Modern Money Network, The "Money Series" 2012-2013

4. DEBT, DEFICITS OR UNEMPLOYMENT: *IDENTIFYING REAL THREATS TO GROWTH*

So today we have three people here to give presentations to continue on the modern monetary seminar series and this one is sponsored by the Unemployment Action Center. Our first speaker this evening will be Dr. John Harvey, who is the former chair of the economics department at TCU and he currently writes a blog for Forbes called Pragmatic Economics. Our second speaker tonight is John Creadal who is a professor of development finance and Talmin University and a senior scholar at Fleming's economic institute of (0:30) Barg College. He also serves as the director of the institutes monetary policy and financial structure program. And as our moderator this evening we have Ethan who is a research student economics research student at the University of Ottawa in Canada. Again, thanks for showing up and the Q&A is at the end for 30 minutes so feel free to ask any and all questions you may have.

Thank you very much I don't know much else to introduce them besides (01:00) their fancy titles, but they are both professors that I find very interesting and I hope you find interesting too on finance unemployment debt and deficits which is the fourth panel that we have today. But we will start now with John Harvard.

**John T. Harvey:** (1:30) Thank you. Now, my wife says I shout, and is this screwing up your camera. Ahh I'll use the microphone. I'll try not shout but I got to be careful with that. First off all, It is a great honor to be invited, the list of speakers are all people I really admire. I would have killed to have an opportunity to see all these people when I was in graduate school. And I have killed before (02:00), so I know I would, because I live in Texas and we're allowed to do that. But thanks so much for Rohan because when he invited me I was really excited about that. I didn't realize it was hurricane season when I said yes, but otherwise it was really nice to be invited out here. This talk that I'm giving right now, cut down to 20-25 minutes, I usually do about 40-45 minute talk. I've been giving it to civic groups and churches and stuff like that. I don't quite know where to go with this. (02:30)

I've got my power points laid out for the beginning and we will see where we go from there. I know where I want to start but I don't quite know what to cut out yet. I will say this though, if you have seen some of the other talks, there is some overlap with Randy Ray and Warren Mosler, for very a good reason, and that is I have learned a helluva lot from Randy Ran and Warren Mosler. But I want to do a slightly different focus by talking about the debt and the deficit. I think that something in our literature that isn't done so much (03:00) is talking about the macroeconomic framework which you have to place all of this to understand it. The reason we don't do it so much is we are talking to each other and we already know what the macroeconomic framework is and we already understand how we think the macro economy works. But when we are speaking to people who aren't economists and... hands up all those who have an econ major, minor, or graduate degree. Most people don't. For that reason I think it is useful to stop and think about "Well, Why is this an even issue?" (03:30). Why do we have to talk about this? So basically I'm going to give you a semester worth of macroeconomics in about 10 minutes.

Aaand… here we go…..mumbling about computer…

(04:00). Okay. That's me. And first of all this is of course what you have heard about the debt and the deficit right there. That its this terrible burden. That should actually say 16 trillion, I apologize the slide is 3 days out of date. Then there is these horrible horror stories. It doesn't take long to find things like this. I love the part where it says that …"we will cede our nation's independence and we will face economic tyranny at the hands of our foreign debt holders". And even better, from the aptly named 'theeconomiccollapseblog.com', it is really hard to find the words to descrie the true horror of the national debt. It was Dick Cheney who famously said that "deficits don't matter". Well, try telling that to the nation of Greece right now. It's very easy to find stuff like that all over the internet. Now you're probably thinking, Yeah, but these people were taking a break from making pipe bombs and writing their manifestos. Well it turns that other people believe it too. For example, this Kenyan Muslim guy who hates our freedom. He too says that, oh by the way, did you know the worst of the recession is over? Well this is in 2011, that the government spends more than it takes in, that this is not sustainable that people deserve a government that does the same as they do.

