

Money and Public Purpose

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Group Exercise: Government Spending and Taxation in a Simple Two-Sector Economy

Round One: The Government Tries to Mobilize Resources from the Non-Government Sector

Group Exercise: Government Spending and Taxation in a Simple Two-Sector Economy

Round Two: The Government Tries Again to Mobilize Resources from the Non-Government Sector

Round Two: Analysis

- Why were the citizens willing to accept currency from the government in Round 2 but not in Round 1?

Round Two: Analysis

- Has the non-government sector make any specification as to whether the Round 2 currency needed to be "backed" by a material commodity?

Round Two: Analysis

- What is the unit of account of the currency?
- Who decided that this would be the unit of account?

Round Two: Analysis

- How did the money tokens enter the economy?

Round Two: Analysis

- Did the government have to raise funds (e.g., by imposing taxes) before spending the currency into existence?

Round Two: Analysis

- Did the government have to borrow the currency before spending it?

Round Two: Analysis

- What was the government's total spending in this period?
- What was the government's total revenue in this period?

Round Two: Analysis

- Did the government run a surplus or a deficit over the course of this period?

Round Two: Analysis

- What is the total amount of the non-government sector's *financial* assets at the end of this period?
- Is the non-government sector in surplus or deficit at the end of this period?

Round Two: Analysis

- What is the relationship between the government sector's surplus or deficit and the non-government sector's surplus or deficit over the course of this period?

Round Two: Analysis

- Did the First Citizen's purchase of B3 of Legos from the Second Citizen affect the non-government sector's overall net financial assets?

Round Three: The Government Adopts “Sound Finance”

As Its Approach to Fiscal Policy

Round Three: Analysis

- Did the government have to raise funds before undertaking Round 3 spending?

Round Three: Analysis

- Did the government have to borrow the currency before undertaking Round 3 spending?

Round Three: Analysis

- What was the government's total spending in this period?
- What was the government's total revenue in this period?

Round Three: Analysis

- Did the government run a surplus or a deficit over the course of this period?

Round Three: Analysis

- What is the total amount of the non-government sector's *financial* assets at the end of this period?
- Did the non-government sector run a surplus or a deficit over the course of this period?

Round Three: Analysis

- How did the non-government sector's *financial* assets change over the course of this period?

Round Three: Analysis

- What is the relationship between the government sector's surplus or deficit and the non-government sector's surplus or deficit over the course of this period?

Words and Narratives Matter

Debt

Credit

Deficit

Surplus

Government

Government spending

Government budget deficit

Government budget surplus

Framing Economic Discussions

Words have ...

- Denotations
 - Dictionary definitions
- Connotations
 - Thoughts and feelings words arouse in our minds, based on
 - Context
 - Our hearing them over our lifetimes

We need to be aware of subtle biases arising from connotations

Stories, Narratives, Cognitive Devices

- We're telling a story about the economy
- We're constructing a narrative about the economy
- We'll use cognitive devices
 - Images
 - Metaphors
 - Analogies

Framing the Discussion

A current example of an economic discussion and how it can be framed

- The Balanced Budget Amendment

The Blue Dogs Want a Balanced Budget Amendment



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bold leadership. commonsense solutions.

Apr 9, 2019 | Press Release

WASHINGTON— Today, the fiscally-responsible Blue Dog Coalition announced that it has endorsed a [Balanced Budget Amendment](#), which was authored by Rep. Ben McAdams (UT-04), co-chair for the Blue Dog Task Force on Fiscal Responsibility and Government Reform. Rep. McAdams is the first House Democrat to introduce a Balanced Budget Amendment during the 116th Congress.

The Blue Dog Coalition

- 27 Democratic members of the House of Representatives
- April 9 press release called for Balanced Budget constitutional amendment



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Today, the national debt is over \$22 trillion, an unprecedented level; and never in modern history has the U.S. annual budget deficit been so high outside of war or economic recession. February this year was marked to be largest monthly budget deficit on record—higher than at any point during the 2008 global financial crisis, when the economy was in peril and the Tea Party took to the streets.

Framing Economic Discussions

Congressman Correa of California warns:

“Washington needs to have a serious, bipartisan discussion about our nation's fiscal state. Republicans and Democrats need to come together now to make tough decisions, and [the] ... Balanced Budget Amendment is [a] step in the right direction to putting our nation on a fiscally sustainable path. If we don't address these problems, every single American will face serious economic repercussions.”

Congressman Ben McAdams

- Author of Blue Dogs's balanced budget constitutional amendment proposal

“Every Utah family understands that when you decide to make a purchase, you must first show how you'll pay for it. Either you find additional revenue, or you cut back on spending elsewhere so that you continue to live within your budget. ...

