The Household Budget Analogy: A Refutation

Introduction

This document is addressed to political activists who support initiatives such as the Green New Deal and Medicare for All. The purpose of this document is to provide those activists with an understanding of how to refute one of the most typical objections to such initiatives, *i.e.*, the notion that *"We just don't have the money*" to pay for them in the budget of the U.S. federal government.

This objection is typically expressed as an appeal to the principles of 'sound finance' as practiced by individual households. As individual households must "live within their means," so too, it is argued, must the federal government live within its means and limit its spending to its existing revenue sources. If, by assumption, increases in taxes are ruled out, then there are no funds to pay for presumptively big-ticket items like the Green New Deal or Medicare for All.

Here we will argue that the federal government's budget is **not** analogous to that of an individual household. While individual households must accumulate monetary funds before they can spend, the federal government does not. The federal government, by virtue of its monetary sovereignty, creates money in the process of spending into the economy. While the federal government may be constrained by the lack of **real resources** needed to pursue the public purpose, it is never **financially** constrained in that pursuit.

'Sound' Household Finance

The portrait of 'sound' household finance typically starts with an image of a 'hard-working American family gathered round the kitchen table' trying to balance its checkbook and plan a budget for the family's needs. Before the family can undertake any spending, whether for short-term or long-term needs, the family must accumulate monetary funds. Income must precede expenditure. Those funds can be in cash, coins or deposits in a bank checking account or some other type of account that is 'checkable', *i.e.*, an account on which payments can be drawn.

For convenience, we'll refer to cash, coins and checking accounts collectively as 'spendable funds' or, even shorter, as 'cash funds'. Cash funds can only come from one of four sources:

- **Current earnings**, assumed to be either from wages, salaries or the proceeds of a family-run small business.
- **Past earnings** which have been placed into **financial assets** such as savings accounts, certificates of deposit, mutual funds which need to be converted into cash funds before they can be spent.
- **Property** which can be sold for cash funds, including autos, real estate, heirlooms and other personal property.
- **Borrowing**, in which the family promises to pay back a loan in the future (usually with interest) in exchange for cash funds today. (We'll classify using a credit card as 'borrowing' only if the family carries over a month-to-month balance and therefore incurs interest charges.)

In this portrait, different value judgments are attached to each of these four sources of cash funds.

Borrowing, except for residential mortgages and auto loans, is assumed to be imprudent. Otherwise, the family tries to 'live within its means'.

We further assume that the family does not own much property which can be converted into cash funds and avoids doing so whenever possible. Taking the family jewels to a pawnshop is assumed to be imprudent.

In this portrait we assume that the overwhelming part of the family's cash funds come from current earnings -- the 'hard work' in which those 'hard-working American families' engage. Limiting spending to current earnings is deemed prudent.

We further assume that the family at least attempts to save out of current earnings for future expenditures -- perhaps for the children's college educations.

In this portrait there is an assumption -- sometimes explicit, sometimes implicit -- that families who refrain from spending all their current income -- families who save -- are prudent and virtuous. "A penny saved is a penny earned." Conversely, families who spend more than they currently earn -- families who fail to save -- are assumed to be less than prudent and less virtuous.

Business Finance

Businesses are similar to households in that they generally have to have cash funds in hand before they can spend -- but the connotations attached to the sources of these funds for businesses are different from those for households.

Businesses can spend out of current revenues, and they can spend out of earnings retained from past periods as well. They can also convert physical assets to cash, and they probably have a broader range of real assets than households do.

It's when we come to borrowing that businesses differ most significantly from households. Business typically have to make payments for inputs -- wages, salaries and raw materials -- before they receive revenue from the sales of the products created with those inputs. So most businesses have to engage in short-term financing to get the process of production started. That's not viewed as imprudent. Neither is it viewed as imprudent to borrow for longer-term needs such as plant and equipment.

In the larger scheme of things, businesses, like households, have to accumulate monetary funds before they can spend.

State and Local Government Finance

State and local governments must likewise accumulate monetary funds before they can spend. These funds mainly come from taxation. When state and local governments engage in short-term borrowing, they face most of the same constraints that businesses do. Interest payments for that borrowing has to be paid out of current tax revenues. For longer-term borrowing, state governments often have to promise to tie revenue streams such as bridge tolls to interest payments. States that make promises for future payments such as pensions without developing an actuarially sound plan to make those payments are viewed as imprudent.

The Household Budget Analogy, Stated

What we'll call the Household Budget Analogy has two aspects.

First, it postulates that the federal government, like households, firms and lower levels of government, must accumulate money funds before spending them. The sources of those funds are current taxation, funds not spent out of earlier tax revenues, government property sales and federal government borrowing.

