Sense and Nonsense in the Balanced Budget Debate: A Socialist Response

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The Republicans have successfully changed the economic debate from jobs to deficit control. Why the urgency? After all, this anemic “recovery” has been marked above all by the lack of job growth. Growth needs to considerable exceed 3% per annum if the private sector is to make any significant headway in reducing unemployment. Instead growth is actually trending downward from its post Great Recession peak. The intractability of long term unemployment now exceeds the duration experienced in the 1930s. Combine this with the fact that economy wide wage gains in the past decade have even lagged those in the Great Depression, when adjusted for deflation, and one can easily appreciate why workers’ portion of the national income has continued to drop consistently, since the recession was declared to have ended.

Yet the American right wing, including of course the business community, insists that deficit spending is already entirely excessive and is leading the country inadvertently down the path to socialism, by which they mean “statism.” This may appear absurd on the face of it, but let me try to put their argument in a coherent form, something right wingers — including right wing economists — seem incapable of doing, and to explain why this is a well-grounded fear.

The theory is that when government finances its activities by borrowing, for instance to alleviate unemployment, it increases the national debt. The increased national debt invokes additional interest payments necessitating government to jack up taxes still further to raise the money to meet its mounting interest obligations. This may not be in the immediate offing, but is, at any rate, eventually unavoidable. The higher taxes, or threat of higher taxes, in turn make investment still less profitable, by reducing the anticipated after tax returns. The private (nonfinancial) sector recedes, adding to the problem of private sector unemployment while generating a spiral of additional government sector borrowing, state expansion and private sector shrinkage. A willingness on the part of government to raise the debt ceiling moreover signals to the markets that the administration is not willing to arrest this cycle. This, in turn invokes a capital strike, wherein the private sector liquidate its inventories, and sits on its revenues, but refuses to broaden investment beyond, say, certain tech industries or foreign markets that promise exceptional short term returns sufficient to offset the anticipated additional tax burdens to come. In the context of a stagnant private sector, bond holders will come to fear a state default and therefore demand additional premiums in the form of higher interest payments before they will relinquish additional funds to the government. This eats further into the net profitability of the non-financial sector — which is now squeezed both by higher taxes (or the immanent threat of higher taxes) and the increased costs of financing its capital formation through recourse to the credit markets.

A mild depression is therefore postponed by government spending, only to give rise either to a more dramatic downturn or prolonged stagnation and paralysis.

Most leftish answers to this scenario are designed to appease the business community. As a practical political imperative, straying too far from this common understanding is expecting too much from political elites educated by the business class to view political economy in these terms. Political economy is fundamentally ideological. Its consequence is to present an evolving picture of reality that reflects how the ruling class perceives its place in the social order. Its basic thrust is to suppress the aspirations of the working class, which, as a propertyless class, can only challenge entrenched interests by wielding political force; by winning the battle for democracy. This means clinging to a framework in which the state is limited to maintaining a general legal and infrastructural framework favorable for accumulation with the flexibility to grant limited concessions needed to secure social peace, without abdicating terrain directly useful to the democratization of economic power. The principles of “sound finance” tethers the growth of state functions to that which can be financed out of profits without threatening capitalism’s ability to accumulate. So long as state finances find their immediate limit in the profit system, private property can hold the pretensions of the working class in check largely through instilling a sense of self-restraint and discipline in the face of overwhelming and impersonal market power. The threats of “outsized” deficits, “run away” entitlements, and unemployment consequential to wage demands nonresponsive to downward international competition are so much a part of the internalized view of society’s rank and file that they are largely drained of the capacity for fight back. It is the market itself that disciplines democracy.

Even progressives such as Paul Krugman, have found fit to work within this narrow compass of understanding — that there is no alternative. It is argued quite rightly, that in the short term the fundamental political and social problem that liberals and the Democratic Party face is chronic unemployment. Mainstream liberals have largely accepted the framework that as long as a reasonable (i.e., manageable) ratio can be established between additional employment — as a result of deficit spending — and debt, the interest payments on the national debt can easily come out of future taxes paid out of a growing national income. This therefore means that both taxes on the wealthy and reductions in spending will both be needed. The former now, with additional taxes to come from a broadened base; the latter down the road when economic momentum has been reestablished. This sort of Laffer curve Keynesianism, in which deficits are said to pay or largely pay for themselves through the economic expansion that deficits breed, still operates within the world view — if not the priorities — of the business class. But in the long run, the consensus of both wings of the establishment is that servicing an outsized state debt is unsustainable. It will be met — if not reined in — by draconian limitations imposed by a punitive bond market acting in preemptive fear of runaway inflation. The question is when to cut, not the certainty of doing so.

