

On April 9th of this year, a group of 27 Democratic members of the House of Representatives known as the Blue Dog Coalition issued a call for an amendment to the U.S. Constitution mandating a balanced budget for the federal government.[1] The Blue Dogs' press release stated:

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

Congressman Correa of California, the Blue Dogs' Co-Chair for Communications, warned:

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

Utah Congressman Ben McAdams is the author of the Blue Dogs's balanced budget constitutional amendment proposal. In congressional testimony on March 9 of this year, he stated:

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

*“... [T]his is what hard-working Utah families do every day when they sit at the kitchen table and balance their checkbooks and we must do the same.”[2]*

The belief that the federal government's budget is the same type of thing as an individual household's budget is what we call the "Household Budget Analogy." The analogy goes like this:

- \* An individual household has to bring in income before it can engage in spending.
- \* So, too, must the federal government bring in income — mainly through taxation — before it can spend.
- \* An individual household has to 'live within its means'. Its income has to match or exceed its spending. Any excess of spending over income puts the household into debt. Persistent debts lead to bankruptcy.
- \* So, too, must the federal government follow the principles of 'sound finance'. If its spending exceeds its revenue, the national debt will grow and eventually lead to some combination of (i) inflation; (ii) refusal of people to buy government bonds; and (iii) bankruptcy.

- \* Hence, any new government spending must be preceded by identifying new revenue sources that will "pay for" that spending. Want Medicare-for-All? A Green New Deal? The first question to be asked is, "How you gonna pay for it?"

It's not just the Blue Dogs who believe in the Household Budget Analogy and who bow down to the virtue of the balanced budget. Proclaiming the virtue of the Balanced Budget is not held simply by a small wing of the House Democrats. It's been a bipartisan ritual for at least the past forty years. Let's go to the video.[3]

## **VIDEO**

We are here today to tell you that the Household Budget Analogy is incorrect. It's bad economics. It's bad public policy. The school of political economy known as Modern Monetary Theory helps us see why and helps point out a better way forward.

But before we go forward, let's go back — back in time to the 1940s, to the time of the Second World War. 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 the 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 didn't. Did anyone say, "We can't afford this war because we just don't have the money"? Ummm, no.

How did we pay for the war? Ultimately, the explanation boils down to this:

- \* The federal government had the authority to create money. Since starting to go off the gold standard in the 1930s, the dollar has been a fiat currency created by government spending into the economy. And that's what the government did during the war — big time!
- \* At the start of the war the economy had yet to fully recover from the Great Depression. There was still large-scale unemployment and unused industrial capacity. As that capacity became

converted to war production, civilian production of goods such as automobiles was halted.

- \* The wages of service members and defense workers constituted new spending power. That would have been severely inflationary, so the government drained that spending power from the economy through higher taxes — facilitated by the introduction of withholding — and through sales of war bonds. The government thereby reclaimed the money it had spent into the economy.

This led economist Abba Lerner to formulate his theory of Functional Finance. The level of federal spending and taxation should be set, not at a balanced budget equality to satisfy the dogma of "sound finance," but at a level that fully utilizes the labor and real resources available for purchase in the currency the government was issuing.

Let's fast-forward forty years to the 1980s. A political dynamic developed in which the Republicans would accuse the Democrats of being the party of "Tax and Spend". The Democrats would get defensive, try to 'out-fiscally-responsible' the Republicans and join calls for balanced budgets,

perhaps to be enforced by constitutional amendment. When Democrats occupied the White House, Republicans would weaponize calls for balanced budgets against the Democrats. When Republicans occupied the White House, their calls for balanced budgets would quickly ebb in volume.

The result was that over time the Democrats came to be fighting with one hand tied behind their backs. Believing that they must always show themselves to be 'fiscally responsible,' they bound themselves by agreeing to "PAYGO rules" which require new spending to be matched by new tax revenues or spending cuts. So when we say we want Medicare-for-All or the Green New Deal, the first response of most Democrats in Congress — not just the Blue Dogs, but Nancy Pelosi, Chuck Schumer and even many of the Progressive Caucus is to say, "How you gonna pay for that? We can't do that because that will send the deficit sky-high!"

In contrast, Modern Monetary Theory argues that the fact that the U.S. government is the monopoly issuer of dollars gives us much larger fiscal space to spend on the public purpose — and tax for the public purpose as well. MMT broadens our political discourse. The conversation does not

have to stop at “How you gonna pay for it?” We can consider policy recommendations such as the Job Guarantee. As MMT leader Bill Mitchell put it just two weeks ago:

*"What an understanding of MMT would generate is a new awareness among the voting public which would force the political elites (of any persuasion) to construct the political narrative in a more open way, stripped of the lies derived from an application of sound finance." [4]*

Thank you very much.

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## References

- [1] <https://bluedogcaucus-costa.house.gov/media-center/press-releases/blue-dogs-endorse-rep-mcadams-balanced-budget-amendment>
- [2] <https://bluedogcaucus-costa.house.gov/media-center/press-releases/icymi-blue-dog-task-force-on-fiscal-responsibility-government-reform>
- [3] <https://www.youtube.com/watch?v=Q1SMjeuyF-Y&t=2986s>; start at 4:26; end at 6:30. Created by a student of Stephanie Kelton.
- [4] <http://bilbo.economicoutlook.net/blog/?p=42170>. Apr 23 2019