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The Fiscal Cliff Mythology and the Full Employment Alternative: *An Affordable and Productive Plan*

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Abstract

This paper critiques the fiscal cliff mythology and the neoliberal push for economic austerity policies and sequestration of government programs. The purpose of the paper is to shift the debate to a social justice alternative that can sustain and enhance the social safety nets by implementing a full employment program that is both financially affordable and economically productive. First, the paper critically assesses the *laissez-faire* approach to job creation and lays out the mechanics of the job guarantee (JG) program as an alternative to the neoliberal model. Next, the paper critiques the deficit hawks' and deficit doves' "fiscal cliff" debate and demonstrates how the JG program can be financed according to modern money theory (MMT). Finally, the paper presents the cost estimation of the JG program for the United States to demonstrate its financial affordability and its productive capabilities.

JEL Classification: B5, E5, E12, E24, J2, J3, H3, H6, O51

Keywords

fiscal cliff, austerity, sequester, modern money theory, functional finance, sound finance, job guarantee, ELR

1. Introduction

Five years have passed since the onset of the global financial crisis (GFC) and its devastating impact on communities around the world. The inability of the United States and the eurozone countries to fight unemployment has become the center of media and public policy attention over the last two years, but the focus of such debates has been primarily on the size of government deficits and national debts and the inescapable austerity or sequester policies that must be put in place, supposedly to prevent economic Armageddon or the so-called "fiscal cliff" from happening. The debate has been limited to whether the government should introduce large-scale draconian austerity or gradually implement a series of small-scale targeted austerity measures to restore fiscal discipline and shore up investors' confidence in those ailing economies. The

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purpose of this paper, however, is to shift the debate to a social justice alternative (Wray and Forstater 2004) that can sustain and enhance the social safety nets by implementing a full employment program that is both financially affordable and economically productive. Section 2 critically assesses the *laissez-faire* approach to job creation and lays out the mechanics of the job guarantee (JG) program as an alternative to the neoliberal model. Section 3 critiques the deficit hawks' and deficit doves' "fiscal cliff" debate and demonstrates how the JG program can be financed according to modern money theory (MMT). Section 4 presents the cost estimation of the JG program for the United States to demonstrate its financial affordability and its productive capabilities. The paper closes with a summary and concluding remarks.

2. The Mechanics of Job Creation

Capitalism is a system that is inherently incapable of producing and sustaining a full employment level of production (Keynes 1936). Keeping in mind that we operate in real/historical time (as opposed to notional/theoretical time) under conditions of fundamental uncertainty where the future is unknowable and the past is unchangeable, profit-seeking firms will only hire workers to produce goods and services if they believe that such activities would be profitable. Therefore, the business cycle and the level of unemployment are driven by waves of optimism and pessimism about the future levels of effective demand (Keynes 1936; Minsky 1986). Business expansion is driven by access to credit to finance the production or purchase of new plant and equipment in order to meet the expected higher levels of demand. As the private sector economy expands, firms increase their debt-to-equity ratio, and move towards more illiquid positions on Keynes's liquidity spectrum. Investing in illiquid positions produces more employment because illiquid assets tend to be more labor-intensive than liquid/speculative financial assets (Keynes 1936).

The 1930s' New Deal experiment and the 1940s' WWII military spending convinced U.S. policymakers that countercyclical government spending could generate full employment when the private sector is not producing sufficient levels of aggregate demand. However, those lessons were quickly overtaken by concerns of inflationary pressure from large deficits, as well as the social, political, and moral consequences of a generous welfare state. During the first half of the Cold War era, government involvement in the economy was mainly favored because it increased military spending and served corporate special interests. However, starting in the early 1970s, social safety nets and labor unions faced sustained attacks by a rising neoliberal coalition of policymakers, corporate lobbyists, and public policy think tanks. As a result, a significant wage-productivity gap began to develop since the early 1970s, which has kept real wages nearly unchanged for the working class, while corporations reaped the benefits of rising productivity (Figure 1). Given that consumer spending has always been the driving engine of the U.S. economy, one would expect this gap to negatively affect economic growth had it not been for the huge amount of debt that households have incurred in order to continue fueling their consumption. This unprecedented credit extension to households has led the household debt-to-income ratio to climb from a steady level of about 70 percent during the post-WWII period to a sharp increase reaching nearly 140 percent in 2007 (Figure 2).

