplus reserves: lend them to other banks in the interbank lending market, buy government bonds, or convert them into liquid cash.
- Contrary to popular belief, too, the problem of shortage of bank reserves is solved after it occurs. The lack of reserve does not restrict banks in providing loans to borrowers, on the contrary. Banks actually lend any good client who shows up even if they have a shortage in their reserves. Any shortage of reserve is treated after it occurs from the interbank lending market at the end of the day, with the central bank as the lender of last resort, if need be.
- Another common misconception is that government deficit spending leads to an increase in interest rates, which limits the activity of the private sector:
  - The first mistake here is that the government needs to borrow to finance the deficit in domestic spending.
  - The second mistake is that government borrowing takes money from a limited base of "lendable funds" available in the economy.

The reality is that the government spends through the issuance of currency. Therefore, government spending creates pressure to lower interest rates, not to increase them, because it adds reserves to the banking system, and does not take from it.

Fiscal and monetary policies

Central Bank operations

- Banks need liquid cash reserves to settle their daily operations with clients and other banks and with the central bank due to withdrawals or loans. The source of these reserves is deposits, or borrowing from other banks surplus reserves at the end of the day in the interbank lending market, usually managed by the central bank.
- The central bank determines the interbank lending rate. If there are no reserves in the banking system as a whole at the end of the day (because of new loans from banks to clients, for example), this puts an immediate pressure to raise the interbank lending rate. In contrast, if banks find too much reserves in the market as a whole, they will try to lend the surplus to the interbank lending market, putting immediate pressure to lower the interbank lending rate.
- The central bank intervenes to control the interbank lending rate by adding or withdrawing (pumping or absorbing) reserves from/to the system. The central bank does this through:
  - Implementing "open market operations" through buying and selling government bonds.
  - Establish a "corridor" of interest rates, with an interest rate slightly higher than the target rate, that offers unlimited lending to commercial banks, and a little less than the target rate, that allows them to borrow unlimited amounts of money.
- The Central Bank pays the commercial banks the target rate of interest on all daily savings, which would achieve the same goal without the need to issue debt.

Abba Lerner Principles of sound Monetary System

- The currency issuance through government spending is used to increase non-government net financial assets, and taxation takes away from non-government net financial assets.
- Debt securities are issued by the Treasury to drain cash reserves to achieve the target interest rate of the central bank.

Fiscal policy and monetary policy

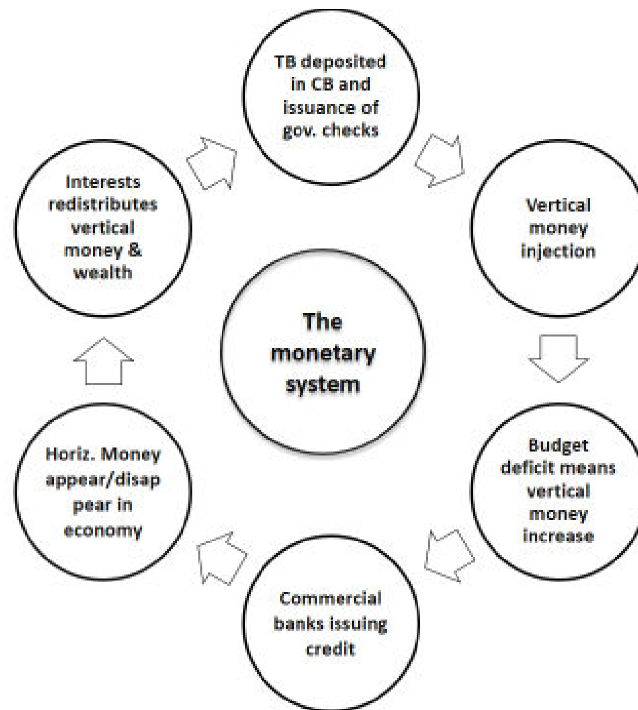
We can now define fiscal policy and monetary policy:

- Fiscal policy is related to government spending and taxation policies. The government controls the macro economy by applying fiscal policy to spending (deficit in the national budget) and absorbing money (taxing).
- Fiscal policy relates to government programs and plans to reduce unemployment. Tax exemptions are aimed at returning more money to the community so as to increase spending.
- Fiscal policy changes the volume of non-government net monetary assets (government bonds issued and monetary base) and is implemented by the Treasury.
- Monetary policy is used by the government to influence the overall level of economic activity, control the supply, circulation and availability of money in an effective manner and control basic interest rates; to achieve economic stability, reduce unemployment, inflation (!), increase growth and control foreign balance-of-payments. Monetary policy is directed exclusively at banks. *The central bank usually manages monetary policy on behalf of the government (!).*
- Monetary policy only changes the components of the net non-government monetary assets, i.e. government bonds issued in exchange for the basic money or monetary base.
- We can also say:
  - The Treasury spends basic money into existence.

- The Central Bank lends basic cash into existence.

Summary: in the monetary sovereign government

- The modern monetary system is characterized by the monopoly of the national government to issue money by sovereign decrees.
- Money in a sovereign government is exchanged at a free exchange rate (by which monetary policy has been liberalized from having to protect foreign exchange reserves).
- The monetary unit determined by the government has no real value. The government does not have to convert it into gold, as it did under the gold standard, or to any other currency (if begged to another currency). This currency is guaranteed only through its acceptance to settle the taxes and financial claims on the Government.
- The usual comparison in economics literature between the family budget and the national government budget is a false comparison, as the capacity of government monetary spending here is not in fact limited by its revenues.
- Statements such as "the government spends taxpayers' money" or "subsidizes prices" are not true.
- Taxation absorbs purchasing power from the private sector, but does not provide any additional fiscal capacity for public spending that did not exist before. From an accounting point of view, government deficit (or surplus) is equal to the total non-governmental surpluses (or deficits).
- Government spending here is the first source of private sector's money that enables it to pay taxes and achieve and retain some surpluses.
- Net surpluses of the financial assets of the non-government sector cannot be achieved unless they are preceded by a corresponding government spending in the form of a deficit in the national budget.
- The government is the only entity that can, by spending money into existence (i.e. budget deficit), provide the non-government sector with net financial assets that cover its net savings so that it can absorb the total private savings and eliminate unemployment.
- The systematic pursuit of government budget surpluses, contrary to prevailing economic arguments, necessarily results in a decrease in private sector savings.
- If the government balances the budget, with a current account deficit over the business cycle, the local private sector will suffer a deficit (deducted from its savings) during that cycle. The decline in private savings levels to finance the government surplus, will erode the private sector's ability to finance its activities and will increase its debt. And ultimately leads to weaker demand through slower real activity.
- The only way to enable the local private sector to save is for the government sector to spend in the form of a budget deficit until the private savings reach the required level.
- The government deficit acts to "finance" private savings by ensuring that total expenditure is sufficient to generate the level of production, growth and income that will achieve the required levels of savings.



Monetary balance

Balanced Society

Self-sufficient isolated balanced society

The total monetary content of the national currency will not matter, as long as:

- Relative pricing of goods and services is balanced.
- There is social justice in the distribution of wealth.
- There are enough currency units to encourage everyone to work.
- All productive and service activities are activated for the benefit of the community.
- Public or national ownership of industries and basic services.
- Relative value of money not important.

A balanced society with a balanced exchange

- Produces and exports what corresponds to what it consumes and imports.
- Balanced exchange with the others.
- Fair and just relative evaluation of goods and services, full employment of all, and equitable distribution of wealth are required.

Directing issued money in the balance of society

- Productive activities are agriculture - industry - hunting - extraction.
- Non-directly-productive activities are education, health, social welfare, services, security & defence, and their cost is to be met by direct government spending adjusted by taxes.
- Recreational activities are to be charged directly if taxes are not enough.

