Jobs and Freedom Now! Functional Finance, Full Employment, and the Freedom Budget

Mathew Forstater

The Review of Black Political Economy

ISSN 0034-6446
Volume 39
Number 1

Rev Black Polit Econ (2012) 39:63-78
DOI 10.1007/s12114-011-9125-z

Springer

Your article is protected by copyright and all rights are held exclusively by Springer Science + Business Media, LLC. This e-offprint is for personal use only and shall not be self-archived in electronic repositories. If you wish to self-archive your work, please use the accepted author's version for posting to your own website or your institution's repository. You may further deposit the accepted author's version on a funder's repository at a funder's request, provided it is not made publicly available until 12 months after publication.

Springer

Author's personal copy

Rev Black Polit Econ (2012) 39:63–78
DOI 10.1007/s12114-011-9125-z

Jobs and Freedom Now! Functional Finance, Full Employment, and the Freedom Budget

Mathew Forstater

Published online: 20 January 2012
© Springer Science+Business Media, LLC 2012

Abstract Forty-five years ago, the A. Philip Randolph Institute issued "The Freedom Budget," in which a program for economic transformation was proposed that included a job guarantee for everyone ready and willing to work, a guaranteed income for those unable to work or those who should not be working, and a living wage to lift the working poor out of poverty. Such policies were supported by a host of scholars, civic leaders, and institutions, including the Rev. Dr. Martin Luther King, Jr.; indeed, they provided the cornerstones for King's "Poor Peoples' Campaign" and "economic bill of rights." This paper proposes a "New Freedom Budget" for full employment based on the principles of functional finance. To counter a major obstacle to such a policy program, the paper includes a "primer" on three paradigms for understanding government budget deficits and the national debt: the deficit hawk, deficit dove, and functional finance perspectives. Finally, some of the benefits of the job guarantee are outlined, including the ways in which the program may serve as a vehicle for a variety of social policies.

Keywords Unemployment · Full employment · Budget deficits · National debt · Public policy · Functional finance · Job guarantee · Public service employment

The "Freedom Budget", the job guarantee, and the *Review of Black Political Economy*

2011 marks the 45th anniversary of the "Freedom Budget," a policy program developed by A. Philip Randolph and Bayard Rustin, working with New Deal Keynesian economists such as Leon H. Keyserling, former Chairman of the Council of Economic Advisors in the Truman Administration. Randolph presented the proposal at the 1966 White House conference "To Fulfill these Rights," calling for a

M. Forstater (✉)
Department of Economics, University of Missouri-Kansas City, Haag 211, Kansas City, MO 64110, USA
e-mail: forstaterm@umkc.edu

Author's personal copy

government-sponsored job guarantee for those ready and willing to work, a guaranteed income for those who cannot or should not be working, and an increase in the minimum wage to lift the working poor and their families out of poverty (A. Philip Randolph Institute 1966).

The two main (and complementary) components of the Randolph-Rustin proposal for full employment and the job guarantee, encompassed in the term *public service employment*, were government as "employer of last resort" and public works: "We should be demanding immediate passage of an accelerated public works program" (Rustin 1971 [1965], p. 130). While accepting the basic Keynesian macroeconomic analysis that unemployment can be an aggregate problem due to lack of effective demand, Rustin and company also took the view that generic demand stimulus would not address the unemployment problem in toto. In addition to Keynesian unemployment there is also structural unemployment, a catch-phrase meant to include unemployment due to structural and technological change. A campaign to address structural unemployment would have to go beyond conventional fiscal stimulus: the private sector would never provide enough jobs, even when being pumped up by government expenditure. True full employment and poverty-reduction can be achieved "only when the government takes responsibility of creating work for those whom the private sector can no longer use" (Rustin 1971 [1968], p. 235):

> [T]he government becomes the employer of first and last resort for the hard-core poor…Neither individuals nor the private sector of the economy has, or can take, responsibility for full employment in American society. This is the responsibility of all segments of the society and thus, finally, of the government. (Rustin 1971 [1968], p. 235)

In addition, the thinkers working around the Randolph Institute saw that a WPA-style program could not only create jobs, but produce goods and services that could address other important needs, such as increased community and social services and infrastructure creation and revitalization. The program thus rejected the "culture of poverty" and "human capital" approaches gaining followers at the time, insisting instead that jobs must come first, with training coming on-the-job:

> We are going to have to have public works programs to put these people back to work and to do it without a lot of talk about pre-training. These people don't have to be pre-trained. All they need to know is that there are jobs. John Dewey said that a man learns by doing. I want to go Dewey one better: we must put these people to work learning *while* doing, and while being paid. In World War II we did not ask if people were too black, or too old, or too young, or too stupid to work. We simply said to them this is a hammer, this is a tool, this is a drill. We built factories and sent these people into the factories. We paid them extraordinarily good wages and in 2 months they created the miracle of making planes that flew. We can find a peacetime method for doing this—public works for schools, hospitals, psychiatric clinics, new modes of transportation, of cleaning the air, of cleaning the rivers. All these improvements would benefit not only the poor but also the affluent. (Rustin 1971 [1968], p. 236)

Author's personal copy

Rustin saw public service employment as providing a number of benefits in addition to job creation and increased public works and social services. First, he viewed the program as resulting in a reduction in both crime and government spending on the poor and unemployed:

> The way things are now we are twice damned. We are paying $15 billion a year for the support and misdeeds of those who cannot find work and end up in prison or on welfare. If they are provided with work and improve the economy, then we have additional growth plus the $15 billion we are now paying for keeping them on welfare and in jail. (Rustin 1971 [1968], p. 237)

Secondly, he viewed the program as good for everyone, Black and white, rich and poor. The job guarantee would be for everyone (i.e., no means tests), regardless of race, and thus would benefit poor whites and others. Furthermore, full employment benefits everyone, even business, whose sales and profits are supported by increased incomes and spending:

> But I want to assure businessmen that the people who benefit from the programs are not going to sit on the money when they get it. They are going to act like Americans. They are going to buy all the junk that is advertised, thereby raising the GNP, raising the economic production and growth of the country, and fundamentally adding to its economic stability. (Rustin 1971 [1968], p. 237)

While the Freedom Budget was never passed, or even officially introduced as legislation, the momentum eventually contributed to discussions within the Congressional Black Caucus that led to the introduction of a new full employment bill by African American Congressman Augustus F. Hawkins (D-CA) in the early 1970s. The original bill included a job guarantee, the creation of a Job Guarantee Office, a Standby Job Corps, and the changing of the name of the United States Employment Service to the United States Full Employment Service (see Hawkins 1975). The bill went through several iterations and name changes until it finally passed in 1978 as the Full Employment and Balanced Growth Act, stripped of the job guarantee.

Randolph, founding President of the Brotherhood of Sleeping Car Porters, and Rustin had previously worked along-side the Rev. Dr. Martin Luther King, Jr. in organizing the 1963 March on Washington, the full, official name of course which was the "March on Washington for Jobs and Freedom." The two men had also led the March on Washington Movement (MOWM) of the 1940s that resulted in then-President Franklin Delano Roosevelt's Executive Order 8802, which created the Fair Employment Practice Committee (FEPC).

During the same period as the Freedom Budget was issued, Dr. King was increasingly including similar themes in his writings and speeches, proposing a federally-guaranteed job creation program as the centerpiece of both his "economic bill of rights" (an idea revived from FDR) and his "Poor People's Campaign" (King 1986 [1968], p. 67; see also Forstater 2002). But King was only one—albeit an extremely important one—of a host of African American leaders and organizations in the sixties and seventies to support not only full employment in general but the specific idea that "government… become an employer of last resort" (King 1971 [1963], p. 32). "This would guarantee

Author's personal copy

a job to all people who want to work and are able to work…It would mean creating certain public-service jobs" (King 1986 [1968], p. 67). This notion in one form or another was embraced by virtually all the most prominent African American organizations, with the list of African American leaders and organizations supporting the policy encompassing a wide swath of the political spectrum (Forstater 2007).

Among those supporting true full employment and the job guarantee were U.S. Rep. John J. Conyers, Jr. (D-MI), James Farmer, Charles V. Hamilton, Bernard Anderson, and Robert S. Browne, the founder of the Black Economic Research Center (BERC) and the *Review of Black Political Economy*. Browne was also a charter founder of the Caucus of Black Economists, a predecessor of the National Economic Association (NEA; Alexis, Spratlen, and Wilson 2008). To assist him in formulating a new full employment bill that would address the limitations of the 1946 Employment Act, Rep. Hawkins organized a small working group in 1972 that included Robert S. Browne and Bernard Anderson, among others (Anderson 2008):

> Robert Browne helped shape and reinforce Mr. Hawkins' thinking about full employment, and how to make the Bill a tool for addressing black joblessness. He emphasized that the declaration of policy would mean little if not accompanied by specific measures to guide policy makers toward reaching the goal. Browne urged specific language in the Bill to spell out how the government would act as the employer of last resort. (Anderson 2008, p. 95)

Also of note, Coretta Scott King was very involved in the struggle for full employment during the 1970s, when she was Co-Chair of both the National Committee for Full Employment and the Full Employment Action Council.

More recently, a job guarantee has been embraced and supported by William Julius Wilson (1996), Ronald B. Mincy (1994), Marable (1997), the National Urban League (1996), Tyner (1994), and the Black Radical Congress (1998). In the context of the current and ongoing crisis of the 2007-onward "Great [i.e., Terrible] Recession," NEA Past-President William A. Darity, Jr., in an article in the *Review of Black Political Economy*, has revived the proposal that the federal government should guarantee a job for all by serving as the employer of last resort (Darity 2010).

Job creation and public investment have tremendous potential social and economic benefits, and many have argued that such programs would essentially 'pay for themselves' and produce benefits that exceed their costs. Nevertheless, it is clear that one of the primary roadblocks in the way of a true full employment policy regards public perceptions concerning the perceived cost, and the impact on the government budget and the national debt. It would serve those concerned about unemployment well to review the arguments surrounding deficit spending, the national debt, and government 'solvency'.

Deficit hawks, deficit doves, and functional finance: a primer

There are three paradigms for understanding government budgets and the national debt: deficit hawk, deficit dove, and functional finance. We will now review each of these in turn, beginning with the deficit hawks. Hawks view government budget

Author's personal copy

deficits and the national debt as almost always and everywhere a negative for the economy and society. Often associated with a 'sound money' or 'sound finance' position, some hawks support a balanced budget amendment to the U.S. Constitution requiring the Federal government to run a balanced budget except in times of national emergency.