“... [T]his is what hard-working Utah families do every day when they sit at the kitchen table and balance their checkbooks and we must do the same.”

Household Budget Analogy

- A cognitive device for framing discussion of government economic policy
- Belief that the federal government's budget is the same type of thing as an individual household's budget

Household Budget Analogy in Detail (1)

- An individual household has to bring in income before it can engage in spending.
- So, too, must the federal government bring in income — mainly through taxation — before it can spend.

Household Budget Analogy in Detail (2)

- An individual household has to 'live within its means'.
 - Its income has to match or exceed its spending
 - Any excess of spending over income puts the household into debt
 - Persistent debts lead to bankruptcy
- So, too, must the federal government follow the principles of 'sound finance'.
 - If its spending exceeds its revenue, the national debt will grow and eventually lead to some combination of:
 - inflation;
 - refusal of people to buy government bonds; and
 - bankruptcy

Household Budget Analogy in Detail (3)

Hence, any new government spending must be preceded by identifying new revenue sources that will "pay for" that spending.

- Want Medicare-for-All? A Green New Deal?
- The first question to be asked is, "How you gonna pay for it?"
If we don't solve this, the government will "run out of money."

Also known as: the **Government Budget Constraint (GBC)**

Examination of the Household Budget Analogy

- Explicit analogy between individual family's budget and federal government's budget
- Prudent behavior for household is said to be prudent for the nation as a whole

Connotations not critically examined

- 'Debt' is assumed to be bad at both the individual and federal levels
- Likewise, 'deficit'
- 'Living within your budget' is virtuous.
- 'Spending more than you take in' is not.

Orthodox economics

- A.k.a. “Neoclassical economics”
- Dominates in academia, central banks, press and media

Heterodox economics

- Modern Monetary Theory (MMT) falls into heterodox economics

Comparison of Orthodox Economics and MMT

How do we frame (or re-frame) economic discussion?

Orthodox Economics Metaphors

- “The nation is living beyond its means.”
- “The nation has maxed out its credit card.”
- “The nation is spending like a drunken sailor.”

(Macro, 124)

Modern Monetary Theory Metaphors

- “Government spending puts money in our pockets.”
- “Government invests in the productive capacity of the nation.”
- “The federal government cannot run out of money; the true constraint is our nation's resources.”

(Macro, 131)

The Nature and Properties of Sovereign Currencies

- The government issues a currency denominated in a money of account of its choosing (e.g. the US dollar, the Japanese yen, the British pound)
- Government and non-government IOUs are denominated in this money of account
- Tax liabilities, fees, monetary contracts, and fines are denominated in the same money of account
- The sovereign government alone has the power to determine which money of account it will recognize

Fiscal Policy - How and Why Governments Tax and Spend

- Taxes don't "pay for" spending
- Spending logically precedes taxation
- Affordability of finance is never an issue for a country which controls its own currency and has floating exchange rates
- Persistent fiscal deficits are normal and often desirable

Monetary Policy - How & Why Central Banks Control Currencies

- Bond sales are a function of monetary policy this is how the Fed controls interest rates, by altering reserve balances in the banking system
- The Fed alone cannot control the money supply; private banks endogenously create money by issuing loans
- Functions of the central bank: Which of its tools actually work?

Endogenous Money Creation

- Banks create new money via credit creation; loans create deposits
- The supply of bank money is determined by demand for bank loans and willingness of banks to lend
- The central bank supplies reserves as needed as banks issue loans; there is no “fractional reserve banking” in the real world

Exchange Rates

- Governments can allow its currency to be freely exchanged (floating rates) or try to manage its exchange value (fixed rates)
- MMT focuses mostly on currencies with floating exchange rates
- Many currencies used to operate on a gold standard with a fixed exchange rate (e.g. \$35 USD for one ounce of gold)
- Gold convertibility in the US was suspended for domestic transactions during the 1930s and for international transactions in 1971

Stock-Flow-Consistent Sector Balance Modelling

- MMT adheres to a stock-flow consistent approach and sectoral balances framework
- In stock-flow accounting, flows are magnitudes per period of time. Stocks are measured at a point in time.
- The sectoral balances framework considers the interactions between the government sector, the domestic private sector, and the external sector

Week 1: Part 4

Where Are We in Economic History?