So too, the endless arguments over the health of the Social Security and Medicare trust funds, one proposal no less unpalatable and reactionary than the next. Should taxes be raised in anticipation of future shortfalls? But what then becomes of an already anemic recovery? Should the age requirements be augmented or means testing be invoked to limit access to these programs or will a shift to private markets be preferable because it controls state costs by passing them on to the individual? But what then of the permanent spike in poverty among the elderly and infirm that will surely result from a market based voucher system? The Obama administration has fully accepted the premise that the budget deficit is an immanent flashpoint and has offered a program for reducing the debt by $4 trillion, while placing all social programs “on the table.” Even AARP has given the green light to throwing Social Security under the bus.

And if we don’t tackle these problems, aren’t we facing a sovereign debt crisis such as Greece and Ireland now experience with even more dramatic consequences to ourselves and world capitalism?

There is no satisfactory way out within the confines of the dominant parameters. And without an adequate and believable alternative, which socialist ideology no longer provides, the working class will acquiesce to its own victimization, each defeat further sapping its regenerative powers of resistance.

And yet on the face of it, this entire line of reasoning — which encompasses the omnibus of alternatives from A to B — is utter nonsense. Borrowing or taxing, the prior appropriation of funds, in order to finance government spending, is a self-imposed system constraint. So too are government imposed debt ceilings. They are not operational constraints. The ability of a society including a capitalist society to provide a decent existence for its elderly and disabled as well as for its working class wealth producers is not based on the ability of capital to finance state activities out of private revenues. Capital’s ability to keep economic demands held hostage to its priorities alone is. That is the reason for such prior constraint. Society’s actual ability to provide a decent and secure existence is only limited by its accumulated productive capacity, a capacity that is currently unused to the tune of approximately 25%. Even under the best of times 15-20% of capacity lies fallow. No economy can be said to be living beyond its means as long as there is excess capacity — unused factories, idle machines, and unemployed labor. So while the mainstream debates the level of austerity and sacrifice "we" should be willing to accept being imposed upon ourselves — naturally, for the sake of our "grandchildren", the accumulated surplus labor extracted from the working class has produced a sufficient and ever growing productive structure that, if fully tapped, could readily be the source of more generous social benefits, including universal health care, deep anti-poverty programs and ample Social Security remunerations. Capital is unwilling to unlock that capacity simply because it lacks current profitable potential and because the resulting tight labor markets would embolden the working class to abandon its habits of submission and subservience to power. It has therefore so constrained the system through legal encumbrances prohibiting it for operating beyond these limitations.

More central is the ruling class concern that the output of idle capacity, once consumed by the state as a result of deficit spending, no longer functions as capital in process. Or worse still, if it were to be used by the state for commodity production, such production would introduce a form competition that would enjoy an enormous inbuilt advantage against the private sector. The bail out of the auto industry — which represented a crimped, anti-working class, microcosm of this possibility, generated howls of fear and outrage on the part of the broader business community. Either way, if consumed as revenue or put to use in state production, that excess capacity impressed into state service would be largely lost to the private accumulation process. Taxing idle balances(or borrowing, which assumes future taxes) and rechanneling them back to the private sector in the form of state purchases will, it is true, have a multiplier effect that will expand economic activity. But unless the additional profits generated through that activity exceeds the taxes needed to finance the process, the exercise has little attraction for capital beyond the immediate beneficiaries of state contracts.

And this is the crux of the matter. These constraints paralyze the public debate.

What is not clearly appreciated by the public is that current state operations are in no way operationally dependent on the prior withdrawal of funds from the private sector. Whatever may have been the true when currencies were backed by a fixed metallic content, modern money is a state issued, state enforced, fiat currency. It is no longer commodity money and is not exuded by the system through the spontaneous interfunctioning of the private sector. The historic function of the capitalist state, when currencies were gold backed, was to guarantee convertibility and thereby preserve the "soundness" (the commodity integrity) of its currency. This meant that the issuance of currency was constrained by the supply of gold in the state's treasury. This tied the hands of government requiring it to appropriate funds (gold) from the private sector before undertaking or continuing any activity. The gold standard effectively subordinated the state to the needs of private accumulation and prevented the outsized growth of the state for fear of strangling the source of its revenue. A state which did not toe the line and debased its currency would ultimately face the prospects of insolvency. It would be compelled to transfer state properties to the financial system, thus allowing private capital to put such properties to profit-making use, before it could regain its ability to access credit markets. This reestablished the "proper" equilibrium between the state and capital.