There are five basic hawk arguments as to the negative impacts of deficits and the debt. Not all hawks subscribe to all five, but virtually all hawks take one or more of these positions. Many of the hawk arguments follow from the basic neoclassical economic vision explicit or implicit in the hawk conception of how the macroeconomy operates. This vision can be described by two main features. First, the market economy has a built-in tendency toward full employment of resources, including labor. Second, savings determines investment through variations in the rate of interest, as in a loanable funds model. Summaries of hawk views can be found in Buchanan (1958); Friedman (1988); Savage (1988); and Peterson (1993, 2004).

1. **Deficits cause inflation**. The economy tends to full employment, so excess aggregate demand caused by deficit spending is inflationary. Actually, the idea that deficits can be too large if they increase aggregate demand beyond the full employment level of output is shared by many hawks, doves and adherents of functional finance. The differences then regard whether involuntary unemployment is viewed as a short term, disequilibrium macro-phenomenon or a normal, permanent feature of the system, consistent with macro equilibrium. But if the economy is at or near full employment, deficit expansion can result in what Keynes called "true inflation" (some cost-push or supply-side instances of rising prices may be more about relative price changes). Interestingly, some hawks would require the money supply to increase for there to be inflation (if they take a traditional monetarist view).
2. **Deficits cause high interest rates**. There are several versions of this argument, some concerning only *long term* interest rates (more later on the empirical evidence). But basically, for the hawks, government spending financed by borrowing increases competition in the loanable funds market, bidding up interest rates.
3. **Deficits crowd out private spending**. This also has several versions, partial versus full crowding out, for example. There are also those who view crowding out as resulting only from government borrowing versus those who hold the position that even government spending financed by tax revenues crowds out private expenditure. In any case, if all resources are fully employed, government can employ a resource only if it takes it away from the private sector. Viewed slightly differently, government borrowing to finance deficit spending reduces the loanable funds available to finance private spending, whether investment or consumer durables.
4. **The national debt is a burden on future generations**. Because they have to pay it.
5. **Deficits and the national debt are generally immoral**. The analogy is often made here between government deficits and debt and firm or household deficits and debt. "If I ran my company with spending in excess of revenue year after year, I'd be out of business!" "I can't continually spend in excess of my income and expect to stay afloat, why should the government?"

Author's personal copy

The point has been made that some of the hawk positions are applicable to an economy on a gold standard or other fixed exchange rate regime, such as a currency board, monetary union, or peg to another nation's currency (or a weighted basket of currencies). This will be discussed in more detail below.

Deficit doves view deficits (and an increased national debt) as reasonable, under certain circumstances, depending on the economic context. Doves have concentrated much attention on issues of defining and measuring deficits and the national debt. The following ten points summarize various dove arguments, including dove responses to and criticisms of the hawks (dove positions can be found in Heilbroner and Bernstein 1963, 1989; Eisner 1986, 1994, 1997; Cavanaugh 1996; and Benavie 1998). Just as most of the hawk positions follow from the fundamental neoclassical vision characterizing their analytical framework, dove arguments tend to follow from a basic Keynesian view of how the macroeconomy operates. Specifically, doves view unemployment and excess capacity as normal features of a modern capitalist economy, and they tend to reject a loanable funds view of savings and investment, instead seeing investment as determining savings through changes in income.

1. **Are deficits being measured in constant or current dollars?** Doves argue that it is wrong to compare deficits between years in current dollars, because the value of the dollar has changed. One way of correcting for this is to look at deficit/GDP ratios (and debt/GDP ratios). These ratios are also important for doves because they argue that a larger GDP means we can afford a bigger deficit or debt. A related issue is the changing *real* value of the national debt due to inflation or deflation. When Reagan claimed that a pile of dollar bills of an amount equal to the size of the Federal deficit or the national debt would reach almost to the moon (later repeated by Clinton), I proposed making dollar bills thinner. A similar, often repeated hawk image is that the same number of bills laid end to end would go around the earth three times, prompting my proposal that we make dollar bills shorter so they would only circle the globe twice.
2. **The Federal Government doesn't keep a capital account**. So when there is a large capital expenditure it looks like much has been paid out in the current period and the budget doesn't reflect the services that will last for multiple years into the future. Firms and state and local governments keep a capital account, but all Federal expenditures go on the current account.
3. **The Government owns assets**. The Government may have a debt, but it also owns assets such as land, buildings, stocks, gold, water sewage treatment plants, hospitals, and schools. Next to the pile of dollars representing the deficit or debt we could make a pile representing government assets that might go past the moon. Hypothetically, these assets could be sold, but what economic reasoning would justify such an action?
4. **State and local budgets often not considered**. The media and politicians often do not make clear whether they are talking about the consolidated (federal, state, and local) government budget balance or only the federal deficit. Historically, federal deficits have sometimes been offset by surpluses at the state and local levels, although in recent years that has not been the case. Federal transfers to state and local governments are also common. Doves take this confusion between the consolidated and federal budget as yet another example of the imprecision in defining and measuring deficits and the debt.