The post-1970s period has been marked with aggressive deregulation of industry and finance, outsourcing of manufacturing, and deindustrialization. Simultaneously, contemporary mainstream thought instilled a philosophy claiming that the primary job creator ought to be the private sector, while the government ought to limit its role in the economy and support the private sector through tax cuts and reduced regulations. Furthermore, it is argued that social safety nets ought to be offered by non-profit organizations and charitable organizations that are funded, managed, and operated by private individuals rather than government bureaucrats.

During the Great Recession of 2008, the United States went through its worst financial crisis since the Great Depression; yet the most aggressive fiscal intervention the government could

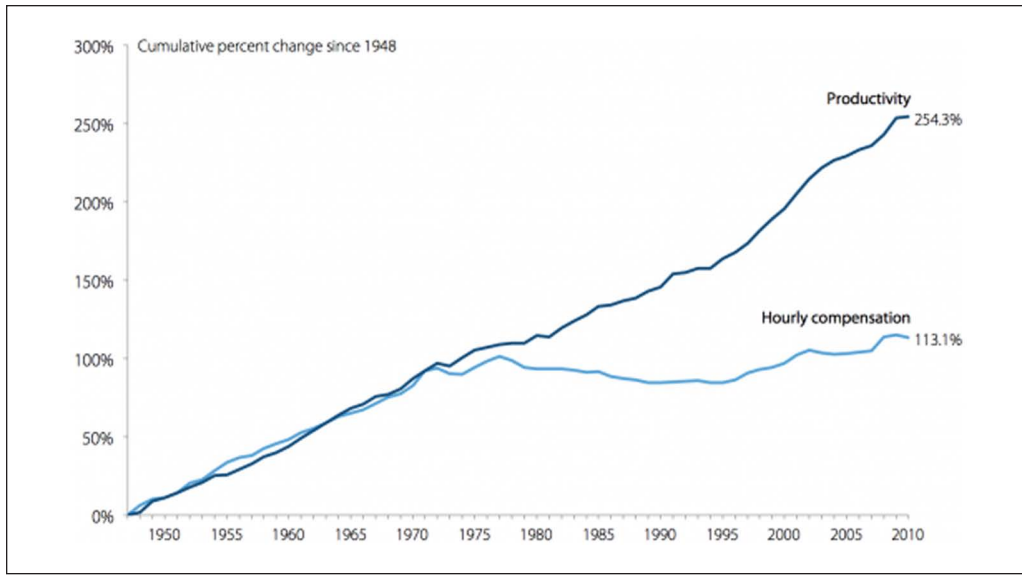

Figure 1. U.S. Productivity and Hourly Compensation.
Source: Bureau of Labor Statistics

