

# 11

## Towards a Spatial Keynesian Economics

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### 11.1 Introduction

What would a Post Keynesian economist see as being the appropriate macroeconomic policy goals of the state? If we polled macroeconomists of all ideological persuasions, and asked them to outline the major macroeconomic policy objectives then the following consensus would probably emerge: (a) full employment; (b) price stability; (c) a robustly sustainable rate of economic growth; and (d) maintaining an equilibrium balance of payments. While these goals are so general that they lack clarity and are regularly used by different economists in ways that do not permit meaningful dialogue, we can use them to motivate our discussion.

In this chapter we support (a) and (b) but contest (c) and (d). We argue that many Post Keynesians have been seduced by orthodox conceptions of a market-based capitalism with commodity currencies and as a consequence have accepted propositions that have no application in a fiat-currency monetary capitalism. Section 11.2 outlines our conception of the desirable macroeconomic policy aims for a progressive government based on the power the state enjoys in a modern monetary economy. Section 11.3 argues that the possibilities available to the state with fiat currency are typically misunderstood by both neoclassical supply-siders and many Post Keynesians alike. A 'progressive' policy approach must use this power to create employment buffer stocks to achieve price stability rather than using unemployment buffers (as in the 'NAIRU' approach).

An employment buffer stock approach defines full employment in terms of the provision of a certain number of jobs specified in terms of hours worked (to match the preferences of the willing labour force), some of which will be delivered via an unconditional (and infinite) fixed-wage offer of state employment to anyone who wishes to take advantage of the offer. While this offer constitutes the minimum state intervention required, further public infrastructure investment or public service employment strategies can be introduced.

We also consider the 'deficit-dove' approach to fiscal policy, which underpins much of Post Keynesian macroeconomics, to be untenable and unjustified. Moreover, much of the 'open economy' analysis, which is also accepted by many Post Keynesians, has no application in the 'modern money' paradigm.

In section 11.4, the argument is extended to justify a Spatial Keynesian approach to macroeconomic analysis (Mitchell and Carlson, 2005), albeit departing from the conventional Keynesian regional policy approach that dominated the early postwar period. Concluding remarks follow.

### 11.2 Goals of macroeconomic policy

#### 11.2.1 Full employment

What do we mean by full employment? We define full employment in terms of a number of jobs rather than a rate of unemployment relative to the inflation rate. Following the Second World War, the problem that had to be addressed by governments was how to translate the full employed war economy with extensive civil controls into a fully employed peacetime model.

The first major statement addressing this problem came in Beveridge's (1944) *Full Employment in a Free Society*. Consistent with the emerging Keynesian orthodoxy, unemployment was constructed as a systemic failure to provide enough jobs and the focus moved away from the personal characteristics of the unemployed and prevailing wage levels. Full employment was defined as an excess of vacancies at living wages over unemployed persons. Beveridge (1944: 123–35) said: 'The ultimate responsibility for seeing that outlay as a whole, taking public and private outlay together, is sufficient to set up a demand for all the labour seeking employment, must be taken by the State.' The emphasis was on jobs. Inflation control was not a major issue although most governments listed it as a policy target.

#### 11.2.2 Price stability

In the 1950s, economists focused on the irreducible minimum rate of unemployment (see Bancroft, 1950; Dunlop, 1950), which soon gave way to the unemployment and inflation trade-off debate. Full employment as a sufficiency of jobs was further undermined by the expectations-augmented Phillips curve of Friedman (1968) and Phelps (1967), which spearheaded the resurgence of pre-Keynesian macroeconomics. Friedman's (1968: 60) Natural Rate Hypothesis (NRH) alleged there was 'no long-run, stable trade-off between inflation and unemployment'. Full employment prevailed with a natural rate of unemployment unless there were errors in interpreting price signals. This left little or no room for discretionary management of aggregate demand. A related concept emerged – the non-accelerating inflation rate of unemployment (NAIRU) (Modigliani and Papademos, 1975). In practical



terms the two concepts equally undermine the pursuit of full employment defined as a sufficiency of jobs.

Various theoretical structures can support the conclusion that unemployment above a certain level will be associated with declining rates of inflation. It can arise within simple excess demand models, as in Modigliani and Papademos (1975), or in Marxist-inspired conflict-theory models of inflation (Rowthorn, 1977). In either case there is some (cyclically-invariant) unemployment rate at which price inflation stabilizes (see Mitchell, 1987 for discussion of the cyclical invariance assumption). With the NAIRU concept (or its Marxist equivalent) dominant, full employment as initially conceived was abandoned.