Author's personal copy

5. **Government agencies own government debt**. For example, state and local governments may invest in government bonds, as do some Federal government agencies, in which case it is argued that we really do "owe it to ourselves." At the start of 2010, over 40% of the national debt was held by government agencies. Interest payments, therefore, constitute inter-governmental transfers. And, of course, all U.S. citizens are citizens of the nation, a state, and a locality.
6. **We should examine the "full employment deficit."** Doves argue that much of the deficit is due to unemployment. When there is unemployment, income is lower, so tax revenues are lower, and government spending on various forms of assistance for the unemployed is higher, so unemployment increases the size of the deficit. Job creation causes incomes and therefore tax revenues to rise, and lowers government spending to support the unemployed, resulting in a decline in the size of the deficit. The 'true' deficit would be the real value of the full employment deficit on the current account, net of government debt purchases and state and local transfers. Estimates of its size have often virtually wiped the deficit clean.
7. **Balance the budget over the business cycle, rather than in one year**. Doves argue that one calendar year is an economically arbitrary amount of time. Instead, it makes more sense to run deficits during recessions and surpluses during booms, so that the budget is balanced over the cycle and debt is not growing. It is true that in recent years the nation has run deficits during both phases of the cycle, but that does not alter the fact that there is little economic meaning to a 12 month period and a constitutional amendment to balance the Federal budget in each calendar year would make sensible fiscal policy impossible, except in a national emergency. A double-digit unemployment rate, by the way, constitutes a real national emergency.
8. **Debt is not a burden on future because we are also creating assets for the future**. Doves encourage consideration of two scenarios: one in which our children inherit a strong economy with high employment, an up-to-date infrastructure, good schools and hospitals, as well as a larger national debt; and another in which the debt is smaller, but the economy is weak, unemployment is high, and the infrastructure is crumbling. Which would our children and grandchildren prefer? Doves also argue that the debt will be paid to those in the future as well, so the whole idea of the national debt as a burden on the future is the result of more misunderstanding and confusion.
9. **Doves argue that if deficits and high interest rates are correlated, the causality goes the opposite way—from high interest rates to big deficits.** When interest rates are high, interest payments are high, pushing deficits higher. In any case, doves point out that short term rates such as the Federal Funds rate and the discount rate are directly controlled by the central bank, and these rates serve as benchmark rates for other important rates such as the prime rate. The argument that deficits cause high interest rates is also not supported by the empirical record (see Evans 1985; Ussher 1998).
10. **To the extent that the analogy with households and firms is applicable, doves think it supports their view.** Well-managed, responsible debt is not a bad thing for households and firms—same with government. Why do households go into debt? Think of the homes we would live in and the cars we would drive if we had to pay cash, or how old we would be before we could purchase a

Author's personal copy

home or a car. For firms, debt is often a sign of strength; firms borrow to invest in producing goods and services for sale to earn revenue and profits. But doves generally do not think the analogy is a good one, as it is rooted in a failure to understand the logical fallacy of composition. As Robert Eisner, who devoted a lifetime to refuting the myths and misunderstandings concerning budget deficits and the national debt, argued, for the economy as a whole, contrary to the popular saying, there may be a free lunch, "and failing to take advantage of it may leave some of us without dinner as well":

> The cost of anything is what has to be sacrificed to get it. What then would be the cost of providing lunch to the needy if we used surplus food that would otherwise be wasted? Would there be a cost to government's giving lunch to hungry children? Would the people, otherwise unemployed, who might be paid to prepare the lunches perhaps thus secure the wherewithal to purchase dinner? [Eisner 1994, xiii–xiv].

The Functional Finance view says both the hawks and the doves are wrong, but in different ways and for different reasons. Managing the government budget according to the principles of functional finance requires a Chartalist or State money system, i.e., a flexible exchange rate system where money is not backed at a fixed exchange rate by gold or any other commodity. Functional finance therefore does not apply to a monetary system with any type of fixed exchange rate—no pegged currencies, currency boards, or currency unions, to give a few examples. Economies operating with a fiat currency or 'modern money' system, however, can and should manage their budget according to the principles of functional finance. The original formulation was by Lerner (1943), with recent elaborations and developments by Mosler (1997–98), Wray (1998), Forstater (1999), and Bell (2000). The functional finance perspective can be summarized by the following 10 points.

1. **The Federal Government is the monopoly issuer of the currency**. Since the United States dollar is a sovereign, non-convertible, floating currency, why would the Federal government need to tax or borrow from the public in order to spend? The Federal government, as the money monopolist and issuer of the (intrinsically valueless) currency, doesn't need the public's money; what the government needs is for the public to need its monopoly money.
2. **In a modern money system, the purpose of taxation is to create a demand for—and give a value to—unbacked (i.e., intrinsically valueless) currency**. If the federal government does not need the public's money in order to spend, why does it tax? By imposing a tax obligation and announcing it will accept only dollars in payment of taxes, the federal government creates a demand for its otherwise intrinsically worthless currency and gives it value. It is obvious that, as monopoly issuer of the currency, the federal government could not collect any dollars from the public in payment of taxes unless it had first spent (or lent or given) dollars in the first place. As the father of functional finance, Abba Lerner, put it in his 1946 *Encyclopedia Britannica* entry on "money":

> If the government announces its readiness to accept a certain means of payment in settlement of taxes, taxpayers will be willing to accept this means of payment

Author's personal copy

> because they can use it to pay taxes. Everyone else will then be willing to accept it because they can use it to buy things from the taxpayers, or to pay debts to them, or to make payments to others who have to make payments to the taxpayers, and so on. (Lerner 1946, p. 693)