But fiat currencies shatter and invert the inherited logic of the metallic based monetary system. Fiat currencies are not a byproduct of private commerce. They are a creature of the state, which has a monopoly on its issuance. Of course, the point of reference here are political entities that are sovereign, not in the juridical sense, but with respect to the issuance of currency. Greece, Ireland, Portugal and Spain for instance are no more capable of issuing fiat currency than are California or Wisconsin. That being understood, fiat issuing entities — such as the US, Britain, China and the EU — have to spend in order to inject liquidity into the system in sufficient quantity to accommodate the interests of commerce. They have to spend, that is, prior to their ability to tax; reversing the polarity of economic causality. With the advent of fiat money, taxation and borrowing no longer exist as necessary adjuncts of state appropriation.

That is, payment due for state wages, for the rental of state buildings, for the purchase of infrastructural products, to fund Social Security and Medicare/Medicaid, to finance the interest due on the national debt, to share revenues with local governments, or, unfortunately, to fight imperialist wars do not require the state to mobilize funds, either in the form of additional taxes or by selling state bonds to the private sector — or foreign governments — prior to meeting its obligations. These obligations can be met simply by computer generated entries from the state into the ledgers of its private sector customers or its own self-administered trust funds, its private and foreign bond holders, and its employees' payrolls. This adds to the budget deficit in a way that never has to be repaid, or paid down and does so at a zero rate of interest. This, as a practical fact, is how wars are financed until, that is, they become so unpopular or counterproductive that politicians conveniently awake to the discovery that the treasury is "out of money." All of which suggests that even ruling class functionaries can with the proper motivation come to recognize that there is no functional requirement to maintain the fiction that a complex network of taxation and borrowing is the precondition for the state to function. The modern state cannot go bankrupt. The interest owed on the trade deficit is an accounting problem, not a social crisis waiting to happen. The state does not have to sell bonds to run a deficit. It does not have to tax its populace or borrow from them to pay the interest. The entire idiotic kabuki performance of haranguing over debt ceilings, debt defaults or government shutdowns, or of acquiescing to mass unemployment, or of negotiating down social benefits to keep the state afloat can all be dispensed with. There is no more imperative for the debate we are currently suffering through than there is a functional requirement to tie one's hands behind one's back and lap up food from a bowl like an animal. Unless, of course, one wants to experience life as a dog. Even so, reasonable individuals acknowledge that this is not a requirement of human existence. So too there is no functional requirement for workers to be kept at the level of animal insecurity merely to satisfy capital's social need for a "sound financial policy," a policy that periodically grinds the state under its heel, arbitrarily checking its ability to expand public consumption at the expense of capital accumulation. Once fiat money replaced commodity money, the genie of state reorganization was already released from the bottle.

This is not meant to imply that there is no further need for the state to tax and borrow. It is rather that these activities properly fulfill different functional requirements; namely to cool down an overheated economy by draining excess demand for consumption and assets that may have been induced by additional state spending. Functionally, these should be tools not for the appropriation of operating funds, but for the regulation of aggregate demand and the adjustment of interest rates needed to preserve price stability including an access to investment capital commensurate with cyclical moderation. The size of the government budget, in short, should only be determined by the shortfall of aggregate demand at levels that would otherwise accommodate full capacity utilization, with the understanding that there are no intrinsic financial constraints on federal spending, beyond those artificially imposed by capital and the political inertia yoked to it. Were these shackles not in place, resources idled by the lack of adequate profit potential could readily be translated into additional decommodified public goods and services with no cost to the consumer. Within this context, the struggle over budget priorities would take on an entirely different cast, not least of which would be the need to combine fiscal stimulus with progressive redistribution.

And if government estimates were to overshoot, building inflationary pressures, excess demand could be skimmed by introducing taxes starting at the top of the income/wealth chain and working their way down on a sliding scale, and through the sale of bonds to drive up interest rates. The government can, in other words, also run budget surpluses. But to reemphasize — the question of surpluses (or deficits) should relate solely to the management of aggregate demand, not to the financing of government operations.