### 11.2.3 Importance of social settlements

Defining full employment in terms of an adequacy of employment opportunities invokes a spatial dimension if we introduce another policy priority – the sustainability of social settlements. It seems reasonable that Post Keynesians would place more emphasis on the importance of local communities as the building blocks of society than their neoclassical counterparts, who privilege notions of comparative and competitive advantage. The resilience and richness of communities, which in turn is predicated on the depth and strength of social networks, should be an intrinsic design element in a spatially-oriented macroeconomic policy whose aims extend beyond a concern with aggregate outcomes. An approach of this kind departs markedly from the pursuits of those who would merely supplement the Schumpeterian Post-National Workfare State (SPWS) with policies to promote 'social capital' (see Fine, 2001).

Motivation is provided by evidence that differentials in regional employment growth rates and regional unemployment rates have persisted in most countries since the early 1990s. In Australia, for example, despite relatively robust economic growth since the 1991 recession, which might have promoted convergence in regional labour market outcomes, spatial disparities in unemployment and employment growth have widened (see Mitchell and Bill, 2005).

Geographers such as Jessop (1999) chart the development of the SPWS in advanced industrial economies driven by transformations in production technology and neo-liberal political strategies. The characteristics of these developments include a 'hollowing-out' of the national state in favour of regional devolution and supranational political forms (for example, NAFTA and the EU), the development of new forms of governmentality (facilitative, catalytic, involving partnerships with NGOs and private sector agencies), and a displacement of Keynesian welfare states with systems promoting international competitive advantage, often at the expense of declining 'old industrial areas'.

Keynesians typically argue that regional employment varies with the changing distribution of industries across space and that the impact of aggregate factors is largely uniform within those industries (see Arestis and Sawyer, 2004). However, even after controlling for industry composition, low growth regions experience stagnant labour conditions and negative shocks endure for a long time (see Mitchell and Bill, 2005). Neoclassical explanations for poor rates of convergence in regional outcomes tend to focus on wage differentials, low labour mobility and related structural impediments. Mitchell and Bill (2005) refute these claims and demonstrate that employment growth differentials and regional job accessibility strongly determine the health of regional labour markets.

There is strong evidence from various countries suggesting that low rates of job accessibility combine with patterns of local interactions (Durlauf, 2003) to isolate the long-term joblessness. In this regard, the emerging literature on social interaction and dependence among economic agents (Glaeser *et al.*, 1996; Jensen *et al.*, 2003) and spatial spillovers (Anselin, 2003) is relevant to Post Keynesians who want to design full employment strategies (Mitchell and Bill, 2005). These effects are compounded by agglomeration effects within industrial districts, which seem to be driven by 'local information spillovers' (Topa, 2001) and capital accumulation processes (Audretsch and Feldman, 1996). Regional spillovers are most likely to exist in regions tightly linked by interregional migration, commuting and trade (Niehuhr, 2001). These spillover effects ensure that local shocks spread to neighbouring regions (Molho, 1995). Topa (2001) argues that neighbourhood stratification and widening inequalities accompany these endogenous spatial dependencies.

### 11.2.4 Environmental sustainability

Full employment and the continuity and health of the social settlement are necessary conditions for achieving economic and social sustainability, which is the overarching aim. However, they are not sufficient conditions. Without a balance being achieved between these elements and the natural (physical) environment, the macroeconomic situation is unsustainable. Thus, a forward-looking Post Keynesian macroeconomics requires economic activity to be in balance with the natural environment. There are two aspects of this concept of 'sustainability' that are relevant to macroeconomic policy design: (i) the level of production (and consumption) must be consistent with the demands of the physical environment; and (ii) locally- or community-based production should be encouraged.

## 11.3 The role of the state in Post Keynesian macroeconomics

### 11.3.1 Mediation between competing classes

In the context of the policy goals outlined in section 11.2, we construct the state as providing mediation between conflicting classes – workers and



capitalists – and thus firmly situate our understanding of the dynamics of power in the modern monetary system within the authority relationships (classes) defined by property ownership. The two sides of property ownership (owning or not) generate specific and conflicting ‘class interests’ and the structure of political relations emerges from this conflict. The fiscal power of the state is to be seen within this context. The non-government sector in general requires an operative fiscal presence of the type we describe below.

### 11.3.2 Government as issuer of fiat currency and sectoral balances

This section summarizes the recent work of Mitchell and Mosler (2002, 2006) (see also Mitchell, 1998; Wray, 1998). Modern monetary economies use fiat currencies with flexible exchange rates. The currency is the only unit acceptable for payment of taxes and other financial demands by the government. The currency supply monopoly presents the government with options it would not otherwise have under alternative currency arrangements.

Figure 11.1 sketches the essential structural relations between government and non-government. First, Treasury and Central Bank operations are combined because ‘within government’ transactions are of no importance to understanding the ‘vertical’ relationship between government and non-government. Secondly, the private domestic and foreign sectors are consolidated as non-government with no loss of analytical insight.

Basic national income accounting indicates that the government deficit (surplus) equals the non-government surplus (deficit). Cumulative government deficit spending is required in order for the non-government sector to accumulate aggregate net savings of financial assets. Net government spending is required to accommodate any net desire to save by the non-government sector. Recognising that currency plus reserves (the monetary base) plus outstanding government securities constitutes net financial assets of the non-government sector, the fact that non-government is dependent upon the government to provide funds for both its desired net savings and payment of taxes to the government becomes a matter of accounting.

