

Deficits and Institutional Theorizing About Households and the State

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In a pecuniary economy, households' spending is limited by the stock of state money and the flow of income received in the form of state money. Thus, households are subject to liquidity constraint as they incur debts in the established unit of account, and consequently need to obtain the widely accepted medium of exchange (Wray 1998; Bell 2001). Even when households' borrowing is unlimited, there is liquidity constraint to the extent that various interest rates and fees are administered by banks and business enterprises upon different households. Consequently, households are concerned with sound finance – or balancing their budgets at some point (albeit not at all times). The state's spending, on the other hand, is not limited by a stock of money, since the state spends by issuing its own IOU (Knapp 1924). Thus, there is no instrumental reason why a sovereign state should follow “sound finance” (Lerner 1943; 1947; Wray 1998).

The idea that a sovereign government or nation faces financial burden due to federal deficits is based on a state-household budget analogy, according to which, in much the same way a household goes bankrupt if its debt continuously exceeds its income flow, continuous government deficits are also unsustainable. The view of government “sound finance” holds that there is some “prudent” government deficit-to-GDP ratio in the same fashion that there are sensible household debt-to-earnings ratios that are used in reasonable lending practices. Under such an analogy, in the same manner that households have a time line for repaying their debts (even if they are rolled over) the state eventually will have to face the retirement of government debt. Thus, according to this view continuous government deficits are wasteful and constitute a “burden” for future generations.

The household-state analogy does not differentiate households and the state as distinct institutions with specific characteristics, powers and liabilities. An Institutionalist discussion of this analogy with reference to household and

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government deficits would reveal some questions of importance for theorizing about households and the state as institutions in a pecuniary culture.

Government Deficits and Households' Financial Positions

The state-household deficit analogy is not merely a rhetorical device and an example of fallacy of composition; it is a habit of thought. The analogy enters the process of valuation in policy analysis and formulation, and is engrained in common everyday "understanding" of public finance and the relation between state and households. The following main issues emerge as a result of the household-state analogy with respect to deficits. First, the special place of the state as a monopoly issuer of money is ignored, which obscures the importance of households' place at the bottom of the "debt pyramid" (Bell 2001). In addition, the way in which the state deficit spends and "prints" money is misconstrued (Wray 1998; Bell 2000). Furthermore, the household-state debt analogy obscures the effect of government deficit on the household sector, as well as its role in generating household sector net savings. We are going to focus on the last point.

The government budget deficit offsets the private (business and households) sector's surplus. This means that the private sector as a whole can save only when the government runs a deficit. Alternatively, while it is true that one household can spend less than its income, and thus can save, another would have to go in debt. Thus, the government deficit represents private sector saving. The private sector saving equals the sum of the government sector deficits, which equals the outstanding government debt (assuming a balanced foreign sector). In such a case, if the government runs a surplus, the private sector will be deficit spending and reducing its net financial wealth at the aggregate level (although some households may still be able to save) (Wray 2006; Galbraith 2006). Consequently, the household-state analogy that undergirds the doctrine of sound finance results in a paradox. Concerns about sustainability of government debt necessary assume that households can run indefinitely deficits, as balancing the government budget would mean that household wealth decreases. On the other hand, in order for the economy to grow, the household sector must become indebted. Yet, when it is argued that the government should balance its budget just as a prudent household, there is a presumption that households indeed are not indebted.

In the case of the U.S. economy, where recent borrowing by the household sector has reached unprecedented levels and debt-service burden has reached record heights, there are warnings that household borrowing relative to income cannot continue indefinitely. Furthermore, these studies show that current economic growth is driven by consumer borrowing, and thus is vulnerable to a decrease in consumer spending (Papadimitriou, Chilcote, and Zezza 2006; Galbraith 2006; Wray 2006). If households are to run indefinitely deficits so that the economy continues to grow, it must be true that households have indefinite access to credit, are not concerned about interest charges, fees, and credit ratings, and thus are willing to continue borrowing. Also, there is an assumption that household consumption expenditure is not going to

be affected by the growing indebtedness and deterioration of the financial positions of households, which at present in the U.S. case, is enhanced due to decreasing housing prices (Papadimitriou, Chilcote, and Zezza 2006). By ignoring the possibility of decreased household sector consumption, the significance of effective demand for the level of output, employment and growth is forgotten.

Rather than insolvency of a sovereign state, the major concern in a monetary production economy under such conditions should be the possible negative effect of a growing household financial burden on household consumption expenditures, and consequently on future expectations of business enterprises and banks, and thus on investment and growth. Of course, within this line of reasoning saving is a residual of investment. Consequently, concerns about government deficits “crowding-out” private investment and absorbing savings are unfounded since investment is not financed by loanable funds, and loans create deposits (Wray 1989; Nell 1996, 100). Indeed, the concerns about a supposed negative economic effect of continuous deficits¹ that undergird “sound finance” are grounded in the commodity view of money and loanable funds theory of investment.