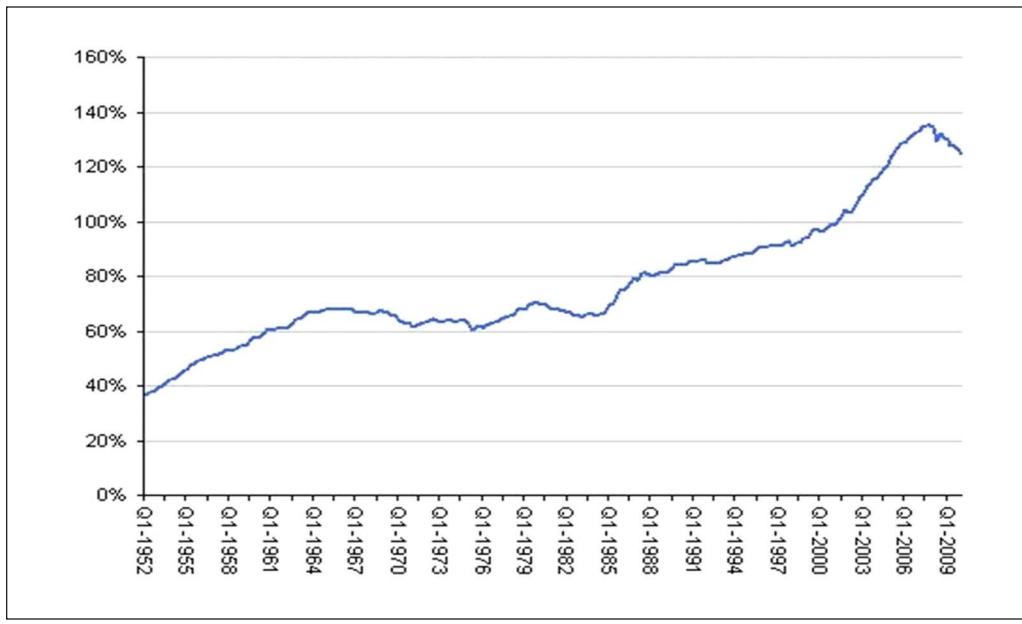

Figure 2. Household Debt as a Percentage of Disposable Income.
Source: Federal Reserve Bank.

muster amounted to tax cuts, tax incentives, extended unemployment benefits, and a modest amount of public infrastructure projects. State and local government expenditures also dried up during the recession because of smaller revenues from sales, income, and property taxes, so they too cut their financial support to local schools and other social services. This resulted in severe

resource shortages and understaffing in social services organizations exactly during the time when those services are needed the most. Naturally, the shortage of funding from government grants and charitable donations hits non-profit organizations simultaneously as they face increased demand for their services. Full-time employment is often minimal in the non-profit sector, especially because most grants do not fund payroll expenditures. Therefore, most non-profits rely heavily on volunteers from the local community to staff their operations, which often produces challenges for planning, scheduling, and execution, all of which result in inefficiencies, delays, and burdensome operational costs.

Following the works of Minsky (1965, 1966), Whalen and Minsky (1996-97), Mosler (1997-98), Wray (1998), Forstater (2006), and Kaboub (2007), the following analysis presents the mechanics of a job guarantee (JG) program that will capitalize on the existing U.S. institutional infrastructure in order to offer employment to anyone who is ready, willing, and able to work at a socially established living wage with full benefits. The standard ideological oppositions to the role of the government as an employer of last resort will be ignored here because such discussion is beyond the scope of this paper. The analysis will exclusively deal with the mechanics of the JG program implementation and its financing.

Rather than attempting to completely dislocate the inner workings of the U.S. capitalist system, the JG program is designed to produce full employment and enhance social justice by utilizing the existing social, political, and technological infrastructure. The JG is a decentralized full employment program that utilizes local non-profit organizations as the catalyst for community development. These are the organizations that know the needs of the local communities, their challenges, and their full potential. They are also better placed to assess the skills of the local unemployment pool in order to prioritize the community development projects to match their needs with the collective skills of the local unemployment pool. The JG funding is the only aspect of the program that is centralized and controlled by the federal government (see section 3), but the planning, project selection, implementation, management, and assessment are all done at the local community level.