Causes of economic imbalance

- A society that is not productive or does not produce enough.
- Not all of the available production and service capacities in the community are activated.
- There is an imbalance in the vertical money content .
- Unbalanced relative pricing to the detriment of some activities.
- Industries and basic services are owned by foreigners.
- Unfair trade agreements with others.

- Financial war to devalue the national currency.
- The economy is transformed into a rentier economy that drains its wealth and pumps it abroad.

Sectorial balances

- The government plays a pivotal role in the economy of the modern money system; it is the currency issuer, the only entity that can spend without generating income, and its economic policies are subject to the democratic process.
- The government's cash balance is the inverse of the non-governmental budget. In other words, the government deficit over the year corresponds to non-governmental surpluses, i.e., the increase in net non-governmental financial assets in the same period.
- There can be no accumulation of net savings of financial assets in the non-government sector without spending a cumulative deficit from the government. Only the Government could provide the non-governmental sector with net cash assets.
- If the balance of the external sector is zero (i.e., the balance of foreign trade is zero), the government deficit corresponds to the net increase in the financial assets of the domestic private sector.
- From the accounting view point, there can be no surplus in all sectors simultaneously. At least one sector must have a negative budget.

The myth of government debt

- The monetary sovereign government in the modern money system is not constrained by revenue. Therefore, the aim of issuing government bonds is not to "borrow to finance the deficit", but to provide a useful savings pot for the non-government sector as well as to set interest rates in the economy.
- Government bonds and the so-called "core/basic money" are two sides of one thing:
    - The basic money is a cash government obligation for which interest is not paid.
    - Government bonds are a government liability for which interest is paid. This needs a zero-interest solution.
- But both are equal and interchangeable unit of calculation, and can replace one another.
- What is perceived as a "repayment of government debt" occurs continuously at the maturity of any government bonds. It is essentially merely an internal transfer (just accounting entries) from the "securities account" to the "reserve account" in the books of the central bank.

Restriction by revenue and the erroneous comparison to household budget

- Companies, households, municipalities and governorates are obliged to spend their total income only, like the euro zone countries, because they are not issuers of euros but only users.
- Countries whose currencies are begged to another currency are also constrained by their income. Therefore, they maintain reserves of the other currencies and have to pay high interest on treasury bonds. Because if the government issued and spent much of its currency in relation to the reserve it is holding, it might not be able to supply enough foreign currency that the public might require to convert and might be unable to meet its obligations and might be forced to devalue its currency.

- Using household budget similitude to understand the financial considerations of the modern money system is not appropriate. The government here cannot become bankrupt or suffer a liquidity crisis in its own currency.
- The government always has at its disposal "an unlimited supply of monetary assets in its local currency." As the sole issuer of its local currency, they can spend as soon as they feed bank accounts, like changing the numbers on the scoreboard in sports.
- It is reasonable to store real assets or financial assets in foreign currencies. But the establishing of sovereign funds from tax revenues or from local currency financial assets makes no sense. This "investment fund" can be formed in any size as soon as the government wills as the issuer of the currency.
- Taxes help to reduce the purchasing power of the private sector, while "borrowing" (the issuance of government bonds) is aiming to change interest rates or reduce inflation - both do not aim to "finance expenditure."

The monetary sovereign government is not monetary constrained

- If government revenues are not constrained in any way, why borrow? There are voluntary restrictions imposed by governments (reflecting ideological tendencies) that have nothing to do with the basic mechanisms of the banking system in the central monetary system.
- Although the government is not cash-strapped, it may issue debt instruments to control the effects of its liquidity in the economy (government spending and the purchase of government bonds by the central bank adds liquidity, while taxing and selling government bonds leads to their absorption). These operations affect the daily liquidity of the system, and can lead on any day to a surplus or deficit in the system, depending on whether the flow of money occurs from or to the formal sector in local currency.
- The central bank aims to maintain the level of interest rates set for its monetary policy.
- There is therefore no substantial reason for a sovereign government to borrow "to finance" its net domestic currency expenditure.
- There are residues of voluntary restrictions on government monetary activity corresponding to those that were employed during the gold standard period. Governments therefore issue debt securities through auctions to cover government spending deficits, while this is absolutely not necessary from a financial perspective.
- Foreigners do not finance domestic spending.