Second, the Household Budget Analogy views federal spending in excess of tax revenues as imprudent and often morally suspect. Just as those 'hard-working American families' must 'live within their means', so too must the federal government live within its means. 'Running a budget deficit' is a bad thing. For the national debt to be constantly increasing over the course of the nation's history is also a bad thing. A balanced federal budget is a good thing; a federal budget surplus is perhaps even better. Suppose we want to institute new federal programs such as nationwide pre-K education for children. New programs entail new spending. So we can't undertake those new programs until we identify new revenue sources to 'pay for' them. Until we do so, we should simply acknowledge that 'we just don't have the money'.

Perhaps we should be very strict with ourselves and pass a Balanced Budget amendment to the U.S. Constitution. That would really be virtuous!

The Household Budget Analogy: Political Discourse versus Reality

Belief in the Household Budget Analogy dominates political discourse around the federal government, its programs and finances, and has done so for decades. Presidents and politicians from both major political parties have dismissed calls for new federal programs on the grounds that the federal government has not accumulated and cannot accumulate the funds needed to 'finance' such programs. Here's a sample compiled by a student of Stepanie Kelton (start at 4:26; end at 6:30).

However, when push comes to shove, nobody in Washington believes this. When the system goes into crisis, nobody in Washington believes that the federal government works the same way an individual household does.

Reality Case 1: The COVID-19 Crisis

Take the onset of the COVID-19 crisis in the spring of 2020. To contain, however badly, the spread of the virus, large parts of the economy had to go into lockdown, shuttering businesses and throwing tens of millions of people out of their jobs. The Congress passed income support legislation and the Treasury began sending out millions of $1,200 checks with Donald J. Trump's signature on them.

Did the money in those checks come from current tax receipts? No, tax receipts were plunging.

Did the money in those checks come from previous tax receipts, say, from a rainy day fund? No, it did not.

Did the government sell off the military's drones to raise cash for those checks? No, it did not.

Did the government go first to the financial markets and to China and ask to borrow money for those checks? No, it did not.

The federal government simply created the money in the process of writing those checks. It could do so because the federal government is a **currency-*issuing*** level of government, not a **currency-*using*** level of government.

Reality Case 2: World War II

Let's take another example. Let's go back to December 1941. The Japanese have attacked Pearl Harbor. Hitler has declared war on the U.S. The war is obviously going to be an expensive proposition.

Did anyone say, "We have to raise taxes and wait for them to be collected before we can spend the money needed to send the troops into battle"? Hmmm, no.

Did anyone say, "We better make sure we don't spend so much on the war that we fail to balance the budget"? No, they did not.

Did anyone say, "We can't afford this war because we just don't have the money"? Ummm, no.

To carry out the war, the government needed to provision itself with the people, weapons and equipment that made up the armed forces. Those people would have to come from the non-government sectors of the economy. Those weapons and equipment would have to be produced by the non-government sectors of the economy. So the government issued paychecks to the soldiers and sailors and checks to companies in defense production. Then it taxed back a portion of the money it had spent into the economy. It did so in large part via withholding taxes, which were first implemented during World War II.

Questions Frequently Asked

- Which comes first?

  "Wait a minute," you might ask, "does that mean that the federal government's spending *preceded* the taxation?"

  Yes, at the currency-issuing level of government, **spending precedes taxation**.

- Do state and local governments differ from the federal government?

  "Earlier you said that state and local governments have to accumulate funds from taxation or borrowing before they can spend. Are you saying that they work differently from the federal government?"

Yes. State and local governments are currency users, not currency issuers. They do have to tax before they can spend, because they cannot create new money in the process of spending. Only the federal government is a currency issuer. We can say that the federal government is **monetarily sovereign**. State and local governments are not.

- Are taxes needed before spending?

  "Does that mean that, in least at theory, the Federal government could conduct spending *without* taxation? And if that's the case, why do we pay taxes?"

  The best way to answer that is to think of federal spending and taxation as *operationally distinct*. The Federal government does have to levy taxes -- but for reasons *not* directly connected to its spending.

  Taxation has several essential functions. According to British tax expert Richard Murphy (*The Joy of Tax: How a fair tax system can create a better society*), some of those functions are:

  - Taxation reclaims money the government has spent into the economy, thereby helping to prevent inflation and enabling government to carry out the public purpose.

    Take the case of World War II. Millions of people were earning good paychecks in defense industries. They had money to spend -- many for the first time after the years of the Great Depression. But, to support the war effort, the government had to limit production of consumer goods. Automobile production was shut down three months after Pearl Harbor. To avoid the situation of "too much money chasing too few goods," the government had to drain spending power from the economy. It did so by raising taxes and by encouraging sales of war bonds -- in effect, deferring consumer spending until after the war.