The JG program hires anyone who is ready, willing, and able to work regardless of skill level, prior work experience, or educational background. The JG also includes an educational and vocational training component to sustain skills and enhance productivity and upward mobility. Naturally, the size of the JG employment pool will increase during the recession because the private sector will lay off more workers during bad economic times, and similarly the size of the JG program will shrink when the private sector is booming. Hence, the JG program operates as a buffer stock mechanism. Private sector employers will benefit from this program because they will have access to a readily employable labor force that they can tap into at any time as long as they are willing to match the overall employment and benefits package of the JG program. Furthermore, the JG program focuses on creating goods and services that are either undersupplied or not completely offered by the private sector. As a result, the JG jobs will supplement private sector jobs rather than compete with them. For instance, the government could use the JG as a way to steer the structure of the economy away from fossil fuels towards more environmentally sustainable production systems (Forstater 2006). The JG projects may range from much-needed public infrastructure upgrades, environmental audits, conservation and cleanups, and affordable housing, to afterschool programs, community and youth centers, childcare centers, and elderly care services (Wray 1998). Needless to say, this is neither a makework program nor is it meant to put mainline government sector jobs at risk. JG employees are free to participate either on a full-time or part-time basis. Logistical implementation obstacles may, of course, occur but those can always be overcome with adequate planning, creativity, and ingenuity. The main obstacle that most critics often perceive is the financial cost of the program and its impact on the deficit and the national debt. To this we shall now turn.

3. The Myth of the "Fiscal Cliff" and the MMT Alternative

Advocates of sound finance theory, which include the so-called "deficit hawks" and "deficit doves," are staunch opponents of the JG program because they believe that the additional JG government spending will add to the tax burden, and if such expenditures remain unfunded, they produce larger deficits and national debt, put upward pressure on inflation and interest rates, devalue the currency, and reduce investors' confidence in the U.S. economy. Sound finance advocates conflate the federal government finance with household and corporate finance. They believe that just as prudent households and firms balance their checkbooks and even accumulate savings, the government ought to do the same. Furthermore, they argue that excessive government debt is not only economically unsound, but also morally irresponsible since it represents a financial burden on future generations and is a form of taxation without representation. This so-called sound finance school of thought likens the U.S. federal government debt to that of Greece, a country on the brink of bankruptcy. The comparison suffers from a lack of understanding of the concept of "financial sovereignty."

According to the modern money theory[1] (MMT) definition of "financial sovereignty," a financially sovereign country has three important features: 1) it has a monopoly over the creation of its own national currency (in other words it is a *currency issuer*, not a currency user); 2) it collects taxes denominated in its own currency; and 3) it only issues bonds denominated in its own national currency (in other words, it never issues debt denominated in a foreign currency) (Lerner 1943, 1947; Bell 2000, 2001; Wray 2012). Based on this definition, Greece is a mere *currency user* that must abide by the sound finance rules imposed by the Maastricht Treaty, whereas the United States enjoys full financial sovereignty; the United States can, therefore, finance all of its expenditures by simply printing its fiat currency. As a sovereign currency issuer, the U.S. default risk is zero because 100 percent of the U.S. debt is denominated in U.S. dollars. According to MMT, government spending injects money into the economy, and tax collection withdraws money from the system. Taxes *do not* and *cannot* logically finance government expenditures; instead they create a demand for the sovereign's fiat currency. Similarly, bond sales *do not* finance government expenditures, but they simply help withdraw excess reserves from the system and maintain stable overnight interest rates. As a result, in the MMT system, fiscal and monetary policies are inherently linked and cannot be artificially separated (such is the case in the eurozone).

At the macro level, government deficit is simply an indication of the surpluses accumulated by the private sector and the foreign sector. To put it simply, the macroequilibrium accounting identity is as follows:

$$\textit{Domestic Private Balance} + \textit{Domestic Government Balance} + \textit{Foreign Sector Balance} = 0$$

This accounting identity holds true for any country. In other words, when U.S. policymakers insist on running a government budget surplus, they must accept the fact that such surplus must be offset by a domestic private sector deficit (unless the United States suddenly becomes a net exporter). Therefore, austerity policies can only hurt the private sector, which includes households and firms, but since firms cannot sustain losses indefinitely, it is households and the most vulnerable members of society who bear the burden of the private sector deficit. Figure 3 below displays a mirror image showing that government deficits have always been offset by private sector and foreign sector surpluses. It is worth pointing out that the Clinton administration government surpluses of the mid-1990s coupled with a large trade deficit (foreign sector surplus) were offset by the largest private sector deficits in U.S. history (Figure 3).

