Money and the Pandemic: Government Budgets

*Anne Emerson, March 2021*

In a previous article (October, 2020), the process of money-creation in a modern banking system was described. This article focuses on a related topic: where does the money originate, for the issuance of stimulus checks?

Technically, creating money is a different process from producing stimulus checks. When the Fed was established in 1914, it was designed to be independent of the US Treasury. Money-creation (or destruction) by the Fed supposedly should be used for proper stewardship of the economy, especially for controlling inflation. It is not supposed to be used for political gain, such as improving the prospects of a political party by generating an economic boost during an election year.

Here are a few explanations of terms. Use of a government’s budget, involving taxing and spending, is called “Fiscal Policy.” This is different from control of the money supply, or “Monetary Policy,” which was discussed in the previous article, and is the responsibility of the Federal Reserve. “Policy” in this context means the ways in which these two types of economic controls are supposed to work. Understanding how these instruments should work does not require a preference for any one policy or another. This article is neutral in that regard.

The US Treasury’s budget is somewhat analogous to an individual’s budget, in that “income” comes in and “spending” goes out. For the government, income derives primarily from tax receipts; spending includes purchases of items such as national defense, infrastructure, and social programs. However, unlike a private budget, a government budget does not need to be either balanced or debt-free.

Two explanations are usually given for these differences. One, requiring a balanced government budget may worsen the natural ups and downs of business cycles. For example, as economic activity declines, tax receipts also decline. If the government reduces its spending when tax receipts decline, in order to balance its budget, then economic activity will likely decline more than it already has.

Some analysts advise increasing government spending during a downturn, in order to compensate for job-losses and other negative effects of the downturn. It has been suggested that, ideally, a government’s budget should be balanced over the course of a business cycle, rather than for each fiscal year. (That is, greater government spending at business cycle lows should be balanced by lesser spending during business cycle highs, or “booms.”)

Two, the US government cannot go bankrupt, because not only can it tax citizens, but also it can “print money” – money-creation, as discussed in the previous article. A third, related, difference is sometimes suggested as well: the US government does not have a fixed lifespan, as individuals do. Any debt can be rolled over in perpetuity. Rolling over a debt means that, when an IOU comes due, more debt is issued in order to pay for the debt that has recently come due.

Before we discuss any “magic” origin of stimulus checks from a government already in debt, here is a reminder of the relationship between a government’s budget and its debt. A budget is usually prepared for a short time period, such as a year. Before, during, and after that year, the budget office compares income against expenses. One either exceeds the other, or they match. For the year, the budget was in the black, or in the red (money borrowed), or balanced.

The total government debt is the cumulative effect of many years of either borrowing or saving. That is, it is last year’s budget shortfall or surplus, plus that from the previous year, and so on.

Back to budgets. In general, if an individual or a business runs a deficit in its bank account, its checks will bounce unless it has an arrangement with the bank. For example, the bank may offer a line of credit against home equity. For businesses, the timing of receipts and outlays can vary widely, and a business may have a revolving line of credit. Banks do not usually enter into such arrangements unless repayment of the loan is either guaranteed (with collateral, such as a home or car), or reasonable to expect (the borrower will make enough money to cover loan repayments).

Back to stimulus checks and the pandemic. How can the US Treasury’s bank account increase enough, absent additional tax receipts, so that it has funds to write stimulus checks that won’t bounce? Answer: The Treasury borrows the money by issuing government debt (known as Treasuries – Treasury bonds, bills, notes, etc. – short- and long-term). It borrows the needed money on the open market for debt instruments. That is, it sells debt, such as Treasury bills, to individuals, companies, and national governments, including other departments of the US government. Official sources state that US government debt on January 1, 2020 was $23,224 trillion. By December 27, 2020, it was $27,539 trillion.

You, also, may sometimes increase your bank balance by borrowing. The difference between you and the US Treasury is that most people think the Treasury is good for its debt. Most individuals could not borrow billions of dollars – their banks would doubt their ability to re-pay so much debt.

The Federal Reserve is the Treasury’s banker. This relationship can raise concerns about the independence of the Fed from the Treasury. (You and I may have bank accounts at commercial banks, such as United Bank. The US Treasury has its bank account at the Federal Reserve – the US central bank, or “banker’s bank.” If you were to look closely at a stimulus check, you would see that it has its own routing number. This makes it hard to see that it is drawn on a Federal Reserve Bank, not on a commercial bank.)

Many debt assets which the Fed buys on the open market are Treasuries (government debt). Thus, buying government debt is a component of Monetary Policy (money creation and destruction – see previous article), while selling government debt is a component of Fiscal Policy (taxing and spending), as described above. Since the Treasury sells on the open market to dealers in securities, and the Fed buys on the open market from dealers, the Treasury does not borrow directly from the Fed.

On March 18, 2020, the Fed owned $2.64 trillion in US Treasury securities; by December 16, it owned $4.66 trillion. Analysts debate to what extent the Fed is operating independently of the Treasury during the pandemic, and how much this matters; also, when, how, or by whom the price for a high debt might be paid. Excessive government debt can lead to high interest rates, followed by insolvency and default; many believe the US government will not default. Excessive money-creation can lead to high levels of inflation, and there is debate about why this is not happening, how severe its impact might be, and on whom, if it should occur.

**Further reading:**

[www.thebalance.com](http://www.thebalance.com) presents various articles on the debt by Kimberly Amadeo. This website explains issues relevant for personal finance, to the general public.

[www.stlouisfed.org](http://www.stlouisfed.org) and usdebtclock.org present data on the amount of debt.

The following two pieces offer different opinions on the impact of stimulus spending: “Will Inflation Return?” The Economist, December 12-18, 2020, especially pp. 25-27. And: https://www.washingtonpost.com/business/2020/04/05/what-2-trillion-coronavirus-bailout-is-really-going-cost/