Government surpluses have two negative effects for the private sector: (a) they reduce private disposable income; and (b) they reduce the private holdings of financial assets (money or bonds). The decreasing levels of net savings ‘financing’ the government surplus increasingly leverage the private sector and the deteriorating debt to income ratios eventually see the system succumb to ongoing demand-draining fiscal drag through a slowdown in real activity.

### 11.3.3 Vertical and horizontal relationships in a monetary economy

The government is never inherently revenue-constrained. Government typically spends by crediting private bank accounts at the central bank.

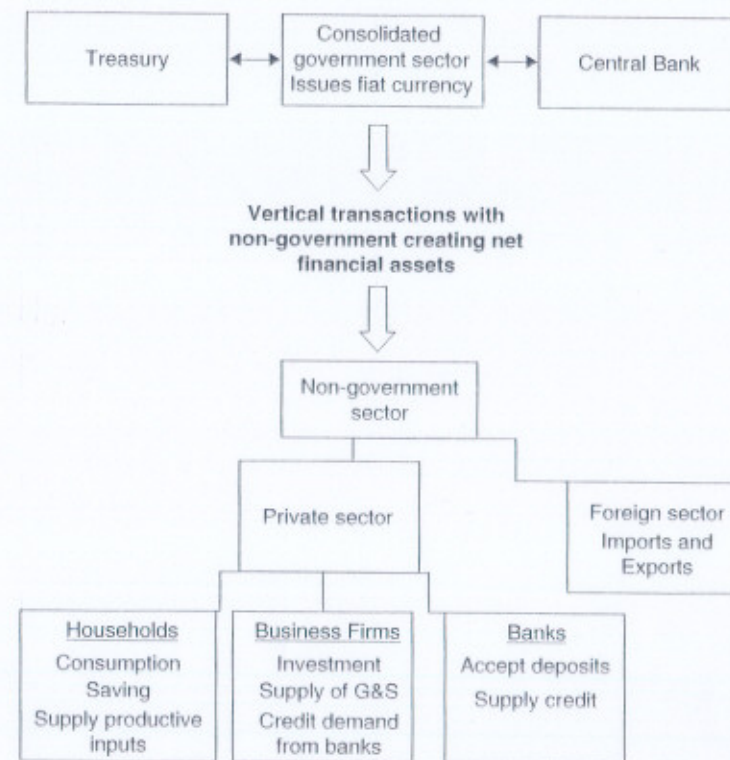


Figure 11.1 Government and non-government structure

Operationally, this process is independent of any prior revenue. Such ‘spending’ does not diminish any government asset or government’s ability to spend further. Alternatively, when taxation is paid by private sector cheques (or bank transfers) that are drawn on private accounts in member banks, the central bank debits a private sector bank account. No real resources are transferred to government and its ability to spend is independent of the debiting of private bank accounts.

Figure 11.2 provides the juxtaposition between vertical and horizontal relationships in the economy. Vertical arrows depict transactions between government and non-government and horizontal arrows depict transactions between agents within the non-government sector. The government impacts on the stock of accumulated financial assets in the non-government sector and their composition. The government deficit (treasury operation) determines the cumulative stock of financial assets in the private sector. Central bank decisions then determine the composition of this stock in terms of



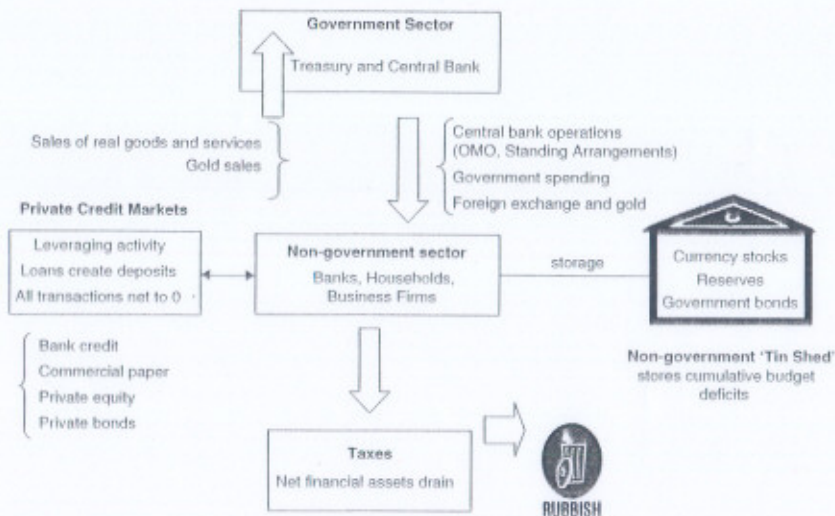


Figure 11.2 Vertical and horizontal macroeconomic relations

notes and coins (cash), bank reserves (clearing balances) and government bonds.