The lack of aggregate demand is primarily a function of an insufficient rate of capital formation due to the chronic lack of adequate profitability. The Bush era boom masked this by means of a massive speculative housing bubble. This, like other financial bubbles, imparted to the falling rate of profit — the developmental trend of capitalism — a wave like character. But, the collapse should have been entirely predictable. The boom was based on asset stripping of the American working class, rather than on the buildup of productive capacity. Home equity was exchanged against surplus value so that declining wages could be offset and supplemented by debt fueled consumption. What remained was canalized into small business expansion and stock market purchases. The profit crises remained latent by the injection of an estimated $2.3 trillion in supplemental demand extracted from the housing market between 2003 and 2008. When this deflated, that is when the issuance of financial instruments outstripped the ability of capital to extract sufficient surplus value to service the accumulated pyramid of obligations, the financial system was forced to the brink of collapse. The hastily cobbled TARP program — a stunning exemplar in itself of ex nihilo money creation — recapitalized the hemorrhaging banks, but the restored financial system had no further interest in injecting capital back into a failing system of private production. The expansionary potential of almost half of the stimulus was thereby neutralized at inception.

Consider what might have occurred if the state had stimulated the economy from the bottom up: if the state had, for instance, abolished all taxes on the working class, including payroll taxes. And this is the most modest, most right-wing of populist friendly proposals. This would have constituted a massive wage increase at no additional expense to employers. Of course, this is simply a thought experiment. No wing of the ruling class would dare do that, unless it could also exploit the opportunity to defund the Social Security and Medicaid/care trust funds as a pretext to later abolish or diminish future benefits. But let us follow this through. Had the improbable happened, workers would have gained sufficient additional income to massively obviate the mortgage debt crisis, pay down credit cards, expand consumption out of income and build savings. As the financial intermediaries of the private sector, the banking sector would have been indirectly recapitalized and the economy massively stimulated. The imaginary responsive state would simply credit the trust funds electronically to compensate for the engineered shortfall insuring no future sacrifices could be retrofitted on a working class as it ages or becomes infirm. And, if the recapitalization of the banking system was not deep enough to penetrate up the ladder to the investment bankers and hedge fund jockeys, a layer of social parasitism would simply have been wiped out with minimal impact on the broader public.

Consider alternatively or additionally, if the federal government temporarily or even permanently assumed the financial obligations of state and local governments. These are entities that cannot create money. Again this would have involved a key stroke on the part of the federal government; entering a credit into the bank accounts of states, cities and municipalities. Like the tax holiday for payroll taxes, this proposal too would further recapitalize the banks and contribute to a meaningful reversal of the mortgage crisis as knock on effects. Demand would again be created by the feds without incurring additional tax or borrowing liabilities. There would be no loss of services, no layoffs, and no pension shortfalls. No raison d'etre for the Christies, Walkers, Kasiches and Cuomos. No answerability to Wall Street bond traders. The current capital strike would have been very effectively broken by the avalanche of additional aggregate demand that would compel idle capacity into play.

The state has the ability not to prevent but to radically reshape the character and impact of capitalist crises. But this requires in the first instance making proper use of the economic latitude accorded by the state monopoly over currency. It is this monopoly that fundamentally alters the mechanism of state operations. It liberates the state from the constraints of revenue, breaking the functional parallel between itself and the private sector where the necessity of financing its spending remains an inescapable constant. It is elite interests working their way through the political process that saddles that restraint on the system, long after its functional necessity has expired. Maintaining that symbiosis is crucial in preventing the emergence of the state as a semi-independent social factor. The point is to make that clear and to break that symbiosis. It requires the real democratization of the budget process.

And there is a mass constituency for this. It appeals not only to the working class, but to that section of the anti-tax crowd, not so drunk on racist poisons that it has lost its capacity to respond to overwhelming self-interest. It is the left and the labor movement that can provide a crucial role for this message by acting as a ginger group for this agenda. But it is equally unlikely that this will find resonance with Democratic Party elites. The Democratic Party remains a ruling class institution, not a rank and file controlled membership organization. Its pro-business agenda is set primarily by its financiers, who pepper its platform with sufficient offers of largess and decorative concessions needed to assure itself a reliable electoral base. It performs what the Republicans cannot: keeping society's working and lower classes docile, lest their unruliness unleashes the far greater repression of Republican social thuggery. It has no interest in loosening the grip of entrenched interests over the state. The DP is a steam valve on the pressure cooker of capitalist society rather than an agent for fundamental redress. Failure to break with the Democrats, in part attributable to a lack of an independent economic perspective, chains labor to the hamster wheel of permanent retrenchment — where all previous social gains are both perpetually negotiable and all new gains vexingly provisional.