[1]See Wray (2012) for a thorough discussion of the MMT approach and financial sovereignty.

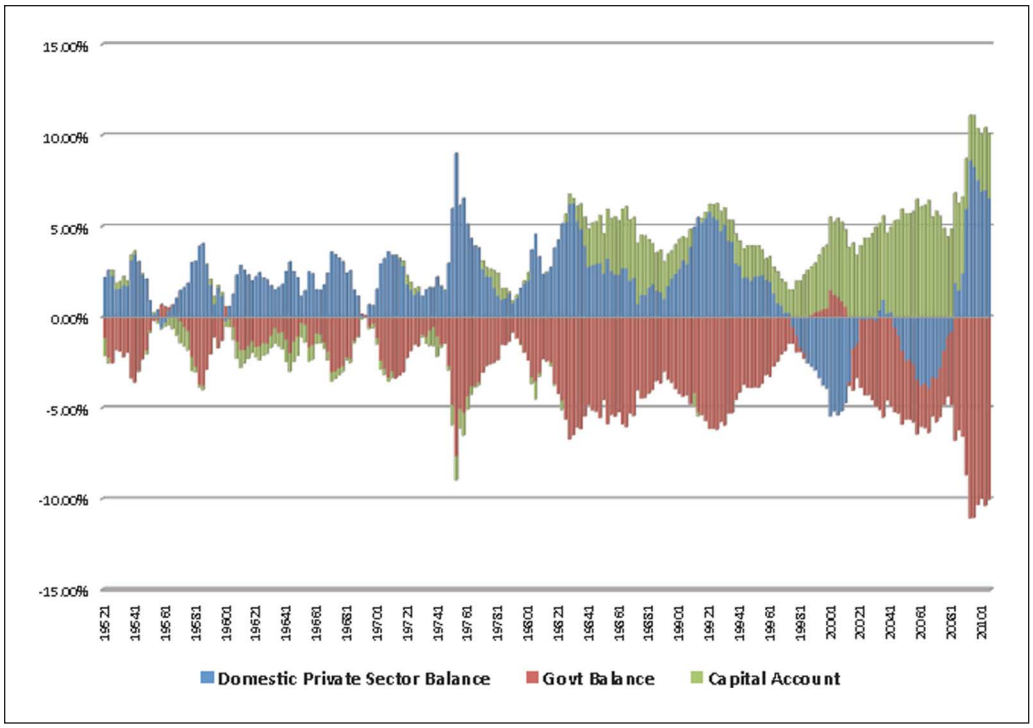

Figure 3. Three Sector Balances as a Percentage of GDP in the United States.
Source: Bureau of Economic Analysis

The so-called "fiscal cliff" is a fabricated myth designed to further the neoliberal agenda of gutting social safety nets. Forcing the government to agree to an artificial debt-ceiling limit that cannot be breached is tantamount to a collective suicide pact. A financially sovereign government does not have to abide by debt-ceiling rules. Neither does it have to agree to automatic spending cuts and tax hikes. These are all self-imposed constraints that have no economic benefits to society. The fiscal cliff constraint has limited the government's capacity to maneuver its way out of the Great Recession because the only two financing options allowed under sound finance are increased borrowing and greater tax revenues, but since higher tax rates have a depressing effect on the economy, the only option left is borrowing up to a self-imposed artificial debt-ceiling limit. The third option is the MMT solution. However, the idea of using the fiat money printing power of a financially sovereign government is not even part of the debate. Ironically, this is the main way that sovereign governments actually spend. The *level* of the deficit and national debt does not matter for the sovereign *currency issuer*; it is rather the *function* of the deficit that is negotiated through a socio-political democratic process that matters. If the *function* of the deficit is to meet certain national priorities such as full employment, price stability, sustainable economic growth, and universal healthcare, then the *level* of the deficit will simply indicate how much those priorities matter for society. The limits to a sovereign government's capacity to spend are not financial, but are rather the technological and physical material resource limitations. Therefore, the so-called "fiscal cliff" should be about our capacity to innovate, engineer, and create rather than the government's credit rating, tax revenues, and overspending.