Taxes lie at the bottom of the 'exogenous vertical chain' (and are 'scrapped') as they reduce balances in private bank accounts. The government doesn't 'get anything' – the reductions are accounted for but 'go nowhere'. The concept of a fiat-issuing government 'saving' in its own currency is nonsensical. It is erroneous to think that when governments run surpluses the funds are stored and can be 'spent' in the future.

The private credit markets represent relationships (depicted by horizontal arrows) and 'house' credit leveraging activity by commercial banks, business firms, and households (including foreigners), which Post Keynesians term endogenous circuits of money. But, crucially, horizontal transactions do not create net financial assets – all assets created are matched by a liability of equivalent magnitude and net to zero.

Figure 11.2 also shows the 'Non-government Tin Shed' which stores fiat currency stocks, bank reserves and government bonds which reflect cumulative budget deficits. Following our earlier discussion, any payment flows from government to non-government that do not 'finance' the taxation liabilities remain in the non-government sector as cash, reserves or bonds. The private leveraging activity, which nets to zero, is not an 'operative' part of 'Tin Shed' stores of currency, reserves or government bonds. The commercial banks do not need reserves to generate credit, contrary to standard textbook representation.

### 11.3.4 The flawed government budget constraint framework

Mainstream macroeconomics errs by blurring the differences between household budgets and the government budget. This errant analogy is advanced by the government budget constraint (GBC) framework that is a standard exposition in most macroeconomics textbooks. While the GBC is just an *ex post* accounting identity, mainstream economists consider it an *ex ante* financial constraint on government spending.

The GBC leads us to believe that unless government wants to 'print money' and cause inflation it has to raise taxes or sell bonds to get 'money' in order to spend. But households use the currency and must finance their spending, *ex ante*, whereas government issues the currency and necessarily spends first before it can subsequently debit private accounts, should it so desire.

### 11.3.5 Government debt sets interest rate

The GBC myth is expressed in erroneous discussion about 'debt monetization' that frequently dominates the policy chapters in macroeconomic textbooks. Debt monetization allegedly occurs when the central bank buys government bonds directly from the treasury. In return, the central bank 'prints money' to facilitate government spending and inevitably leads to inflation. So, logically, the government sells bonds to the public to 'finance' net spending. In reality the central bank has no option but to 'monetize' any outstanding or newly issued federal debt. As long it desires to maintain a target short-term interest rate, the size of its purchases and sales of government debt are not discretionary.

The central bank administers the risk-free interest rate and is not subject to direct market forces. While the funds that the government spends do not 'come from' anywhere and taxes collected do not 'go anywhere', there are substantial liquidity impacts from net government positions. Government spending and central bank purchases of government securities add liquidity and taxation and sales of government securities drain liquidity. These transactions influence the daily cash position of the system which on any one day can be in surplus or deficit. The system cash position bears on the central bank's ability to maintain their desired interest rate and influences its use of open market operations.

Fiscal deficits result in system-wide cash surpluses, after spending and portfolio adjustments have occurred. When commercial banks try to loan these excess funds, downward pressure is put on the cash rate. Exchanges between commercial clearing accounts do not change the system-wide position. So the central bank must 'drain' the surplus liquidity by selling government debt to maintain control over the interest rate.

The central bank's lack of control over reserves underscores the impossibility of debt monetization. If the central bank purchased securities directly from the treasury which then spent the money, its spending would manifest



as excess bank reserves. The central bank would be forced to sell an equal amount of securities to support the target interest rate. The central bank would act only as an intermediary between treasury and the public. No monetization would occur. So government debt functions as interest rate support and not as a source of funds.

Within this framework we can also see why financial crowding-out, inherent in standard IS-LM analysis used by many Post Keynesians, is impossible. In an accounting sense, the 'money' that is used to buy bonds (that is regarded as 'financing government spending') is the same 'money' (in aggregate) that government spent. Nugent (2003) says that 'in other words, deficit spending creates the new funds to buy the newly issued securities'. So government securities function to 'offset operating factors that add reserves', the largest 'operating factor' being net spending by treasury. In this sense, the purchase (or sale) of bonds by (to) non-government alter the distribution of assets in the 'Tin Shed'.

Thus it is nonsensical to think that government spending rations finite 'savings' which could alternatively finance private investment. Nugent (2003) says 'that in Japan, with the highest public debt ever recorded, and repeated downgrades, the Japanese government issues treasury bills at .0001%! If deficits really caused high interest rates, Japan would have shut down long ago!'

What if the government sold no securities? The 'penalty' for the government that doesn't pay interest on reserves would be a Japan-like zero interest rate rather than their target cash rate. If a default support rate is paid, the interest rate would converge on that support rate. Any economic ramifications (like inflation or currency depreciation) would be due to lower interest rates rather than any notion of monetization.