To think about where we're going, we have to know where we are

To know where we are, we have to know where we've come from

*(Week 1, Part 4 draws on **Macroeconomics**, by Mitchell, Wray and Watts, chapters 8 and 32)*

Primacy of Production

- Production of goods and services needed for human survival is primary
- Consumption and distribution are important, but logically follow production

Forces of Production

Technologies human societies used for production

- Raw materials
- Tools
- Machinery

Social Relations of Production

Relationships established among humans in process of production

Modes of Production

Set of social relations of production which prevail in particular time and place

- Differentiate periods in history by prevailing modes of production
- Four major modes of production (so far)

Tribal Production

Tribes operate as "egalitarian, communal, kinship-based social organisations."
(Macro, 40)

- Goods generally produced for tribe's own consumption
 - Subsistence agriculture
- Goods not generally produced as commodities
 - Not primarily produced for exchange in markets
- Social hierarchy within the tribe, but not antagonistic social classes

Slavery as Mode of Production (1)

- More advanced production techniques
 - Large-scale agriculture
- Production no longer communal; societies no longer egalitarian

"... production decisions are mostly made by the owners of slaves, who also own the output the slaves. ... Typically, production by slaves is mostly used for consumption by the owner of the slaves and for subsistence of the slaves. However, slave production can also be used to provide goods and even services which are sold on the market." (Macro, 41)

Slavery as Mode of Production (2)

Slave production can be embedded in larger set of market relationships

- Western Hemisphere: 16th thru 19th centuries
- Slavery dominant because the owners could exploit the labor of enslaved persons to produce sugar, tobacco and cotton for the world market

But: slavery mode of production is not intrinsically focused on production for exchange.

Emergence of the State (1)

- The state is a form of social and political organization
- Emerged alongside slave mode of production
- People have to be en-slaved in order to work as slaves
- Force required to enslave people and keep them in slavery
- What do we call that force? The state.

Emergence of the State (2)

But, there are other reasons for the emergence of the state besides domination of the labor force

- Large-scale agriculture in river valleys
- Irrigated by river waters
- Rivers flood; need for hydraulic infrastructure
- What do we call the organization that provided that infrastructure? The state.

Feudal Mode of Production (1)

- Lords and peasants
 - (lords versus peasants)
- Peasants had customary rights to farm tracts of land
- Land itself was not alienable
 - It could not be bought and sold
- Peasants could also graze animals or hunt game on land not controlled by any individual
 - The commons

Feudal Mode of Production (2)

The lords also had rights to land, but they didn't work. Instead ...

"... peasants were expected to work the lord's allocated land, and to turn the produce over to the lord. The labour required to work the lord's allocated land was called rent." (Macro, 42) ...

"In other cases, the lords did not have a right to land but, rather, exercised a right based on custom to a portion of the output of each peasant's land. This portion was also called rent, paid in the form of agricultural output." (Macro, 42)

Review of Pre-Capitalist Modes of Production (1)

Antagonistic social classes?

- Tribal: no
- Slave: yes
- Feudal: yes

Production primarily for consumption?

- Tribal: yes
- Slave: yes
- Feudal: yes

Review of Pre-Capitalist Modes of Production (2)

Production primarily for exchange (commodity production)?

- Tribal: no
- Slave: no
- Feudal: no

Can be described mostly without reference to money?

- Tribal: yes
- Slave: yes
- Feudal: yes

Money in Pre-Capitalist Modes of Production

- Goods generally not produced for exchange against money
- But money existed!
- Money as a unit of account has existed as long as the state form of political organization has existed
- However, in these modes of production the point of production wasn't endless accumulation of money
- Tokens of money were relatively scarce

Transition from Feudalism to Capitalism

- Human relationships are never static; always dynamic
- So too the social relations of production
- We construct a narrative ...

Peasants Face the Market Economy

- Peasant must start to think about how he's going to acquire the money tokens with which to pay his rent.
- Peasant must learn about markets
 - Under what conditions will my grain enter into exchange in the market?
- Peasant's grain has become a **commodity**: a work-product that has a social relationship embedded in it.

Feudal Lord Approaches Production in a New Way

When he was being paid rent in kind, he used the rent to:

- Support his own luxury consumption
- Support consumption of his retainers
- Pay the sheriff to enforce collection of rent from peasants

Nothing required lord to accumulate wealth ad infinitum.

What Happens Once Rent is Payed in Money

Feudal lord:

"If I asserted a right to the commons, I could have the sheriff arrest the peasants as poachers when they tried to hunt on my land. Then I could raise sheep on that land and sell the wool in the markets."

Consequences of Enclosure of the Commons

- Peasants become impoverished
- Peasants needed to obtain money to pay rent, taxes, buy necessities
- Peasants began to sell their ability to work for money wages
 - The gig economy: 18th-century style

Rinse, repeat over several centuries!

New Class Relationships

- Small ruling class which owns the means of production
- Much larger working class that does not own the means of production
- Unlike the slave or the peasant, the wage laborer is "free" in that she is not owned and not tied to the land.
- But she has also been "freed" of ownership of the means of production and is "free" to sell her ability to work -- her labor-power -- to anyone who has the funds to employ her and who thinks he can profit by doing so.