  - Taxation creates a demand for the currency in the first place. The federal government requires us to pay our taxes in dollars -- and those dollars originated with the federal government in the first place. For short, **taxation drives the currency**.

  - Taxation can redistribute income and wealth. That's what the *progressive* income tax is supposed to do. Granted, that redistribution can go either way. When U.S. law permits the President of the United States to pay less in income taxes than the undocumented immigrant workers who tend the grounds at his golf resorts, that is using the tax system to redistribute income and wealth the wrong way.

- Should we tax the rich?

  "Alright, I'm starting to understand this. But let me ask you about something I've read. I've read many people on the left side of the political spectrum -- people who would characterize themselves as 'progressives', 'leftists' or 'socialists', say, 'We need to tax the rich to pay for the Green New Deal (or to pay for Medicare for All'. What do you say to that?"

We should tax the rich because they're too damn rich -- not because we need those funds for the Green New Deal or Medicare for All.

As discussed earlier, both Democrats and Republicans in Washington have said that we can't have any new government programs because we just don't have the money -- unless we are willing to raise taxes. And "everyone (in Washington) agrees" that raising taxes is a bad thing. So in Washington they have self-imposed "PayGo" rules that say any new spending must be matched by a new source of revenue.

If we say, "We have to raise taxes on the rich *before* initiating a Green New Deal or as a *prerequisite* to Medicare-for-All, we're trapping ourselves in that PayGo mentality. We're accepting the elites' way of *framing* the issues. We're fighting on the enemies' turf.

So suppose we cannot get higher taxation on the rich through Congress. Does that mean that we have to stop our efforts on behalf of the Green New Deal or Medicare-for-All? It should not, provided that we understand that, in reality, as we saw in both World War II and the COVID-19 crisis, the federal government's spending decisions and federal taxation are also operationally distinct.

- What about real costs?

"But there will be real costs to the Green New Deal and Medicare-for-All, correct?"

Correct. The Federal government, being a currency issuer, never faces *financial* constraints on its ability to spend. A monetarily sovereign government can always create the money needed to purchase any labor, goods and services that are for sale in its currency.

What *really* constrains the Federal government -- or any other monetarily sovereign government -- is the **real resources** available for purchase in that currency.

Take the COVID-19 crisis, for example. Back in the spring of this year, we discovered that certain crucial medical supplies, ranging from sophisticated equipment like ventilators to mundane supplies like cotton swabs, were no longer being produced in the United States -- at least not in the quantities needed to respond to the pandemic. Why? Well, in pursuit of the cheapest labor they could find, U.S. manufacturers have for decades been moving production "offshore" to other countries. Fortunately, those countries are still willing to accept U.S. dollars in payment for those medical supplies. But what if we were a poor country in the global South that did not have any domestic production of those medical supplies? Would we have been able to obtain the dollars needed to purchase them on the world market?

Summary

Let's try to put this altogether.

We as progressives want to see the U.S. undertake programs like the Green New Deal and Medicare-for-All. They're the right thing to do. Indeed, we feel that they're the things we *must* do to continue living on this planet.

We know that as much as these programs are necessary, they are nonetheless big and disruptive -- and how could they not be? And in politics, it is often the case that a well-organized group of people who fear they will be affected adversely by disruptive change can stymie the will of the majority. So we need to prepare ourselves to respond to a wide variety of arguments from both proponents and opponents of our programs.

In particular, we need to be able to respond to arguments which are intended to shut down discussion of our programs before we even get started.

It has been our contention in this document that the Household Budget Analogy is one of those arguments. The Household Budget Analogy says that the federal government's budget works just like an individual family's budget. If an individual family "just doesn't have the money" to undertake spending, then it can't undertake the spending, no matter how necessary it might be. So too, goes the analogy, if the federal government "just doesn't have the money" to carry out a Green New Deal or implement Medicare-for-All, then we can't enact those programs -- even if our survival depends upon them.

As the video clip we showed earlier demonstrates, both Democratic and Republican politicians use the Household Budget Analogy to dismiss discussion of major initiatives like the Green New Deal and Medicare-for-All before those discussions even get started. Most of the time their motives for using the Household Budget Analogy are completely cynical. They don't want a real discussion of systemic change, so they throw obstacles in the path of that discussion. But even progressive politicians like Bernie Sanders will from time-to-time put forward slogans like "tax the rich to pay for Medicare-for-All" in which they mistakenly accept the enemy's framing of the issue, which is that new programs require new, higher taxes.

What we've seen is that in reality, the Federal government is not financially constrained in its spending. It's only constrained by the real resources needed to implement the public purpose. In reality, the United States has incredible amounts of untapped resources -- particularly human resources.