Ultimately, private agents may refuse to hold any more cash or bonds. The private sector at the micro level can only dispense with unwanted cash balances in the absence of government paper by increasing their consumption levels. Given the current tax structure, this reduced desire to net save would generate a private expansion and reduce the deficit, eventually restoring the portfolio balance at higher private employment levels with lower required budget deficits. Whether this generates inflation depends upon the ability of the economy to expand real output to meet rising nominal demand. The size of the budget deficit doesn't compromise that and the government would have no desire to expand the economy beyond its real limit.

#### 11.3.6 State money implies possibility of unemployment

If government spending is not revenue-constrained, then what function is served by taxation? Taxation promotes offers from private individuals to government of goods and services in return for the necessary funds to extinguish the tax liabilities. So taxes create unemployment (people seeking paid work) in the non-government sector and allow a transfer of real goods and services

from that sector to the government sector, to facilitate its economic and social programmes. Government spending provides the funds necessary to pay the tax liabilities and thus provides the paid work which eliminates the unemployment created by the taxes.

Thus, it is the introduction of 'State Money' (government taxing and spending) into a non-monetary economics that raises the spectre of involuntary unemployment. As a matter of accounting, for aggregate output to be sold, total spending must equal total income. Involuntary unemployment is idle labour offered for sale with no buyers at current prices (wages). Unemployment occurs when the private sector, in aggregate, desires to earn the monetary unit of account, but doesn't desire to spend all it earns, and net government spending is insufficient to accommodate the tax liabilities and the private desire to net save.

As a result, involuntary inventory accumulation among sellers of goods and services translates into decreased output and employment. In this situation, nominal (or real) wage cuts *per se* do not clear the labour market, unless those cuts somehow eliminate the private sector desire to net save, and thereby increase spending. The basis of demand-deficient unemployment is at all times inadequate net government spending, given the private spending decisions in force at any particular time.

Post Keynesians appear united in the contention that unemployment reflects a systemic failure in aggregate demand. Post Keynesians also concur that government intervention is required to close the spending gap. Significant differences emerge, however, when we get down to the detail of how the government should close that gap and what supporting mechanisms are required to sustain full employment. There are two broad approaches: (a) generalized expansion predominantly driven by investment together with mechanisms whereby individual nations can manage structural imbalances between trading nations; and (b) spatially-targeted expansion with buffer employment stocks. Section 11.4 compares and contrasts these approaches.

#### 11.3.7 Opposition to Chartalist macroeconomics

There are two camps in economics that oppose our conception of macroeconomic analysis: (i) the orthodox monetarists/rational expectations/new classical schools which eschew government debt and advocate balanced or surplus budgets. Their wrong-minded logic has imposed extremely high macroeconomic costs in terms of lost growth and high unemployment since the mid-1970s; and (ii) the progressive 'deficit-doves' (for example, Glynn, 1997) who correctly believe that federal net spending stimulates employment, but fail to understand the essentials of modern money. They erroneously consider that net spending is 'financed' by debt-issuance and then construct the viability of any particular fiscal stance through a comparison between the respective levels of national debt and national wealth.



They also decompose deficit into structural and cyclical components, believing this to be a meaningful distinction (Eisner, 1989). They tend to propose balanced budgets over the business cycle rather than on a year-to-year basis (Glynn, 1997). This argument is often supported by the fallacious household/business analogy that justifies growth in debt in terms of asset building which underpins future rates of return. Many Post Keynesians fall prey to this logic (for example, Palley, 1996). While comfortable with using deficit spending to increase economic activity, they adopt a conservative logic bounded by stable movements in the debt to GDP ratio (see Bispham, 1988; Glynn, 1997). However, Glynn (1997: 226–7) claims that ‘financial markets, the ultimate arbiters of such matters, may look simply at the size of the deficit... [and that]... given the experience of the past twenty years it would be difficult to convince that increased deficits at the beginning of the expansionary programme would be rapidly scaled down as the private sector took up the main thrust of expansion. There seems little alternative to financing through taxation most of an expansionary programme’. Further, Glynn (1997: 224) says ‘it is misleading to treat them (interest rates) as entirely exogenous. It is likely that beyond a certain level, a higher deficit will lead financial markets to exact a higher real-interest rate.’

In terms of our previous analysis, it is clear that the two camps, whatever their differences on the role of government in relation to creating full employment, fail at the most fundamental level to understand the macroeconomics of a modern monetary economy. They fail to understand the priority of government spending and misconstrue the role of debt issuance as interest rate maintenance.

## 11.4 Current ‘progressive’ approaches to unemployment

### 11.4.1 Introduction

All Post Keynesians agree that the orthodox unemployment buffer stock approach (NAIRU) to inflation control is costly and unacceptable. The neo-liberal solution to the resulting unemployment is to pursue supply-side policies (labour market deregulation, welfare state retrenchment, privatization, and public–private partnerships) to give the economy ‘room’ to expand without cost pressures emerging. Post Keynesians, in general, reject this strategy because the sacrifice ratios are high and the distributional implications (the creation of an underclass and working poor and the loss of essential services) are unsavoury.