Value Structure and Government Deficits as Tools

A pecuniary culture is constituted by institutions that have ceremonial and instrumental aspects, such as households, business enterprises, and the state. Consequently, the culture can be dominated by either ceremonial or instrumental methods of valuation. The household-state analogy, with regards to deficits, is a habit of thought based on ceremonial methods of valuation, and is a part of the value structure of the pecuniary culture. A value structure is a combination of the predominant methods of valuation. Together with “tools” (skills, practices, and devices), a value structure constitutes a given state of “technology.” Government deficits can be viewed as tools that permit the economy to function at full employment, as well as to achieve other goals that are in correspondence with the predominant value structure within the culture. Thus, the recognition and application of the principles of functional finance in place of the doctrine of sound finance would constitute a change in the value structure. Consequently, a combination between the tool of government deficit and the principles of functional finance would represent a new state of technology in the broader Institutionalist sense.

However, the availability of a tool does not mean that its application is socially acceptable. Only tools that can be reconciled with the existing value structure of the community would be sanctioned for problem-solving purposes. Thus, there is a “ceremonial feasibility” that is determined by the predominance of ceremonial methods of valuation in the structure of valuation. On the other hand, instrumental feasibility is determined by the tools available to the community. However, only the tools that meet “ceremonial adequacy” (Bush 1988, 141) will be permissible for usage. Consequently, even though government deficits are available to the community, at the present state of the value structure, they are not accepted as a normal part of the

growth of the economy, and thus their usage for addressing most problems of livelihood is ceremonially inadequate. Ceremonial adequacy determines the legitimacy of the implementation of specific tools as a part of problem solving. "Legitimacy" is in terms of conceiving the effectiveness, feasibility, and desirability of the implementation of a specific tool. In other words, ceremonial adequacy determines the conditions of the possibility for implementing the tools available to the community in problem solving. Running government deficits consistent with full employment is technically achievable but is ceremonially inadequate.

The interface between tools and the structure of valuation defines the space of institutional change. We can envision the following types of institutional change: ceremonial encapsulation; progressive; and regressive, which represent various permutations of ceremonial (non)feasibility and instrumental (non)feasibility (Bush 1988, 141-142). Progressive change occurs when a change in the value structure in the culture occurs in a manner that ceremonial dominance gives way to instrumental dominance. The opposite is true for regressive change. In the case of ceremonial encapsulation, the value structure does not change, but some innovations are introduced.

Ceremonial Encapsulation vs. Progressive Institutional Change

Ceremonial encapsulation is a situation where innovation is both ceremonially and instrumentally feasible. A problem-solving tool will be incorporated into the predominant habits of thought to the extent that the community believes that the existing ceremonial aspects of a given institution (e.g. the business enterprise) will not be disrupted. Any disruption from the implementation of new tools for problem solving will be "offset" by simultaneous reinforcement of the existing myths, which "encapsulate" the introduction of the instrumentally warranted tools. Thus, variants of "gender budgets and green budgets" are examples of such quasi-institutional change, since they refer only to the distribution of outlays of a given government expenditures. While these innovations are manifestations of agency, and composition of the government deficit is immensely important, these tools are usually implemented within the existing value structure that embodies the habit of thought of sound finance without questioning the notion of a prudent deficit-to-GDP ratio.

Progressive institutional change on the other hand is a process characterized by instrumental feasibility and ceremonial non-feasibility. Progressive institutional change is an enhancement of the application of instrumental methods of valuation. Such change occurs when the community "allows" for ceremonial inadequacy and implements the habitual use of a tool in problem-solving (Bush 1988, 144). Thus, if we view government deficit as a tool, the implementation of functional finance would be an example of progressive institutional change.² On the other hand, the adoption of balanced budget rules would be an example of a regressive institutional change, as it puts forward the application of ceremonial methods of valuation.

Regressive Institutional Change – Bankruptcy Reform

Regressive institutional change exhibits elements of ceremonial feasibility and instrumental non-feasibility. There is an attempt to achieve outcomes that are represented as instrumentally feasible, but in reality are pursued by means of ceremonially warranted methods – regressive institutional change (Bush 1988, 148-149). The recent U.S. bankruptcy reform is an example of a regressive institutional change with respect to households' financial positions. The reform makes it much more difficult and costly for individuals to file for bankruptcy and requires debtors to try to work out repayment plans through counseling agencies before they go into bankruptcy court.

Legislation approved by the House (HR 333 on March 1, 2006 by a vote of 306-108) and Senate (S 420 approved on March 15, 2006 by a vote of 83-15) prevents individuals from using liquidation under Chapter 7 (under which the debtors' estate is sold by a court appointed trustee and remaining unpaid debts are discharged) if they have the ability to pay \$10,000 or 25 % of their debts, whichever is less, in three to five years following their request for debt relief. The ability to repay debts is determined after individuals have paid attorneys fees, monthly living costs and other miscellaneous expenses approved by a judge.