But fortunately, the Republicans don't believe…. OH MY GOD THEY DO. Apparently to (05:30) Romney, not only can he not fathom spending more than we earn year after year, but it is not just bad policy, but it is immoral! Well apparently, the debt and the deficit are absolutely horrible. Well the one thing that the Kenyan Muslim who hates our freedom, and the pipe bomb makers, and the guy who abuses classmates who don't agree with him when he's in prep school, the one thing they have in common is that they are all dead wrong. They have no idea what they are talking about in terms of the way the debt and deficit work and again I don't want to recover what Randy Ray and Warren Mosler talked about. Let me give you a sort of macroeconomic lesson and try to understand where the debt and deficit fit into that.

My poor wife has seen me give this talk about a dozen times now. In fact, she is out giving it right now. No I just made that up. She said, and I know I have a sophisticated crowd here, but just in case here is some quick definitions. The big thing is of course is to differentiate between the budget deficit and the trade deficit. The budget debt is the annual amount by which government spending exceeds tax revenues. And the budget surplus… and national debt… but the trade deficit is obviously a different issue, but something is related that we could talk about later. And last, and see when you talk about this and you tell people as we do that well there is no debt that can't be repaid (07:00) and that we need to spend in deficit people get very upset. So Melony pointed out you need to tell them they are right about something. So they are right that state and local government are budget constrained and they can't spend forever without ending up in terrible debt so everything we are talking about here relates to the federal budget.

Okay. Macroeconomics Lesson. Let's say that this is a representative economy and these 10 people right here. I'll be the entrepreneur, they are all potential workers. So they come to work for me, they earn a salary from me, they go out and to buy the goods and services that they have made in my factory, and then I profit from that. In this example there is no government and no foreigners, which is every Texans dream. The way this works is, let's say however, and this is critical, that we don't need all 10 people to produce all the goods and services for all 10 people. Let's say that 7 people can make enough for 10, and that 3 of those people are redundant. 3 of those people can make enough goods and services for them, but we don't need them to participate in the process of making goods and services in order to make enough for them as well. And as the entrepreneur, I'm not going to make enough for 10 people then am I. There's no point. Only 7 people can have the income to buy goods and services. So I'm only going to hire those 7 people, I'm going to lay some people off that would otherwise been producing the goods and services for the 3 redundant people (08:30). I'm going to make the math real simple. I don't know why 1 person was enough for the 3 other people but let just say they were. So I lay off one more person. Now we're in a situation where four involuntarily unemployed people who do not have the income to purchase the goods and services we can afford to produce. We have the one entrepreneur who is content, but I'd people happier if sales are higher, and we've got the 6 willing workers who do have jobs, but they are paying some kind of cost to be unemployed. Either Uncle Bob is living with us again or Mom got stabbed at the 7-eleven again or something like that in turns of the cost of unemployment.

This is sort of a historical context. I asked my students "what was different between the 20's, and we will look at the average rates of unemployment here during the what 20's? (09:30)The roaring 20's. We all knew that. The roaring 20s. And in fact from the first 2 years were recessionary but after that would have been 4.2% unemployment and average GDP growth of 4.89% and then look what happens next. And look what happens next. An average unemployment rate of 1723% and I don't know if you were paying attention but that is higher than the previous slide of 4.98%. And average GDP growth the first 3 years from when the recession really hit of -8%. Now what was different? I mean did we have less productive capacity in the 30s? was there a big fire that burned down all the factories? Or did people forget how to make stuff? Or was there an alien attack from outer space? No! We had the productive capacity in the 1930s to produce not only as much as we did in the 20s but more! Because the 1930s were a long period of buildup in physical capital, we should have been in the 1930s the greatest economic period in US History. But instead, of course, we could see what the unemployment rates did. Point being, I think that this background story of we have the capacity and I think that is what is lost on a lot of people, we have the capacity right now to have an unemployment rate that was the same as around 6 years ago around 4.4%. With 6 million unemployed people. There is no reason we can't be there. (11:00) There is no fundamental constraint that is keeping us from being unable to produce at that same level. Just as in a far more dramatic example that there is absolutely no reason from a physical productivity standpoint, form a standpoint of could we make the stuff, that we couldn't have had the same standard of living, in fact a better one, during the great depression than we did in the 20's. And those numbers are unbelievable. Look we had unemployment as low as 1.9% in 26, 3.2% in 29, up to 8.7% and rising as high as 24.9. And of course, what did they start to do in 1937. They said oh my gosh the worst of the recession is over, let's try to balance the budget. And that worked out really well, as you can see, so hopefully history will not repeat itself. And so there is this sort of secular trend where you have the rise in productivity making it harder and harder in a market economy to generate sufficient demand to hire everyone whose able and to work. Because it gets easier and easier to produce output with fewer chunks of people. So as a consequences it's not profitable, we have the physical capacity to produce those services but it is not profitable to produce those goods and services.