However, there is no alternative consensus. Some Post Keynesians, closely following the policy recommendations of Keynes himself, advocate what we will term ‘generalized expansion’, where the government ensures that spending is sufficient to purchase all available output. In essence, this policy purchases at market prices or provides incentives to profit-seekers to create

private employment expansion. Typically, public and private capital formation is targeted. This strategy ignores the role for a buffer employment stock policy, which allows the government to guarantee full employment using automatic stabilizers by purchasing at fixed prices. The buffer stock approach also distributes jobs across geographic space thus underpinning a regional safety net.

### 11.4.2 Generalized expansion

Typically, Post Keynesians advocate generalized fiscal and monetary expansion mediated by incomes policy and controlled investment as a solution to unemployment (Ramsay, 2002–3; Seccareccia, 1999; Kadmos and O’Hara, 2000; Sawyer, 2003, 2005). Davidson (1994: 79), representing the mainstream Post Keynesian approach, writes ‘Government fiscal policy is conceived as the balancing wheel, exogenously increasing aggregate demand whenever private sector spending falls short of a full employment level of effective demand and reducing demand if aggregate demand exceeds the full employment level.’

However, (indiscriminate) expansion in isolation is unlikely to lead to employment opportunities for the most disadvantaged members of society and does not incorporate an explicit counter-inflation mechanism. It also fails to address the spatial labour market disparities. Arestis and Sawyer (2004: 11, 18) argue correctly that ‘the industrial structure of a region and... variations in productive capacity as well as in aggregate demand of the region... [drive these disparities and conclude]... in terms of policy implications, appropriate demand policies are required to stimulate investment and underpin full employment.’ But how can we be sure that the investment will provide jobs in failing regions? Upon what basis are the most disadvantaged workers with skills that are unlikely to match those required by new technologies going to be included in the ‘generalized expansion’? Where is the inflation anchor?

### 11.4.3 Buffer employment stocks and spatial Keynesianism

The state can resolve demand gaps which cause unemployment in two distinct ways: (i) by increasing net spending via purchasing goods and services and/or labour at market prices as explained in the previous sub-section; and/or (ii) by using its currency issuance power to provide a fixed-wage job to all those who are unable to find a job elsewhere. This employment buffer stock approach is termed the Job Guarantee (JG) (see Mitchell, 1998; Wray, 1998). The JG is an effective strategy for a fiat-currency issuing government to pursue to ensure that work is available at a liveable wage to all who wish to work but who cannot find market sector employment (including in the regular public sector). The government would become ‘an employer of last resort’ and provide a buffer stock of jobs that are available upon demand.



The JG differs from a Keynesian expansion because it represents the minimum stimulus (the cost of hiring unemployed workers) required to achieve full employment rather than relying on market spending and multipliers. The JG also provides an inherent inflation anchor missing in the generalized Keynesian approach (Mitchell, 1998). Clearly, and emphatically, a mixture of (i) and (ii) is likely to be optimal although (i) alone is not preferred.

The JG is juxtaposed with the NAIRU approach which accompanied a regime shift in macroeconomic policy in the 1970s. The NAIRU approach is exemplified by tight monetary policy that targets low inflation, using unemployment as a policy tool rather than a target. The countries that avoided high unemployment in the 1970s maintained a 'sector... which effectively functions as an employer of last resort, which absorbs the shocks which occur from time to time, and more generally makes employment available to the less skilled, the less qualified' (Ormerod, 1994: 203).

The JG absorbs and hence minimizes the real costs of private sector demand swings. When private employment declines (expands), the JG pool automatically increases (decreases) and full employment is retained. The JG wage rate set at minimum award levels does not interfere with the private wage structure.

Kadmos and O'Hara (2000: 10-12) criticize the focus on government consumption of low-skilled services by JG advocates. They claim the leading sectors rely on information, knowledge, communications and networking. They advocate a boost to public infrastructure investment which enhances the profitability of private sector investment, in addition to contributing to aggregate demand and employment. Clearly, if a political will exists to construct public infrastructure then employment levels will rise subject to real resource availability. This is independent of the need for a JG. Yet, the JG should be accompanied by social wage spending to increase employment in education, health care and the like (Mitchell, 1988). But sole reliance on public sector investment to achieve full employment would create considerable economic inflexibility. The ebb and flow of the private sector would not be readily accommodated and an increasing likelihood of inflation would result (Forstater, 2000).

Crucially, public investment is unlikely to benefit the most disadvantaged workers in the economy. The JG is explicitly designed to provide opportunities for them. By way of example, during the golden age in Australia (1945-75), when public capital formation and social wage expenditure was strong, full employment was only achieved because the public sector (implicitly) provided a JG for low-skilled workers. This experience is shared across all advanced economies. Further, the JG does not replace social security payments to persons unable to work because of illness, disability, or parenting and caring responsibilities.

