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Reliance of the Government on a Central Bank's Printing Press

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Abstract:
This research paper explores the debate surrounding a government's dependence on central bank money creation instead of taxation, often termed "monetary financing" or "helicopter money." Examining the advantages and drawbacks of this novel approach, the paper finds that reduced taxation can enhance fiscal flexibility, stimulate growth, and benefit businesses and consumers. Examples from regions like the United Arab Emirates, Monaco, and Texas illustrate the viability of low or no taxation models, though extreme positions are common.
Critics raise concerns about central bank independence erosion, inflation risks, and intergenerational fairness. The absence of taxation can spur economic growth but may lead to rising money supply, inflation, and worsened trade terms. Modern Monetary Theory suggests that money printing is viable until full employment if higher taxes absorb excess money.
While it offers flexibility in crises, the absence of taxation can foster fiscal recklessness, potentially causing currency crises and excessive inflation. It may encourage overspending, leading to central bank debt monetization, known as fiscal dominance.
Furthermore, taxation's absence raises equity concerns, impacting wealth redistribution, market correction, and efficient resource allocation. Taxation plays a crucial role in achieving economic policy goals, including debt management, deficit control, and inflation regulation.
In summary, relying solely on central bank money creation has short-term advantages but poses long-term risks to economic stability, equity, and fiscal discipline. Striking the right balance between taxation and money creation remains vital in modern fiscal policy.

Keywords: -Central bank, monetary policy, easy money policy, government, fiscal policy

The debate over the absence of government taxation and the exclusive reliance on newly created money by the central bank as a means of funding its expenditure has captured the attention of economists and policymakers alike. This alternative approach, which is seen through "monetary financing" or "helicopter money", presents a paradigm shift in fiscal management.

Proponents of reduced taxation assert that it offers distinct advantages, including enhanced flexibility in fiscal policy and the potential to stimulate economic growth in nations (Vedder and Gallaway), benefits corporations ("The Benefits of Setting a Lower Limit on Corporate Taxation"), and (being an expansionary fiscal policy) leaves consumers with more money in hand. For the topic of low to no taxes, there is a general radicalisation of beliefs. (Jantscher) Strong arguments can often be made, taking into account known examples of economic success with low to no taxes (income or corporate): The United Arab Emirates ("United Arab Emirates: Economy")(Oton), Monaco ("Business and Economy"), and the state of Texas, USA ("Texas Economic Snapshot").

Concerning the complete reliance of a government on the central bank, critics express concerns about the potential ramifications, such as erosion of central bank independence and the risks of inflation (Mathai), and intergenerational equity. This essay will delve into the potential advantages and disadvantages of a state depending solely on money creation by the central bank.

One of the biggest advantages of the situation of no taxation is growth in the economy. Governments typically use revenue raising through taxation and spending to influence the economy's demand and allocation of resources. ("Monetary and Fiscal Policy") Tax rates, direct and indirect, when cut, lead to growth in consumption and investment as it puts more money in the hands of individuals and businesses – pushing the aggregate demand curve rightward. (Gale and Samwick) The government then has lesser money to spend. These measures are taken when the government wants to take counter-cyclical steps to pump prime the economy. However, consider the impact on the government – it typically runs a larger fiscal deficit or a lesser surplus. That also implies more debt issuance by the government, which may lead to crowding out of private sector borrowers in case the government perpetually runs a large deficit. But, when debt to GDP is low to moderate and the deficit is not large, then the scenario of crowding out is ruled out. This scenario, possible only in countries with high net exports, also allows money supply and printing as a tool to boost economic growth. However, with economic growth comes other problems forced by the printing of money for government expenditures.

Taxes are needed for the government's expenditure or transfer payments. In this situation where governments do not tax to raise revenue for expenditure, the shortfall or deficit will have to be financed by new money printed by the central bank. In the case of nations which are net consumers, this will lead to too much new money hence the purchasing power of the currency will decline (Pettinger) and so will the terms of trade. It will lead to higher price levels in the economy as imports will be dearer and costs of production will increase as well. On the other hand, tax rates will be lower (which helps consumers and businesses), but this is only for a short period. As inflation continues to climb sharply, it becomes a higher 'tax' for all. That 'tax rate' can spiral out of control and often leads to the collapse of economies. It leads to irreparable costs for future generations.

Modern Monetary Theory is a common argument used to state that printing new money is harmless as long as the economy has not reached full employment (and printing does not create inflation until then). This theory, unlike the situation being examined here, accounts for a higher tax rate that returns excess money to the government – hence preventing inflation). (Sikander)

Flexibility in fiscal policy is an advantage that the situation being studied offers in times of war or economic crises. Yet, this also creates the disadvantage that the government can have money printed to get itself out of any situation – harming the people in the process. After the government realizes it has a limitless buyer for debt, it abandons all fiscal control. According to Lawson and Feldberg, "… it was explicit policy in India before a series of reforms in the 1980s and 1990s. Uncontrolled monetization can cause currency crises in fixed-exchange-rate regimes and lead to excessive inflation." Governments that have the freedom to create money to pay debt and spending may also "exercise far less fiscal discipline than otherwise." Governments could spend lavishly and cause the economy to overheat if debt is issued with no prospect of repayment. A central bank is left with little choice in the event of a financially reckless administration. Interest rates on government debt will grow if the deficits are not monetized, which might raise the likelihood of default. The central bank will not have much option but to monetize eventually. This phenomenon, fiscal dominance, is a significant drawback of the system in issue. (Lawson and Feldberg)