I've got the capacity as the entrepreneur to produce for all those people but it is not profitable to produce for all those people. (12:30) And I'm not a jerk, I have a family! I run this factory here, I'm not running a charity! I'm not going to hire those other 4 people when in fact I cannot sell that output that they produce! As a consequence and a long term problem and of course this is where the deficits come in, in a minute. And also, I threw this slide together this afternoon, just in a cyclical sense too, I don't think I'll say too much about this as well not only over the long term but if you look at the business cycle what you see is in fact at the end of every expansion that's the first part expansion minus 12 months is all of the expansion in the US from 1950 first quarter to 2009 3rd quarter. That first line there is the average number…. Crap..My number came off. That's the % change in investment over all but the last year of the expansion then the last year of the expansion, and what I want you to see is the first column there that the first column there should actually be the % change in investment. So the rise and physical investment, firms building factories, replacing inventories, that sort of thing. During the first part of expansion it tends to rise about 16% then it still rising but it is rising at a very low rate. We are saturating the demand for physical capital. We are saturating that demand. For example. The construction workers are building restaurants for you, but they get done building restaurants. (14:00) So then we lay off the construction workers. And the about the time the restaurants open up you don't have as many customers and you try to figure out why that happened and then you panic and then you cut back. But again, the cyclical and the long term problem of keeping demand hard enough to hire everybody who is willing to work. And again, we have the capacity to produce the goods and services. That's not the problem we have the ability to do it. What's the solution? We need to supplement that demand. However, in the midst of a recession of course businesses and households are not in the position to do that. "They can't do it." I put that in parentheses, and Rohan was asking me to talk about a collective action problem and I'm not quite sure that this really fits. But it's interesting to think about. Everyone was better off if you spent more money. But if you did so individually you would be worse off. If you as an entrepreneur, think what the heck I'll start up a couple more restaurants what do I have to lose, you will probably lose. But if everyone does this at the same time you might generate sufficient demand. But I think it is more fundamental than that. We just didn't need any more restaurants.

So what sector do we have left? Well we can do as the Chinese do and use the foreign trade to support demand in our country. Or we can use the government. Lets do that. Lets make those 10 people again and lets make the last 3 a police officer a marine and a teacher. And now lets just print up a pile of money and hand it to them. And obviously it's a problem to decide how much money to give them but I think that is something that would keep economists in work and it is manageable (15:45). So they now have the income to go to the store and make profitable the stuff that we have already produced. We could already produce it, now they make it profitable.

Furthermore what's going to happen to the person who is still redundant right now? I'm going to hire that person back. I can say what the hell I can sell more stuff so I'm going to go and hire that last person back because now I can profitably produce output for 10 people were as I could not before. So the net effect is 3 people that have been unnecessary now have the ability to purchase the output we have always been able to produce. The person that I had laid off gets hired again, I've got higher sales, and those who already had jobs gave up nothing. They gave up nothing. There is a free lunch when there is less than full employment. But we are not at less than full employment. If we are in the middle of WWII and unemployment is at 2% and the government tries to expand spending then yeah, we are going to have to take, we are going to have to have rations, we are going to have to have the government capture more resources for itself. We are going to have potentially inflation unless we have things like wage and price controls. We aren't in a situation like that right now. We have unemployed resources so yes there is a free lunch. And oh yeah, we give them nothing, they no longer carry the burden of the unemployed, they are protected against domestic and foreign aggression and you can send your kids to school for a public education if you want to. Of course I teach at a private school too so I think that's a really bad idea.

So in summary then, in periods of high unemployment, only the federal government has the ability and obligation to address the problem. Furthermore, this is again, they are not "borrowing" to buy something they cannot otherwise afford. It's not like Michelle Obama went into the Oval office and said a big screen TV would look really nice here and Barack says yeah but we don't got any money. Well hell lets just borrow from the Chinese! Then they go and buy something that they could not otherwise afford. That's not what the federal government is doing.