Kadmos and O'Hara (2000) and Seccareccia (1999) also claim that the low-wage service JG employment produces skills which are of little benefit to the

private sector (also Sawyer, 2003). Kadmos and O'Hara (2000) allege that in a tightening labour market with structural unemployment, firms drive up wages to retain skilled staff, thereby maintaining unemployment in the context of wage/wage inflation. But structural unemployment is itself a loaded term because it ignores the fact that firms adjust hiring standards across the business cycle and offer training slots as part of their recruitment strategies when labour markets tighten (Thurow, 1976). Certain individuals are excluded from job/training offers by discriminating firms because they are deemed to possess 'undesirable' personal characteristics although discrimination reduces as activity increases. But progressives should question why these discriminative practices occur rather than perpetuating the idea that there are 'structural' labour market impediments.

The JG redresses this discrimination that many wrongly label as structural unemployment. Further, via regionally-based job creation programmes, the JG can also productively employ all workers who cannot find a private employer. The JG also does not preclude training initiatives (see Mitchell, 1988). Appropriately structured training within a paid employment context helps overcome the 'churning' of unemployed through training programmes, workfare and other schemes under current neo-liberal policies. Specific skills are usually more efficiently taught on the job.

The JG is thus designed to ensure that the lowest-skilled and least experienced workers are able to find employment. The JG is a full employment policy and should be judged on those terms. It does not presume that JG jobs will suit all skills. For some skilled workers who become unemployed in a downturn the income loss implied would be significant. Yet Seccareccia (1999) acknowledges that a fully employed economy with the JG workers paid minimum wages represents a Pareto improvement, when compared to the current unemployment.

But Seccareccia (1999) also argues that in a low-wage regime, government employers may choose to replace some current public sector employees with those paid at the minimum wage, thereby reducing their costs of employment. These cost-minimizing strategies are not specific to a JG implementation and are available to most employers.

While environmental constraints militate against generalized Keynesian expansion, JG proponents emphasize the regional dispersion of unemployment. Higher output levels are required to increase employment, but the composition of output remains a pivotal policy issue. JG jobs would be designed to support local community development and advance environmental sustainability. JG workers could participate in many community-based, socially beneficial activities that have intergenerational payoffs, including urban renewal projects, community and personal care, and environmental schemes such as reforestation, sand dune stabilization, and river valley and erosion control. Most of this labour-intensive work requires very little capital equipment and training (Mitchell, 1988). We denote this form



of spatially targeted employment policy as Spatial Keynesianism, in contrast to the bluntness of orthodox Keynesian tools which fail to account for the spatial distribution of social disadvantage.

#### 11.4.4 Balance of payments constraints

Some Post Keynesian economists focus on alleged 'stop-go' constraints on growth emerging from current account constraints (Davidson, 1994). The alleged constraint is often used to justify contractionary policies. This made sense under fixed exchange rates because the current account influenced central bank reserves and made domestic expansion dependent on the defence of the external parity. Under floating exchange rates the constraint is not binding and domestic policy can pursue full employment targets, leaving the exchange rate to absorb any adjustment. In claiming that flexible exchange rates are a 'liberal notion', Ramsay (2002-3: 275) demonstrates his misunderstanding of the options facing a government in a fiat currency economy, which are difficult to construct as being liberal. The neo-liberal practice denial of these options has resulted in persistent unemployment.

Given the monetary perspective in section 11.3, there are strong grounds for doubting the relevance of Post Keynesian and Post Kaleckian analysis to a floating exchange rate world. In effect, the analysis indirectly ratifies the erroneous notion of government-budget constraints, through the medium of the external constraint (Dow, 1988). Regional policy interventions are then privileged to the extent that they alleviate rather than aggravate this external constraint, which requires the promotion of extra-regional export activity (McCombie and Richardson, 1987).

We would argue that under flexible exchange rates these 'sustainability' concerns are no longer applicable. Balance of payments considerations should not be allowed to get in the way of deficit spending to achieve full employment. A current account deficit merely indicates that foreigners desire to accumulate financial assets denominated in the domestic currency and are willing to ship more real goods and services (in aggregate) than they receive in return to accomplish this desire. Exports represent a real cost to any domestic economy and are therefore not in themselves virtuous. While the desires of the foreign sector may change over time a fiat-issuing sovereign government should not determine its net spending decisions (aimed at maintaining full employment) with reference to any particular foreign balance.