The situation of no tax also creates another major problem – equity concerns. Fiscal policy has long been the core of stabilisation measures and redistribution of money. Governments maintain progressive income tax systems, as well as other taxation on goods and corporates, to redistribute some of the wealth in the economy. As stated by Dr Amirthalingam, "Taxation is used to encourage or discourage certain types of behaviour, to correct market imperfections, and to modify the distribution of income or wealth." (Amirthalingam) The main reason for a tax system to exist is to allocate the cost of government in a fair way. (Bird and Zolt) In other words, the removal of taxes leads to failure to achieve other objectives of economic policy, such as an efficient resource allocation, an equitable and competitive trade sector and a populace (Bovenberg). Other macroeconomic variables, such as economic growth, public debt, fiscal deficit, and inflation, are significantly influenced by a nation's tax structure. The macroeconomic health of a nation also has a significant impact on its tax system. (Amirthalingam) Teera and Hudson note that taxation policy has always been an important instrument for augmenting revenue, especially in developing countries, where it is the major source of domestic revenue. (Teera and Hudson) Increased revenues are desired for many other purposes including expanding socially desired government current expenditures. The growth of public spending has generated large fiscal deficits in many countries, leading to increases in the share of public debt relative to GDP. The existence of a large public debt has important implications for the taxation potential of any country. The government must generate the funds required to pay down its substantial debt. The level of taxes must increase when interest payments on debt exceed net borrowing and any potential decrease in non-interest expenses, unless economic development is swift enough to offset the increase. Therefore, public debt and government spending have an impact on whether or not a country can fully utilise its tax capacity. (Jantscher and Tanzi).

Central banks conduct monetary policy through a variety of tools such as managing the quantity of money in the economy and the cost of money. The liquidity operations often involve buying of securities by the central bank when it wants to infuse liquidity in the banking system, and vice versa. In times of extreme risk aversion, when the government issues new debt securities for the purposes of spending in the economy, the central bank prints new currency. This is an advantageous option when deflation has set in, and interest rates are low; central banks prefer to flood the economy with enough currency so that spending is re-ignited and a low level of inflation is reinstated, much like Japan since the early 2000s. However, the success of this policy is also contested by critics. (Greenwood). Now, this essay will explore some examples relating to a lack of taxation and large-scale money printing.

A notably successful country where income taxes have been zero for a while is the United Arab Emirates. However, the UAE – much like many other nations in the Gulf – had the flexibility to do so since they filled the government coffers through the sale of oil. Often resources, when extractable, lead to nations becoming rich and provide their governments flexibility of keeping taxation low or nil for a prolonged period. This is possible when the Debt to GDP is reasonably low. But most nations that are net consumers and have trade deficits need the ability to fund those deficits in order to stabilise the value of their currencies or the general price levels in the economy. Take Australia, which has vast (producing and reserve) resources, yet taxes far above the global minimum; this is because it has a high debt to GDP. ("Australia Government Debt: % of GDP") In nations like Germany and China which are net producers as well but are large economies, tax rates have often been the advantageous policy tool for encouraging consumption or investment. Tax policies and revenues have been used substantially for the development of infrastructure and promotion of production and supply of goods. This has kept inflation stable over long periods of time and allowed the central bank to be independent while implementing monetary policy and managing the debts and borrowing that the government runs up.

One of the best examples of large-scale printing of money was after the Global Financial Crisis, when the Federal Reserve Board of the United States of America carried out quantitative easing programs. This helped stabilise the financial system, saved financial institutions and helped bring economies back into growth (from the point of liquidity crisis and freezing up of the flow of money). Governments were able to avoid stimulus through taxes, as the need of the hour was liquidity and not counter-cyclical stimulus. The long-term impact of the need and quantum of quantitative easing has yet to be seen, but in the medium term, it leads to restoration of trust in the banking and monetary systems, stabilised trade flows and revived economic growth. It did not lead to hyperinflation (as was widely expected at the time when Ben Bernanke set out his 'Helicopter Ben' policies), but fractional reserve banking helped contain the growth as banks were not willing to lend but were keeping excess to create backups, or store with the central bank. According to Ben Bernanke, new monetary policy tools like quantitative easing in the post-crisis experience have, in the United States and elsewhere, helped ease financial conditions and led ultimately to significantly better economic outcomes than would have otherwise occurred. This policy, initially heavily doubted, has appeared to be successful for a while now. While this has been advantageous in a post-crisis situation, the question of whether such a policy can work under ordinary circumstances is unanswered. (Bernanke)

Thus, imposing taxes leads to governments thinking hard before acting as it affects the wider populace and has political implications as well. This is not the case with reliance on new money printed by the central bank (but for periods of financial crises). The former is finite while the latter is unlimited. Additionally, central banks will lose control over the conduct of monetary policy if governments just print new money to spend their way out of any economic situation. Boosts in consumption due to more money in the economy can only be partially successful in the short term. If all of the government's expenditure depends on newly printed money, the economy would likely face more harm than the advantages it receives.

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