They are pumping funds into the private sector in order to make profitable the production of goods and services we could already make.

Now, that's what I knew I wanted to talk about. I have 5 minutes left and I'm trying to decide where I want to go from here. Let me just do this very quickly although I think this is more on the lines of what Johns going to talk about. But, you know again, when I'm talking to lay people, there is a more of a sensible aren't surpluses good (18:15)? Why wouldn't you want a government surplus? And I say alright lets think about it like this. Suppose there are only two people in the macro economy. You have Alfred Marshall, a very influential economist you've probably never heard of, and Adam Smith, a very influential economist that you probably have heard of.  Those are the only 2 people in the macro economy. If Smith pays Marshall $150, and Marshall pays Smith $100, than Marshall has a surplus of $50 and Smith has a deficit of $50. Who would you rather be, Marshall or Smith? People generally answer I'd rather be Marshall. Okay, that's who you are. If you replace the Marshall with the private sector and smith with the public sector, when the government has a deficit of $50 that creates a private sector surplus of $50 which is a lot along the lines of what I think John is going to talk about here in a minute. So this is  where the injection of demand comes from. And furthermore, if you are asking the government I just don't get this, they are talking so much about this, if you are asking to balance the budget and to reduce government spending or reduce the deficit. Well if you are asking to reduce the public sector deficit, you are asking to reduce the private sector surplus. If you are asking to cut this down to 40, then this is 40. 30, and that's 30. Make that a surplus over here (government side) then it's a deficit over here (private sector side).

(20:00) So now I have a very long slide, I apologize for that. I know that if you are using PowerPoint you should not use it to put your entire talk on. No actually I just really like this quote from a speaker who is coming here later, I think in January, named Tcherneva, and she says essentially the same thing I just did If you're asking the government to reduce the deficit then you are asking the government to reduce your surplus. If you're asking the government to pay off it's debt, you are also asking the government to pay off its debt, then you are also asking for the private sectors assets to be traded, you know the t bills to be traded, for cash. And presumably, if you wanted to do that you would have done it already. But anyway, I'll let her talk about that later in more detail. Again I have a more sophisticated audience here and approximately 2 minutes and 7 seconds, but, and I have no particular reason for putting a picture of Lando Calrissian on this I just came across this while I was putting this together and I just not stand not using it somewhere. I always call my wife when I'm doing this. You are going to a church group and they think we are all going to die if we don't pay off the debt and the deficit well and this is something that Warren and Randy have talked about. What are the odds that the US is forced to default on debt. Nathan what's the likelihood that the US would be default on its debt?

**Nathan:** Zero.

**Harvey:** Oh my god! Its as if he has seen my next slide and yet he had not. This next slide again in trying to convince you—I did a talk at TCU, good lord, and we were worried that there might be some, we almost put up metal detectors in case some Tea Party people came in armed to it to kill me, and that was literally, we worried about it. (21:30) We talked about it at something very similar to this and we thought my God. And there were some comments that were written. This one guy hated me. This guy wrote more comments then everyone else added together. He hated me. So anyways. This for that reason, cause I knew this group would be very upset by this answer, I have a massive page full of quotes. Because that always offsets peoples misgivings when you see a massive page full of quotes. And basically all it is a variety of people from different backgrounds and different politically persuasions for the United States to default on its debt.  The entire US debt is denominated in dollars and so it is impossible for the US to default. Well of course Greek did, that is not in occurrence because Greece isn't allowed to print because they don't know how to print anything. And actually one of the speakers that is coming up here next semester Mike Norman, the fourth one down there he is, and there we have Alan Greenspan, the Federal Reserve Bank of St. Louis, its impossible, and so if we have a sector of the macro economy that cannot default and we have a macro economy that does not consistently generate sufficient demand to hire everyone who is able to work. Even though we've got the productive capacity why would we not draw on that resource where they can make employment? Well off the record with politically problems absolutely. The biggest one is the question is of government power if you allowed to do this unchecked. Well also if you Takanawa is going to talk about the employer of last resort (23:00) where there is a built in sort of rules based means that spending so that you can keep this in control more. But absolutely there are issues. But one of the issues is not default. One of the issues is not default take that completely off the table. Also we have to do something because the system does not generate sufficient demand to hire everyone who is willing to work. Why not draw on the system that cannot default but can inject demand into the macro economy. And you've seen him already. And this is Randy Ray again. I'll jump to my conclusion because I am not at 21 minutes and 8 seconds. And so we demand aggregate demand but that's a brief introduction of that. And then Dr. Kregal. I don't know if you want anyone to see that yet because I've ruined a surprise.