3. **The purpose of U.S. government bond sales is not to finance spending, but to drain excess reserves created by deficit spending in order to maintain positive short term (overnight, interbank) interest rates**. Government spending, lending, and giving of money add to the reserves in the aggregate banking system; government taxing, borrowing, and taking of money drain reserves from the system. When the federal government runs a budget deficit, the amount of reserves added by government spending are greater than the amount drained by taxation, and so the net effect of a budget deficit on aggregate bank reserves is positive. These excess reserves will cause the Federal Funds rate to fall toward zero. If the authorities desire a positive overnight (interbank) lending rate, bonds are sold to drain the excess reserves from the system. Notice that budget deficits put *downward* pressure on interest rates, the exact reverse of what most hawks claim.
4. **In the functional finance view, the relation of G and T doesn't matter—all that matters are the *effects* of any policy**. Policies should be judged on their ability to achieve the goals for which they are designed and not on any notion of whether they are 'sound' or otherwise comply with the dogmas of traditional economics. There is nothing inherently 'good' or 'bad' about any particular relation between government expenditure and tax receipts. It depends on the economic circumstances and on the results a particular budget stance will promote under those circumstances. As Lerner put it, if the amount of taxing or spending required to achieve macroeconomic goals such as full employment "should conflict with the principles of 'sound finance' or of balancing the budget or of limiting the national debt, so much the worse for those principles" (1951, p. 11). Promoting a balanced budget or surplus or a paying down of the national debt regardless of the macroeconomic effects would best be referred to as *dysfunctional finance*.
5. **"Printing money" can have no effect on the economy independently of fiscal operations (in this case, the spending, lending and giving of money by the Treasury and/or Central Bank**). If a trillion dollars are printed and left in a closet there will be no impact on the economy. To have any impact, money must be spent, lent, or given away. Therefore, if these fiscal operations are comprehensively accounted for, and "printing money" is also considered, this would constitute double-counting. Therefore, "printing money" can be effectively disregarded.
6. **The 'sound money', 'sound finance' view of the hawks treats the modern money system as if it were on a gold standard.** Former Federal Reserve Board Chairman Alan Greenspan has said as much: "since the late'70s, central bankers generally have behaved as though we were on the gold standard…[W]e've behaved as though there are, indeed, real reserves underneath the system" (Greenspan 2005). Fixed exchange rates, such as a gold standard, reduce or even eliminate

Author's personal copy

a nation's ability to use fiscal and monetary policies to pursue the public purpose. Under a gold standard, government spending is constrained by the accumulation of gold (or by the accumulation of foreign currency under a peg), and the central bank's ability to set short-term interest rates are sacrificed to the requirements of maintaining the peg. In any case, different systems operate according to different logics, and managing a modern money system according to the logic of a gold standard is like playing chess using the rules of checkers.

7. **Doves are wrong because, by saying that the deficit is not really as big as it seems, or that we can balance the budget over the cycle, they are giving in too much to the hawk view and end up harming the position of supporters of common-sense budgetary policy**. According to what has come to be known as "Lerner's Law," trying to placate the public and the media for reasons of short term political expediency will inevitably backfire. Eventually, one will be revealed as a hypocrite, one's hands will be tied, or both. This seems a likely explanation of what has happened to Democrats who decided to call the Republicans fiscally irresponsible during the 1980s. Currently, Republicans and the Democrats each vie to be more 'fiscally responsible' than the other, and they are likely to run the nation's (and possibly the world's) economy into the ground in the process. As one student remarked when I explained that virtually all members of both parties are now hawks: "Anything that all Democrats and Republicans agree on [i.e., that deficits and a larger national debt are harmful] must be wrong!"
8. **The deficit is just accounting information—it tells us how much the domestic private and foreign sectors want to 'net save' in assets denominated in the domestic currency.** The government budget deficit is the mirror image of the non-government surplus in the basic macroeconomic accounting identity:

$$\text{government deficit} = \text{non-government surplus}$$

where non-government surplus includes both the domestic (or resident) private sector and the foreign (non-resident) sector, which includes foreign firms, households, and governments. It is therefore equivalent to the well-known identity:

$$(G - T) = (S - I) + (M - X)$$

Government budget deficit = domestic private sector surplus + foreign sector surplus

where the foreign sector surplus is another way of expressing the trade deficit. The government budget deficit permits both the domestic private sector and the foreign sector to 'net save' in the government's unit of account. Only a domestic government budget deficit permits the domestic private sector and foreign sector to actualize their combined desired net saving. Deficits do not reduce savings, as the hawks argue, but just the opposite: deficits generate savings.

Another way of stating the problem is to focus on the relation between the desired and actual levels of holdings of net financial assets, or net nominal savings. Nobel Prize-winning economist William S. Vickrey argued that if, at the full employment level of output, "the total asset supply held by individuals falls short of what they desire to hold, the curtailing of expenditures by individuals in an attempt to bring their net worth up to a desired level will reduce sales, production, employment, and

Author's personal copy

GNP until the corresponding demand for assets has been reduced to the available supply" (Vickrey 1997, pp. 497-498). Unemployment may be viewed as the real, material evidence of a discrepancy between desired and actual levels of net nominal savings, for if the desired level was lower, individuals would be spending more, sales would be higher, and firms would be hiring more workers.