But the rationalization of the budget process combining all the modern financial tools at the state's disposal, even if it were to open new terrain for public participation, would not be socialism. And we should be clear about this. Production and distribution would still not be managed democratically from below by society's constituent elements. Market generated inequalities would continue to exist, though they could to a large extent be shrink fitted, and markets would continue to act in response to these disparities assuring that class privileges are faithfully reproduced. Neither would have capital relinquished its tentacled grip over the forces that shape public opinion and define the feasibility of social alternatives. And to the extent that political space is expanded, any vacuum not filled by greater democratic participation from below will be filled by managerial or bureaucratic "experts," with the potential to develop and propagate their own independent class interests and to impose them on society. Though no panacea, unlocking the potential of modern monetary system nevertheless has the raw potential for a civilizational upgrade within capitalism.

More crucially, it in no way dispenses with the need for socialism. The functional basis of the entire system still rests on capital accumulation. The state can therefore never attain full independence from the laws that govern the contradictory process of value-expansion. The tendency to replace living labor with ever more automated production processes tends to drive down the rate of profit. Each unit of capital becomes associated with an ever declining base from which surplus value can be extracted. The NY Times, for instance, recently reported that spending on machinery and technology has increased by 26%, while spending on employees has inched up by just 2%. And the goods producing sectors of construction and manufacturing in particular have actually shed 26% of its workers. Still, as long as the rate of accumulation is sufficiently high, the fall in the rate of profit can be offset in practice by a rise in the mass of profits. When this is no longer possible, it signals the need for a purgative of excess capital values. This is the necessary deflationary function that accompanies economic downturns. It recalibrates the system by devaluing capital, allowing the aggregate production structure to recombine on a more efficient, leaner basis which leads to rationalization and the intensified exploitation of labor power. When this process works its way sufficiently through the system, it removes the previous barriers to production and reestablishes the ability to again accumulate on a profitable basis.

Effective countercyclical activity such as proposed here would paralyze that function. Removing the downward pressure on prices allows the least efficient capitals, which would otherwise first feel the brunt of the crisis, to maintain their pre-crisis values. Rather than be reorganized into a more productive capital complex, the equivalent output value of these sectors would be indirectly converted into public consumption. But capital formation is critically determined by the excess of production over consumption. The expansion of consumption without a parallel increase in productivity and capacity hinders the process of capital formation and moderates the critical rate of accumulation. And it does so in a context in which state buttressed demand creates tight labor markets compounding further the urgency to replace living labor throughout the reproduction process.

The crisis mechanism is part of the biological functioning of the system. It is the automatic feedback mechanism, the high fever, of capital that forces upon itself the need to exude the toxic poisons of excess capital before it can be restored to health. So too, the budget crisis, as it is currently waged, is an historic outgrowth of the genetic need for capitalism to suppress nonproductive state consumption and to reconcentrate, when called upon, economic resources from the state to the accumulation process. The modern state can temporize the nature of economic crises — as has been argued here — by directly, realizing a portion of produced goods outside the mechanism of the market. And it can do so effectively while dispensing with the entire labyrinthine and functionally superfluous process of budget appropriations now underway. But at length this neutralizes and reverses the function that crises otherwise perform of converting currently unprofitable capacity into conditions where its redeployment will again allow it to participate in the process of capital self-expansion

The state, therefore, can at length only expand the sphere of decommodified use-values if the accumulation of total capital is not impaired by their production. If capital cannot resume accumulation on its own terms, state-induced production will lose its driving force and become an obstacle to its resumption. This means that the state cannot avoid consciously assuming responsibility for the restructuring process that the crisis mechanism now periodically performs organically with such massive social disruption and dislocation. The alternative is long term stagnation. This of course would be a new type of stagnation — stagnation without mass unemployment, spikes in poverty and idled resources and, therefore, from an historical perspective, — a monumental step forward. But it would still be ultimately characterized by pitiably insignificant improvement in aggregate living standards; virtually a stationary state. The already low rate of capital formation in the Unites States exasperated by the claims of war, armaments production and the meager social benefits now in place have long enticed American capital to export surplus value to where more favorable investment opportunities await. A rationalized process of restructuring that supplants the haphazard social chaos of the business cycle necessarily requires a degree of social planning, an industrial policy, capital controls, aggressive infrastructural initiatives and a massive retraining program supported from below by an equally effective educational policy.

The question then unavoidably presents itself. If all this planning is needed to avoid the crisis mechanism of capitalism and to manage aggregate demand, while expanding the sphere of decommodified production and mass consumption, why should society continue to suffer the indignities, the inequalities, the oppression and exploitation of capitalism? Why not take democratic control over the sum total of surplus value and put it directly to social use?