Mumbles.

**Jan Kregal:** I forgot to ask you John, are you a real Texan?

**Harvey:** No I was born in London.

**Kregal**: Hmm. So I'm the real Texan (25:00). I was born in Dallas. Okay, What I'm going to try to do, first of all lets get rid of this. We are going to look at some pictures by doing this. I'm going to start of by doing this I was born in Dallas. And like all sensible Texans I left very quickly. I was also a student of Joan Robinsons at Cambridge and Joan always had a very favorite phrase when she started out to talk about discussions like the ones we've got into. Well the first thing you have to is decide what exactly are the questions you are trying to answer and much of the difficulty we have in the current debate is there is a great deal of confusion between the questions people are asking and the results they believe they get fro answering those questions. So on the one hand we have the argument that John's talked about, debt is too large we will default on the debt. Well is that really the problem? Or is the real problem that we think government is simply too large? A very well-known advisor to Richard Nixon and also to Ronald Reagan, Herb Stein more or less gave the game away when he admitted that the fact that when Republicans were in office they were always Keynesians deficits spenders who ran up the debt as high they possibly could which created this very difficult problem for Democrats because when they came into office and wanted to use government expenditure for reasonable purposes they couldn't do so. But the real idea behind all of this was to run up the debt so large that when republicans got out of all this they could say to the democrats "Look the debt is simply too large you've got to cut!" and cut funding meant what? It didn't mean repaying the debt if you notice we don't repay the debt very frequently (26:45) and we get to talk about that in the one case that we did. But the point was to cut down the size of government. And that was the basic question you were asking. What is the appropriate size of government? Now unfortunately this is no longer a question that we ask any longer because we have on the one side the republicans who are telling us that any government is really no good, its bad, so make it as small as you possibly can. And on the other side we have a very part of the Democratic Party which is if you've saw the NY Times today lead by people like Robert Gruben and Hamilton Coalition and everybody else who says we actually have to cut the size of the debt. Which means yes we do need to cut the size of the government.

So we have this really strange position in which the contrasting objects of 2 political parties are leading both to the same solution and they are both leading to what is effectively an absolute disaster in turns of the impact on the economy because I would say yes what has happened is we have the wrong questions. Economists have always talked about the size of government. Why? Well if we go back to the point of what we used to call political economy and go back to the 16th or 17th century we had Keynes, and Stallbrits and people like that and who worried about what they should be doing in order to make their countries strong (28:30). And this is a thing that we find even in Adam Smith who is supposed to be someone who is favor of the market who wrote a book that talked about the production of the Wealth of Nations. And that book was what? It was sort of a handbook for governments on what they should be doing in order to maximize the Wealth of the Nation.

Now how do you maximize a wealth of a nation? Well obviously you maximize the wealth of a nation by utilizing all of the resources that you have available. And this was the tradition that was set up about the appropriate size of government. The appropriate size of government was not that it was too large or too small but that it was appropriate to in fact utilize all of the resources that you have available in order to make the conditions of the citizens the best that you possibly could. Because back in those days the sovereign knew that if you didn't then you could have a problem. In particular the French gave a lesson a number of other sovereigns that if you treated the people to badly they would come back and they would bite you. So that if we look at the basic traditions in economics we have address a question and that question has always come back in that particular way. Just exactly what do we do to be able to utilize our resources in the best possible way? So what we look at the idea of deficits or we look at the so called fiscal stance you can say well the fiscal stance should be what (30:00)? The fiscal stance should be well we will get to in a minute it should be to behave just like regular household does.

Prepared by Sam Hoskins and Seth Vogelsang