There is only one solution to closing the gap between desired and actual levels of net nominal savings: government deficits. This is because there is no other source of change in the private sector's total holdings of net financial assets (in dollars). If one individual in the private sector wants to increase their holdings of net financial assets, this can only occur if another individual is willing to decrease their holdings by the corresponding amount. The private sector is incapable of creating net nominal assets. Thus, Vickrey concludes, there is "no adequate solution without long-term and continued increases in government debt" (1997, p. 499): "The 'deficit' is not an economic sin but an economic necessity" (Vickrey 2000 [1993], p.189).

It must be emphasized that this is not a 'closed economy' argument, as the foreign sector—including foreign governments, firms, and households—is included in the private demand for assets. As Vickrey recognized, exporting unemployment through "export surpluses…is essentially a beggar-my-neighbor policy not available as a general policy" (1997, p. 499). While Americans could indeed net save dollar assets with a trade surplus, this would only be temporary, as the resulting world-wide dollar squeeze would cause the government deficit to rise.

9. **The national debt is just accounting info**. It is the record of government's draining of excess reserves through bond sales to maintain short term interest rates. It might therefore be better called the "IRMA" (interest rate maintenance account) than the national debt.
10. **The national debt is not a burden on the future, because there can be no financial burden on a money monopolist in a modern money economy**. The only financial constraints are those that are self-imposed. There may be other constraints, such as political, ideological, or even environmental ones, but the *financial* capacity of a modern money monopolist is infinite. As Alan Blinder, former Vice Chair of the Federal Reserve Board of Governors put it, "As long as our borrowing is denominated in dollars, we never need fear defaulting, for we can always print as many dollars as we need" (Blinder 1991, p. 218).

As previously discussed, functional finance is equally valid in an open or closed economy context. It may be true that, without a full employment policy, a country must suffer over its trade balance. With a full employment policy, however, there is no need to worry about importing "too much" relative to exports.

In the absence of full employment guaranteed by functional finance, a country must worry about rising unemployment stemming from an increase in the value of imports over the value of exports. Thus, an excess of imports over exports is considered an "unfavorable balance of trade" and the reverse is considered a "favorable balance of trade." But Lerner viewed foreign trade as "the means by which we obtain for our own use goods that are manufactured abroad" (Lerner 1951, p. 321):

> The *input* of the foreign-trade industry consists of the effort involved in the manufacture of our exports…The *output* of the foreign-trade industry consists

Author's personal copy

> of the imports which it yields to us for our use. (Lerner 1951, p. 321, original emphasis)

In other words, *exports are a cost*, and *imports are a benefit*. Thus, with a real commitment to full employment, an increase in a country's imports relative to its exports is an increase in its benefits. It is only without a full employment policy that this is undermined, as such a development will have a negative impact on aggregate demand, output, income, and employment. Countries therefore attempt to increase employment through promoting exports and restricting imports, i.e., by promoting costs and restricting benefits.

> The idea that a country can cure unemployment only by developing an export surplus is completely baseless unless the society has developed a taboo against every other way of increasing the level of spending…Functional Finance dissolves any "imported unemployment." (Lerner 1951, pp. 327, 332).

Vickrey was skeptical of the conditions of the European Economic and Monetary Union, and utilized that case to express a more general concern about the desirability of fixed vs. flexible exchange rate policies:

> Freely floating exchange rates are the means whereby adaptations are made to disparate price level trends in different countries and trade imbalances are brought into line with capital flows appropriate to increasing the overall productivity of capital. Fixed exchange rates or rates confined to a narrow band can be maintained only by coordinated fiscal policies among the countries involved, by imposing efficiency-impairing tariffs or other restraints on trade, or by imposing costly disciplines involving needlessly high rates of unemployment as is implied by the Maastricht agreements. (Vickrey 2000 [1996], p. 204)

As Vickrey recognized, a successful domestic full-employment policy requires flexible exchange rates:

> Restraints on exchange rates, such as are involved in the Maastricht agreements, would make it virtually impossible for a small open economy…to pursue an effective full-employment policy on its own. (Vickrey 2000 [1996], p. 204)

Fears regarding the current account and flexible exchange rates are generally about a fall in the currency as international investors dump the currency, but three things must be recognized:

i. Under flexible exchange rates, this has no effect on the central bank's ability to set interest rates and thus on the term structure of rates on the government's debt. Dumping the currency doesn't mean that the government has more debt service unless it has borrowed in another currency—which a functional finance approach would argue strongly against doing in the first place.
ii. If the currency drops, the trade balance improves and the government's deficit can fall. Orthodox economists generally think this is a good thing. But note that is what it means to dump the currency—stop net saving in that

Author's personal copy

currency, and by definition the current account improves, unemployment falls, and so on. Yes, domestic businesses that borrow in other currencies would be in trouble, as in the Asian Crisis of 1997–98, but that suggests that domestic businesses didn't hedge against a fall in the domestic currency and that mostly happens under a fixed peg, not a flexible exchange rate (again, Asia during 1997–98). Under a flexible exchange rate, businesses should know that they should hedge.

iii. The purpose of functional finance is to expand the economy to full employment and no further, so there should be no additional inflationary pressures. A nation with full employment would seem to be an attractive place to invest, so it is not clear why investors would be dumping that nation's currency.