Budget deficit is the norm in a growing economy

- There is no defect in the government deficit per se. It does not necessarily compete with private sector activity, does not represent a "burden" for future generations and cannot lead to "financial ruin" for the government. The continuing government deficit is the expected rule in the case of economic growth; it adds to the net financial assets (currency and bonds) of the non-government sector, which provides the necessary basis for savings.
- The government should not "over expand" the liquidity needed to save and grow, so deficits will not be spent beyond potential demand or what the economy can expand to meet. This occurs when the economy is close to the state of full utilization of energy and employment. In such case, as the government continues deficit spending, this will cause inflationary pressures –i.e. an increase in prices in the economy as a whole.
- Credit can support economic growth for some time. Although this usually results in the liquidation of family assets and resort to borrowing, because it replaces the sustainable

government deficit spending by the unsustainable private deficit spending. If debt continues to increase, a point will come where income is simply not enough to serve interest payments.

- Liquidity crises can never occur with a planned government deficit. The only risk here with this fiscal policy is the inflation that could arise if the government pushed nominal growth rates above the real capacity of the economy to absorb this increase.

The wishes of the private sector for saving

- The non-government sector usually tends to save, i.e. accumulate net financial assets, by retaining some of its income. This usually occurs in a growing economy. Savings are also affected by the value of current net financial assets and income and other economic and cultural factors.
- The savings cause leakage in demand and hence unemployment - unless the economy is injected with some monetary assets to balance the leakage.
- Monetary assets saved in the banking system can be absorbed by issuing government bonds.
- Accumulation of financial assets in local currency occurs only if the government sector or the foreign sector is managed in deficit.
- A foreign trade deficit in the case of a strong currency is a manifestation of the desire of the rest of the world to retain some of the currency in question, as with the USD.
- If the foreign exchange sector is balanced, there is no way for the local private sector to save unless the government budget contains deficit spending to fund the required flow. Without a government deficit, there will be no savings.

Government deficit is not a burden

- Government deficits are not a burden on the government or on the public (other than the potential inflationary effects that can be remedied); it simply means that the government spends more than the taxes it receives, i.e. issues and injects more basic money into the non-governmental sector than is withdrawn (or destroyed).
- This government deficit fully corresponds to the surplus or increase in net financial assets in the non-government sector. Otherwise, non-government net financial assets remain constant.
- With a carefully planned deficit, the government can allow non-government net financial assets to grow sustainably forever, a normal situation in a growing economy.
- Government spending in productive activities injects non-interest-bearing money into the economy, and its circulation in the economy produces growth.

Deficit in itself does not lead to inflation

- Government deficit spending (by issuing currency) does not automatically and inevitably lead to inflation.
- Companies tend to respond to growing demand by increasing production rather than increasing prices as long as they can.
- The calculated increase in the monetary base does not necessarily lead to price increase as long as there are still undeveloped energies in the economy.
- Excessive spending leads to inflation; because if actual demand exceeds the potential of the real economy to expand to meet it, this will result in inflationary pressures.

A deficit less than what is needed leads to unemployment

- When the government cuts spending or overcharges taxes, it reduces the monetary base, which could lead to a reduction in economic performance below the available means, leading to stagnation, unemployment and possibly deflation.
- This understanding of modern money frees the government from the need to finance the deficit in the public budget by borrowing in local currency, reduces the restrictions on the government, and gives it a greater degree of freedom to achieve full employment and stability of prices, which cannot be achieved under the begged currency system.