#### 11.4.5 New regionalist supply-siders

The persistently high unemployment rates observed since the mid-1970s in many OECD countries has motivated 'solutions' that purport to steer a course between the 'extremes' of Keynesianism and neo-liberalism. These so-called progressive Third Way movements include new ideas about space which attract the label of New Regionalism (NR). While NR has appealed to many progressive economists, its characterization of unemployment, albeit

somewhat blurred, is hard to distinguish from the NAIRU approach (Lovering, 1999; Peck, 2001; Cook, Dodds and Mitchell (CDM), 2003). NR has adopted the individualistic and market-based constructs inherent in neo-liberalism, and rendered unemployment as an individual problem – the ultimate 'privatization'. NR proposes a series of 'solutions' or separate policy agendas that build on these individualistic explanations for unemployment and accepts the litany of myths used to justify the damaging macroeconomic policy stances now common in OECD countries. By failing to ask the correct questions, these 'solutions' then appear, on first blush, to have (undeserved) plausibility.

NR emerged in the mid-1980s and was driven largely by case studies documenting economic successes in California (Silicon Valley) and some European regions (such as Baden Württemberg and Emilia Romagna). Lovering (1999: 380) says that NR consists of a series of ideas comprising: '(1) the historico-empirical claim that "the region" is becoming the "crucible" of economic development; and (2) the normative bias that "the region" should be the prime focus of economic policy'. Scott and Storper (1989) argued that regions have displaced nation-states as sites of successful economic organization, allegedly, because of changing technological and organization dimensions of production and the downfall of 'Fordism' as a production mode (Storper, 1995). Following the deindustrialization of many regions (the decline of Fordism in NR jargon), 'many small firms began to adopt a system of flexible specialization as a means of dealing with the uncertainty engendered by the fragmentation of formerly secure and stable mass markets' (Danson, 2000: 857).

NR advocates argue that regional spaces provide the best platform to achieve flexible economies of scope that are required to adjust to increasingly unstable markets. These socio-spatial processes involve localized knowledge creation, the rise of inter-firm (rather than intra-firm) relationships, collaborative value-adding chains, the development of highly supportive localized institutions and training of highly skilled labour (Lovering, 1999; Ohmae, 1995). These dynamics require firms to locate in clusters, often grouped by new associational typologies (for example, the use of creative talent or untraded flows of tacit knowledge) rather than by a traditional economic sector such as steel. The new post-Fordist production modes emphasize new knowledge-intensive activities encouraging local participative systems (Sassen, 1994). By achieving critical mass of local collaborators, a region could be dynamic and globally competitive (Castells, 1997; Cooke and Morgan, 1998).

Most of these claims are based on induction of regional 'successes' without regard for the specific cultural or institutional contexts, and lack any coherent unifying theoretical underpinning. Lovering (1999: 384) concludes that NR is 'a set of stories about how *parts* of the regional economy *might* work, placed next to a set of policy ideas which *might* just be useful in *some* cases'.



It is also doubtful whether some of the examples used to advance NR actually represent 'proof' of NR claims. For example, Staber (1996) argues that Baden Württemberg does not fit the NR model; Markusen (1996) criticizes the applicability of the term to Silicon Valley; and Jones and MacLeod (2002) and Lovering (1999) challenge empirical claims concerning UK regions. As an example, Lovering (1999: 382) cautions

If one factor has to be singled out as the key influence on Wales' recent economic development... it is not foreign investment, the new-found flexibility of the labour force, the development of clusters and networks of interdependencies or any of the other features so often seized upon as an indication that the Welsh economy has successfully 'globalized'. Something else has been at work which is more important than any of these, and it is something which is almost entirely ignored in New Regionalist thought... It is the national (British) state.

While many criticisms can be levelled at NR, its major weakness is that it perpetuates the notion that regions can entirely escape the vicissitudes of the national business cycle through reliance on a combination of foreign direct investment and export revenue. It thus supports neo-liberal claims that fiscal and monetary policy is impotent and, in turn, it constructs mass unemployment as an individual phenomenon. While highlighting local initiative (for example, Henton *et al.*, 1997), NR fails to understand that in a constrained macro-economy the scale of job creation required dwarfs the capacity of local schemes. NR thus fails to develop a full employment policy framework (Ohmae, 1995; Danson, 2000; CDM, 2001; Lovering, 1999). By ignoring the fact that mass unemployment demonstrated the unwillingness of the central government to spend sufficient amounts of currency given the non-government sector's propensity to save, the neo-liberal position is left unchallenged and is actually reinforced and a new style of Say's Law emerges with claims that post-Fordist economies need to focus on 'supply-side architectures'.

### 11.5 Conclusion

The Chartalist perspective on the monetary system is adopted here as the basis of a Spatial Keynesian policy framework to achieve the objectives of full employment, price stability and environmental sustainability. This policy agenda stands opposed to both the neo-liberal, supply-side policies of the 'new regionalism', and Keynesian policies of generalized expansion, especially those muted by unnecessary concerns about either the sustainability of public sector debt or the resilience of the balance of payments situation. Throughout, we have highlighted the activist role of the state in issuing fiat currency, targeting interest rates, and setting the deficit to appropriate

levels under the auspices of a Job Guarantee scheme designed to achieve full employment through the provision of regionally targeted jobs remunerated at the minimum wage.

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