Finally, one of the main objections to the JG program is the risk of inflation. If a sovereign country like the United States can simply finance a JG program by printing money, then can it be a trigger to runaway inflation? And if the JG wage is higher than the current minimum wage,

then would the subsequent increase in private sector wages also cause inflation? First, none of the historical experiments with JG programs has produced runaway inflation (e.g. New Deal in the United States, Jefes in Argentina). Second, the best proxy to such a scenario would be the historical increases in minimum wage laws, which have forced private sector wages to go up. Those are always one-time wage increases and have never caused any inflationary spirals, so why would a JG one-time wage increase cause inflation? Third, inflation is a complicated phenomenon that is not solely linked to wages; it also has to do with the overall productive capacity of the economy, labor-capital bargaining power, as well as several external factors such as global commodity prices. The risk of inflation cannot be dealt with by constantly maintaining an idle portion of the labor force. What MMT and JG demonstrate is that the mainstream trade-off between unemployment and inflation is a myth that can be overcome with the implementation of the JG. The next section will debunk the myth that JG is unaffordable (even under a sound finance regime).

4. An Affordable and Productive Full Employment Program

Critics of the JG program often claim that it is very expensive and unaffordable. The aim of this section is to demonstrate that on the contrary, the JG program is not only financially inexpensive for the United States, but also productive in terms of its contribution to GDP growth. Let us consider a JG program that targets the core of the unemployment problem, namely the 23.4 million underemployed people. This number includes those who are officially unemployed, the marginally attached to the labor force, and the involuntary part-time workers (BLS Statistics 2012). We assume a three-tier JG wage structure such that skilled workers earn $21/hour, semi-skilled workers earn $18/hour, and unskilled workers earn $15/hour. Additionally, JG workers will receive an annual benefits package of $10,000. For the sake of argument, we will assume that the 23.4 million people in the JG program are working 40 hours/week even though not all JG workers will opt for full-time employment. Let us further assume that the annual material cost of running the JG program is $50 billion. Finally, we will assume that the unemployment pool is evenly divided between skilled, semi-skilled, and unskilled workers.

As described in section 2, a decentralized JG program will rely on the extensive network of local non-profit organizations to compile a reserve shelf of "shovel ready" JG projects across the country. If we also assume a modest Keynesian multiplier of 1.5, an average income tax rate of 15 percent, and an average sales tax of 6.5 percent, then the total annual wage bill of the JG program would be $808 billion; and if we add material costs and benefits package costs, then the total cost of the program will amount to $1.09 trillion annually.

On the tax revenue side, the JG program will generate $52.5 billion in sales tax revenues annually for state and local governments, and $121.3 billion in income tax for the federal government. Additionally, we must take into account a variety of cost reduction benefits that will be derived from the program. Those would include an estimated $150 billion in savings from unemployment benefits, $100 billion from food and nutrition assistance programs, and $75 billion from incarceration costs. There is a variety of other cost saving benefits, but for the sake of argument we will limit our analysis to these three items. As a result, the net annual cost of employing 23.4 million workers in the JG program is only $593.8 billion or 3.93 percent of GDP annually. Compare this to Bush's $700 billion bailout and Obama's $787 billion Recovery Act spending, with stubbornly high unemployment rates for the last five years. Furthermore, the multiplier effect of the annual net wage bill of the JG program will amount to $1.03 trillion or 6.83 percent of GDP. Note that this analysis tends to overestimate the costs and underestimate the benefits of the JG program. For example, the maintenance of higher levels of employment, income, and spending will automatically stimulate the private sector and will lead to an increase in private sector employment, and consequently to a decrease in the size of the JG labor pool.