The most cited purpose of the bankruptcy reform is to prevent “deadbeats” who can pay back their loans to declare bankruptcy. In effect, the reform precludes debtors from liquidating their assets in order to repay some or all of their debts and get a fresh start. While not as harsh as debtor's prison, this bankruptcy reform ensures that debtors keep on working and making payments to their creditors. The effect of the bill is that it secures continuous payments to the financial sector while contributing to the deterioration of the instrumental aspects of financially bankrupt households.

Driven by the vested interests of creditors, the bankruptcy reform is not concerned with the underlying causes for indebtedness.³ The most common reasons for filing for bankruptcy are high medical bills in the household, loss of a job, or a divorce resulting in alimony and child support payments. From the point of view of the highly indebted household, one problem is that in order to secure payments, debtors must work for wages, (usually under conditions below full employment) while at the same time they need to secure access to child-care services. Under these circumstances, the possibility of one person staying in the home and providing child-care may not even be an option, as the major concern of the household becomes of a pecuniary nature.

Bankruptcy reform is a regressive institutional change – ceremonially feasible and instrumentally infeasible – because it secures the pecuniary interests of creditors, and further inhibits the instrumental aspects of households, material provisioning and care. Thus, there is a net loss for the community in terms of instrumental efficiency with respect to the development of human resources. A more general consequence of the reform is the reinforcement of the “self-help” habit of thought and more specifically the canon and practice that child-rearing, and workers' health

are solely a private responsibility of households, rather than being part of the macroeconomy. Under the absence of accessible child-care and health care, there must be a presumption of an altruistic behavior within the household. This altruism/labor power, which is supposed to secure the survival of the household as a going concern, then must somehow be immune to financial restrictions.

Conclusion: Disembodied Households and a Personified State

In accordance with sound financial principles, the government is supposed to balance its budget like a responsible household. At the same time, bankruptcy reform is introduced on the grounds that bankruptcy filings have been steadily increasing, and that there are too many irresponsible individuals/households. The reform is a good example of dealing with symptoms by killing the patient. The problem should be reformulated and the medicine that the indebted household sector needs is a larger federal budget deficit with an adequate composition that addresses the major points of households' vulnerability. However, these vulnerabilities are obscured, while unreal problems such as balancing the federal budget and Social Security trust fund "solvency" are focused on by vested interests.

The obsession with sustainability of government deficits ignores the role of net government expenditures in a monetary production economy, and specifically its effect on households' financial positions. Implicitly, if balancing the federal budget is the end-in-view in policy formulation if economic growth is to occur, there is a presumption that growing household debt is sustainable. Such an assumption, however, treats the state as an entity with a life span. On the other hand, households are treated as some kind of entities with no biological life span. Within this view, the state in effect, is personified while households are disembodied.

First, the notion that a sovereign state eventually has to pay down the debt, and that it can go "bankrupt," cannot be logically defended (Wray 1998; Galbraith 2006). Invoking the term "bankruptcy" when discussing "looming government debt" is of course legally inaccurate (Galbraith 2006) and can be viewed as an emotional reference to some notion of "moral bankruptcy." Such reasoning personifies the state and gives it a kind of biological status: after all, according to the Institutionalist tradition it is inadequate to see morals as separated from body/nature (Dewey [1922] 1983). This embodiment/personification of the state is not without consequences for the political process and ideology.

Second, there is a simultaneous "disembodiment" of households – they are viewed as inorganic entities whose financial positions are somehow separate from nature. If households are presumed to run indefinitely deficits, they are treated as if they have an indefinite life span, which means that members of the households do not die, nor are they born or give birth. Consequently, the household-state analogy obscures the biological/social vulnerabilities of households by virtue of disassociating households' financial positions from their biological and social character.

Thus, an Institutionalist critique of the household-state analogy with regards to deficits brings two major questions with respect to theorizing about households

and the state. First, what are the consequences of ignoring the anthropogenic character of households? Second, what is the relevance of a personified notion of the state for ideology and institutional change? The answers to these questions could be developed in the context of existing discussions in these areas (Dugger 1992; Jennings 1992; Eichner 1985; O'Hara 2000; Danby 2004).

Notes

1. For a more detailed exposition and critique of these arguments, see Lerner 1943; Eisner 1986; Wray 1998; Vickrey 2000; Bougrine 2000; Forstater and Nell 2003; and Shaikh et al. 2003.
2. Another example of a progressive institutional change would be the establishment of the Social Security program. On the other hand, the establishment of a Social Security trust fund is an example of a regressive institutional change, as it puts forward pecuniary methods of valuation and foregoes the instrumental function of the program - to assure entitlements to goods and services to anybody in their old age.
3. Banks, credit card companies and credit unions have been leading the drive to rewrite the U.S. bankruptcy laws. In 1998, the American Financial Services Association, the trade group that represents the major credit card companies, joined other financial industry trade associations, Visa and Master Card, to form the National Consumer Bankruptcy Coalition. In addition to the financial sector, the gambling industry, car dealers, and retail stores are those who pushed for consumer bankruptcy reform. Consequently, we have to note that theorizing about the institutions of the household and the state is interwoven with the theory of the business enterprise.

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