Capitalist Mode of Production

M → C → Production → C' → M'

- **M**: capital in the form of money
- **C**: capital in the form of commodities
- **Production**: process of production
- **C'**: More capital in the form of commodities
- **M'**: More capital in the form of money

Role of Capitalist (1)

Owner of means of production amasses money; purchases commodities with that money

- Labor-power
- Raw materials
- Tools
- Machinery

Role of Capitalist (2)

Owner of means of production organizes process of production

- Consumption of labor-power adds value to commodities
- Owner of means of production tries to sell commodity output for more money than he started out with
- Cycle repeats

"The capitalist form of production is undertaken to sell output and to make monetary profits." (Macro, 45)

Accumulation of Capital

Indefinite self-expansion of capital is purpose of this mode of production

Money Is Essential to Capitalist Production (1)

- Capitalist must assemble capital in money form at the start of the process (M)
 - Unlike tribal, slave, feudal modes of production
- Capitalist needs to realize the addition to the value made during the process of production at the end of the process by selling the outputs
- Needs to transform commodity capital back into money capital -- more money (M') than he started out with

Money Is Essential to Capitalist Production (2)

- M' must be $> M$
- If capitalist fail to convert commodity capital to money capital, he's on the way to bankruptcy
- If capitalist did not expect to realize more money at end of process, he wouldn't have begun it in first place

Intellectual Origins of Modes of Production and Social Relations of Production (1)

Two mid-19th-century intellectuals and political activists

- European correspondent for Horace Greeley's *New York Tribune*
- Manchester-based son of textile manufacturer

Both political refugees from pre-empire Germany

Intellectual Origins of Modes of Production and Social Relations of Production (2)

- Karl Marx
- Frederick Engels

But ... how would we characterize development of capitalism since mid-19th century?

Capitalism Since the Mid-19th Century

Hyman Minsky: forefather of Modern Monetary Theory

Minsky focused on evolution of finance

Minsky's Periodization of Modern Capitalism (1)

Commercial capitalism

- Second half of 19th century
- Firms financed their investment in capital goods largely internally
- Firms turned to commercial banks for financing of raw materials, inventories, etc.

Minsky's Periodization of Modern Capitalism (2)

Finance capitalism

- Late 19th/early 20th century
- Vast increase in scale of production inputs: railroads, steel
- Firms turn to investment banks for help raising capital via bond and stock issuance
- *Finance Capital*: Rudolf Hilferding
- But finance capitalism became more and more concerned with financial speculation
- Led to Great Crash of 1929 and subsequent Great Depression

Minsky's Periodization of Modern Capitalism (3)

Managerial/welfare-state capitalism

- Great Depression to early 1970s
- New Deal
- Separation of commercial and investment banking
- Tighter regulation of financial markets
- Economic instability mitigated by legalization of collective bargaining, social welfare spending (unemployment insurance, Social Security)

"Stability is destabilizing"

-- Hyman Minsky

Minsky's Periodization of Modern Capitalism (4)

Money-manager capitalism

- 1970s to date
- Vast increase in capital needing management
- Investment banks and "shadow banks" provided this service for hefty fees
- Commercial banks wanted in on lucrative business
- Commercial banks sought to erode separation between commercial and investment banking
- Achieved by late 1990s: economy was now "financialized"
- Resulting in ...

Great Financial Crisis (2007-08)

Unlike New Deal, Obama did not impose significant reorganization on financial sector

- No bankers went to jail
- No major banks were taken into resolution
- No major bank boards were deposed
- No major bank shareholders were wiped out
- Greater concentration of capital in financial sector than before GFC

So we have not evolved past Minsky's money-manager capitalism.

Randall Wray on Keynes and Minsky on Capitalism (1)

“Keynes’ *General Theory* (1936) identified two fundamental flaws of the capitalist system: chronic unemployment and excessive inequality. The two are linked: excessive inequality puts too much of the income into the hands of the rich, who prefer high rates of saving rather than spending. That depresses demand and keeps jobs scarce.

...

Randall Wray on Keynes and Minsky on Capitalism (2)

“Minsky added a third: instability is a normal feature of modern capitalism, which is a *financial* system. Furthermore, persistent stability cannot be achieved -- even with apt policy -- because it changes behavior in ways that make “it” -- a depression and debt deflation -- likely.”

-- L. Randall Wray, *Why Minsky Matters* (2016), p. 194

Handout

- Practical Learning Objectives for Students
- Homework Assignments
- Self- and Group-Test
- Reading Materials