Understanding modern money and macro balance sheets enables a society to use the government budget for achieving economic and social policy goals. We can afford prosperity under such institutional arrangements, and the good news is that this is exactly the way our current system operates. The question then becomes whether we can find the political will to move forward, or whether we will continue to choose austerity over expansion. In a nation with millions unemployed and living in poverty, and in a world with billions living under similar and worse conditions, economic prosperity is the only long term solution to the challenges of the twenty-first century. In the U.S., both political parties must decide to call a halt to the "deficit" scares. This is what a "Freedom Budget" must mean today.

Jobs and freedom—now!

A Public Service Employment program based on the principles of functional finance can guarantee full employment without the rigidities associated with very high levels of private sector employment, can provide public and community services that are in short supply, and may be used as the basis for humanistic social policy. The huge economic and social costs associated with unemployment can be eliminated, and the national economy can be managed in a sensible way that is consistent with the idea, formalized in the United Nations Declaration of Human Rights, that every individual has the right to earn a livelihood in a self-respecting way.

A Public Service Employment approach to full employment and price stability can also serve as the basis for humanistic social policies. Under such a program, a wide variety of social policies may be introduced that otherwise would not stand a chance. To understand how this might work, consider that workers will always have the option to take a Public Service job. Now imagine what might happen if the Public Service wage-benefits package included health insurance. Employers in the private sector would have to match the Public Service wage-benefits, either line by line, or in some other compensating way. Private businesses would be encouraged by 'market' pressures to either offer health insurance or compensate in some alternative way (higher salary, more chance for advancement, other benefits, or some other attractive part of the offer).

Author's personal copy

Likewise, since the Public Sector wage would be the de facto minimum wage, increases in the Public Sector wage could also be used to pressure businesses to raise wages (or some other compensating feature of their offer). Consider what might happen if the Public Sector job came with child-care. Likewise, worker health and safety issues, and general job environment. The list of ways in which Public Sector employment might be used as a 'benchmark' to increase the quality of private sector jobs is limited only by the imagination.

Next, consider the possibilities offered by millions of new workers available to do Public Service. Suddenly, there would no be longer any financial or labor constraint to the provision of public and community services (other than the 'real' constraints of population size, skills and education, and so on). Habitat for Humanity and Meals on Wheels would always have enough labor, public libraries and community centers could stay open every night, and there would be additional helping hands on playgrounds, at subway stations, in nursing homes, and at recycling centers. The environment benefits would be numerous, from increased clean-up and enhanced parks and recreation to tree-planting and the provision of new hiking trails. We know from the history of the WPA and other successful Public Service programs just how productive the contributions can be (we can also learn from the mistakes of such programs—e.g., race and gender discrimination must not be tolerated).

A Public Service Employment program could also be used to redefine just what constitutes valuable work in our society. Presently, the market is used as the measuring rod, so if you cannot make your way in the private sector, your life-calling must not be valuable. Under the Public Service Employment program, society is free to decide what qualifies as a Public Service job. Musicians and artists might be free to follow their calling. Oral histories can be documented and preserved through interviews with the elderly. Community gardens can thrive, with Public Service chefs preparing meals. Addressing the historical legacy of patriarchy and gender exploitation, care for one's own children and one's own home can be considered valid Public Service work. Even getting additional education or training may be considered a Public Service. It follows that individuals who stay employed rather than unemployed, and that are able to take advantage of education and training opportunities, will likely boost productivity in the private sector when the demand for labor rises during an economic upturn.

Forty-five years ago, U.S. scholars and activists such as Bayard Rustin and Robert Browne provided a blueprint for true full employment, a guaranteed minimum income, and a living wage to provide the working poor and their families a way out of poverty. Their proposal for a job guarantee has recently been revived by Darity and others as a highly appropriate response to persistent unemployment and increasing poverty and inequality in the context of the socioeconomic instability and financial fragility of the recent and ongoing Great Recession. Such a program has a number of additional potential benefits, including the provision of public goods and community services that are in short supply. A significant obstacle stands in the way of proceeding with this type of policy, however, in the form of concerns regarding the impact the program might have on the government budget deficit and the national debt. From a functional finance perspective, these concerns are greatly misplaced and misguided. Deficit Hawks analyze our monetary system as if we are on a gold standard and our macroeconomy as if there exists a built-in tendency to full

Author's personal copy

employment and as if the relationship of savings, investment, and interest rates is accurately portrayed by the neoclassical loanable funds model. Deficit Doves, by arguing that the budget can be balanced over the cycle and that measurement problems mean that deficits and the debt are not really as big as they appear, give in too much to the views of the Hawks that how big the national debt is or whether the budget is balanced matter. This kind of dysfunctional finance threatens economic stability and even the very fabric of society. True full employment based on the principles of functional finance, however, has the potential to be a centerpiece of a holistically-constituted social economy. This would be something quite worthwhile to bequeath to future generations.

References

A. Philip Randolph Institute. A "freedom budget" for all Americans: budgeting our resources, 1966–1975, to achieve freedom from want. New York: A. Philip Randolph Institute; 1966.

Anderson B. Robert Browne and full employment. Rev Black Political Econ. 2008;35(2–3):91–101.

Bell S. Do taxes and bonds finance government spending? J Econ Issue. 2000;34:603–20.