This JG proposal can add more than $1.4 trillion to GDP by 2020[2] in addition to maintaining continuous full employment; needless to mention all the non-economic benefits that full employment will bring to those who are currently excluded from fully contributing to the economy. Finally, one could argue that the logistical challenges of creating 23.4 million jobs at once can be overwhelming, so it might be more reasonable to follow a gradualist approach to phase-in the JG program over a 3-year period (or even longer); regardless the financing cannot be the obstacle, only logistical and physical constraints can potentially hinder the success of the program (Kaboub 2013).

In short, the annual net cost of the JG program does not exceed $600 billion. This is only a fraction of the $29 trillion that the Federal Reserve Bank has spent to bail out[3] Wall Street since 2007 (Felkerson 2011). The problem, however, is that the $29 trillion bailout did not end the GFC, nor did it reduce unemployment, poverty, inequality, or economic uncertainty. The JG proposed in this paper would ensure full employment, price stability, sustainable economic growth, and social justice. The lesson we must draw from the $29 trillion experiment is that the Fed and the Treasury do have the legal and technical capacity to create money without congressional approval, and that they do have the tools to inject money in the economy without fearing the inflationary consequences. What needs to be done is for the U.S. Congress to abandon the self-imposed sequester, austerity, and fiscal cliff mythology, acknowledge the full financial sovereignty of the U.S. federal government, and give the Fed and the Treasury the mandate to finance full employment.

5. Conclusion

Neoliberals have mastered the art of using recessions to further their agenda in a remarkable way by holding the economy hostage. During recessions, profits fall; so corporations put pressure to weaken labor unions, reduce wages, cut benefits, and cash-in on tax cuts, tax incentives, and lucrative government contracts. When government deficits rise, neoliberals cry wolf and threaten to cause further layoffs unless "entitlement programs" are cut. Those threats also persist during the recovery, and therefore tax cuts and social safety net cuts become permanent and irreversible. What this paper has argued is that there is an alternative solution that could counter the neoliberal narrative. The MMT-JG alternative can enhance social justice by providing a full employment alternative that is both financially affordable and productive in terms of its contribution to GDP growth. The paper has established that a financially sovereign government (a currency issuer) should not be financially constrained by artificial debt-ceiling limits. Countries like the United States, Canada, U.K., Australia, and Japan enjoy full financial sovereignty despite the level of deficits and national debts they have. Because their national debts are denominated in their own national currency, they can never face a sovereign debt crisis. However, Greece, Spain, Italy, Portugal, and their eurozone neighbors are not financially sovereign. Their governments' spending can only be financed by tax revenues or government borrowing, which is subject to Maastricht Treaty limits (3 percent deficit-to-GDP limit, and 60 percent debt-to-GDP limit) and the capital markets' willingness to lend to them. This puts the eurozone countries almost in the same position as the State of Ohio, or New York, or California, all of which are non-sovereign *users of the currency*. The main difference, however, is that individual states in the United States are backed by the federal government, which can act as employer of last resort, and can bail out industries

[2]The $1.4 trillion is the nominal value of the JG net contribution to GDP in 2020. This figure is calculated based on the JG program contributing an estimated additional 1.06 percentage points to GDP growth on top of the average 3.89 percent of the 2001-2011 period.

[3]Felkerson (2011) has produced the most comprehensive estimate of the Fed's intervention in the aftermath of the GFC. His study puts the total cumulative amount at $29,616.4 billion, which includes direct lending and asset purchases.

and households as it sees fit. Therefore, comparisons of the U.S. economic troubles with those of Greece and Spain are highly misguided. The United States could finance a generous and productive full employment program for less than $600 billion annually.

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