Benavie A. Deficit hysteria. Westport: Praeger; 1998.

Black Radical Congress. The freedom agenda. In: Marable M, Mullings L, editors. Let nobody turn us around. New York: Rowman & Littlefield; 1998. p. 2000.

Blinder A. Debt and the twin deficits debate. Mountain View: Mayfield; 1991.

Buchanan J. Public principles of public debt. Homewood: R. D. Irwin; 1958.

Cavanaugh FX. The truth about the national debt. Boston: Harvard Business School Press; 1996.

Darity WA Jr. "A direct route to full employment". *Rev Black Polit Econ* 2010;37, No. 3.

Eisner R. How real is the federal deficit? New York: The Free Press; 1986.

Eisner R. The misunderstood economy. Cambridge: Harvard Business School Press; 1994.

Eisner R. The great deficit scares: the federal budget, trade, and social security. New York: The Century Foundation Press; 1997.

Evans P. Do large deficits produce high interest rates? Am Econ Rev. 1985;75(1):68–87.

Forstater M. Functional finance and full employment. J Econ Issue. 1999;33:475–82.

Forstater M. Jobs for all: another dream of the Rev. Dr. Martin Luther King, Jr. Forum Social Econ. 2002;31(2):45–53. reprinted in D. Menkart, et al., eds., 2004, *Putting the Movement Back into Civil Rights Teaching*, Washington, D.C.: Poverty & Race Research Action Council.

Forstater M. From civil rights to economic security: Bayard Rustin and the African American Struggle for full employment, 1945–1978. Int J Polit Econ. 2007;36(3):63–74.

Friedman B. Day of reckoning. New York: Random House; 1988.

Greenspan A. Hearing on monetary policy report. Washington DC: US House Committee on Financial Services; 2005.

Hawkins AF. "Full employment to meet America's needs". Challenge. 1975;20–28. November/December

Heilbroner RL, Bernstein PL. The debt and the deficit: false alarms, real possibilities. New York: W. W. Norton; 1989.

Heilbroner RL, Bernstein PL. A primer on government spending. 1963.

King ML Jr. "Showdown for nonviolence". Look. 1986 [1968];32:23–25, reprinted in J. M. Washington, ed., "*A Testament of Hope: The Essential Writings of Martin Luther King*, *Jr*.," New York: Harper & Row.

King ML Jr. Letter requesting support for the March on Washington. In: Goodman R, After the Planners. New York: Simon & Schuster; 1971 [1963]

Lerner A. Functional finance and the federal debt. Soc Res. 1943;10:38–51.

Lerner A. Economics of employment. New York: McGraw Hill; 1951.

Lerner A. "Money". Encyclopedia Britannica. 1946

Marable M. In: Black Liberation in Conservative America. "Full employment and affirmative action,". Boston: South End Press; 1997.

Marcus A, Spratlen T, Wilson CZ. Robert Browne and the caucus of black economists. Rev Black Political Econ. 2008;35(2–3):61–6.

Author's personal copy

Mincy, RB. "The Underclass: concept, controversy, and evidence". In: Confronting Poverty, edited by Sheldon H. Danziger, Gary D. Sandefur, Daniel H. Weinberg. Cambridge, MA: Harvard University Press, 1994.

Mosler WB. "Full employment and price stability". J Post Keynesian Econ. 1997–98; 20(2):167–82.

National Urban League. The state of black America 1996. New York: National Urban League, Inc; 1996.

Peterson PG. Facing up. New York: Simon and Schuster; 1993.

Peterson PG. Running on empty. New York: Farrar, Straus and Giroux; 2004.

Rustin B. "The anatomy of frustration". Address to the anti-defamation league of B'nai B'rith. 1971 [1968], May 6, 1968, reprinted in *Down the Line: The Collected Writings of Bayard Rustin*, Chicago: Quadrangle Books.

Rustin B. "The influence of the left and right in the civil rights movement". paper prepared for the Negro Leadership Conference. 1971 [1965]. January 30–31, 1965, reprinted in *Down the Line: The Collected Writings of Bayard Rustin*, Chicago: Quadrangle Books.

Savage JD. Balanced budgets and American politics. Ithaca: Cornell University Press; 1988.

Tyner J. Crime—causes and cures. In: Marable M, Mullings L, editors. Let nobody turn us around. New York: Rowman & Littlefield, 2000; 1994.

Ussher L. "Do budget deficits raise interest rates? A survey of the empirical literature," *Transformational growth and full employment project*, Working Paper No. 3, New York: New School for Social Research; 1998.

Vickrey WS. A trans-Keynesian manifesto (thoughts about an assets based macroeconomics). J Post Keynesian Econ. 1997;19(4):495–510.

Vickrey WS. "Fifteen fatal fallacies of financial fundamentalism". In: Warner A, Forstater M, Rosen S, editors, *Commitment to full employment*, Armonk: M. E. Sharpe; 2000 [1996].

Vickrey WS. "We need a bigger 'Deficit'". In: Warner A, Forstater M, Rosen S, editors. *Commitment to full employment*, Armonk: M. E. Sharpe; 2000 [1993].

Wilson WJ. *When work disappears: the world of the new urban poor*, New York: Knopf; 1996.

Wray LR. Understanding modern money. Cheltenham: Edward Elgar; 1998.