# The Making of a Good Society: Economic Freedom, Instrumentalism, and Government Control

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# 1 Economics and the Good Society

I have entitled this chapter the "The Making of a Good Society." While I have paraphrased from Robert Heilbroner's now famous Ph.D. dissertation, the title suggests that a "good society" is something that is made. It is a process, in fact it is a continual process. A process by which clearly defined (though modifiable) goals are forged and effort garnered towards their eventual acheivement.

Regardless of one's ideological belief, the goals for a good society are towards that which enhance the general welfare. Typically, macroeconomists are concerned with three overarching concerns. These concerns can be generally categorized into three macroeconomic problems or similarly analyzed as three macroeconomic goals. There is 1) the problem of unemployment or the goal of full employment, 2) the problem of recessions or the goal of macroeconomic growth, and 3) the problem of inflation and the goal of price stability. The objective of macroeconomics is towards the development of a theory which both explain these phenomena and provides solutions for the achievement and maintenance of the goals of a good society.

There has been partial consensus among macroeconomists as to the macroeconomic problems worth investigating, there has been little consensus among economists as to how to approach both studying these phenomena and little consensus as to the viable solutions. There is an ideological divide among economists and this has led to a methodological divide in both the analysis and the construction of viable solutions for macroeconomic problems. The key issue is that the macroeconomic goals for the good society are all encompassing. These goals promote the general welfare, not the individual welfare.

The ideological debate even to the present day is centered around neoliberalism, and the neoliberal state versus heterodox economic thought which advocates government intervention for the fulfillment of macroeconomic goals.

Neoliberalism is premised on the assumption that the promotion of individual freedom leads to the promotion of society's general welfare. In other words according to the neoliberal view there is no disconnect between the micro goals of individuals and the macro goals of society. Promoting the former promotes the latter. This leads to the fundamental features of the neoliberal state which are towards the protection of individual property rights, and the protection of institutions which provide for freely functioning markets, the promotion of free trade (Harvey, 2005, 64). The neoliberal agenda has become dominant in both the economic dialog and dominant in the American political spectrum.

> "Common interests and values among the great powers are also the basis for promoting peace and security around the globe. ... As we preserve the peace, America also has an opportunity to extend the benefits of freedom and progress to nations that lack them. We seek a just peace where repression, resentment and poverty are replaced with the hope of democracy, development, free markets and free trade. ... Free trade and free markets have proved their ability to lift whole societies out of poverty – so the United States is working with the entire global trading community to build a world that trades in freedom

and therefore grows in prosperity (Bush, 2002)."

The quotation from the former president of the United States embodies the neoliberal tradition of free markets and free trade. The agenda can be reduced to the promotion of individual freedom. The neoliberal agenda is not new. It has it's roots in England with Friedrich Hayek, and further rooted in the United States with Milton Friedman and the Chicago School of Economics.

Hayek's (and the Chicago School) view of the individual is centered around the "knowledge problem." The knowledge problem deals with coordination and action of economic actors. For Hayek individuals lack all the information that is necessary to coordinate economic activities. Hayek's viewpoint is that individuals are filled with limited and mostly erroneous knowledge. Because of this it then becomes impossible for centrally planned economies to collect, much less filter, all the knowledge that is required for answering questions related to production and distribution. Because of this, Hayek defends free market capitalism, and suggests that the market, not government, is clearly the most efficient device to coordinate economic activities.

Hayek suggests that the free market coordinates economic activities through the formation of spontaneous order. "the formation of spontaneous orders is the result of their elements following certain rules in their responses to their immediate environment (Hayek, 1973, 43)." As such it is the result of "human action not of human design (Forstater, 2003, 189)." In other words, macroeconomic order is assumed as the unintended consequence of individuals pursuing their own self interest (Fehl, 1994, 197). If such order is to be consistent with the goals of a good society, it must be shown that the promotion of individual freedom and free markets can always produce such macroeconomic results.

There are two problems to this conclusion. The first problem can be immediately recognized from Hayek's definition of spontaneous order. According to Hayek, macroeconomic order is the unintended consequence of the individualistic behavior if and only if "[the] elements follow certain rules in their responses to their immediate environment." In other words, profit and utility maximization directs the behavior of producers and consumers respectively. These directives guide economic behavior both in response from and according to the rules of supply and demand (Lowe, 1987b, 143).

Further, Adolph Lowe suggests that "spontaneous order" (or as Lowe terms "spontaneous conformity") presupposes a level of rational understanding of social processes. Lowe suggests that such understanding of complex processes, such as industrial capitalism, exceeds the normal capacity of an individual (Lowe, 1987a, 12). Henceforth, it is highly unlikely that the behavior of all individuals will conform to the strict rules of the free market process. Individual behavior can neither conform to the laws of supply and demand, nor do individuals have the capacity to make rational decisions required for free market processes. The promotion of individual freedom can not at the same time promote the larger goals of a good society. Lowe (1942; 1987b; 1951; 1935) was highly critical of such a deterministic relationship between supply and demand. Lowe's early objections are shared by many contemporary heterodox theorists.

On the other side of the methodological (and ideological) debate is heterodox economics. Heterodox economics diverges from the neoliberal ideology and is stark opposition to contemporary neoliberal thought. Heterodox economic theory seems to hold steadfast to these principle tenets: 1) the economic system must be viewed as a non-ergodic historical process, 2) fundamental uncertainty is significant, 3) questions of production and distribution are important, 4) the workings of economic life do not take place in a vacuum, and 5) the economic process is a social process with social classes and political institutions. Heterodox theory stems from a diverse collection of economists with differing and sometimes competing viewpoints, however a survey of the heterodox literature seems to show that these five tenets remain fundamental.[1].

In what follows, it will be proposed that Adolph Lowe's "instrumental approach", or policy discovery approach, is consistent with the tenets of heterodox theory as outlined above. Secondly, it will be shown below that the neoliberal approach of supporting free markets and individualistic behavior does not create society where macroeconomic, welfare enhancing objectives, such as full employment of society, are achieved. Rather it will be seen that the exact opposite is the case.

The neoliberal approach confounds individualistic microeconomic goals with macroeconomic goals. An instrumental methodological approach requires the separation of the goals of individual producers and consumers with the larger macroeconomic goals of society. By isolating just one of the macroeconomic objectives, the goal of full employment, it will be seen that the promotion of free markets in the United States over the past three decades has not, and can not achieve this goal. Further, the "unintended consequences" of the macroeconomy has been the deterioration of the working class, an increase in crime, and a deterioration of the psyche of those affected by unemployment.

Using full employment as a case study, it is addressed below that contrary to neoliberal thought, there must be a clear separation between the macroeconomic goal of full employment, and the microeconomic goal of profit generation. The latter does not promote the former, in fact individual businessmen guided by the profit motive will always and everywhere not only fail to achieve a fully employed society, but rather by promoting their own self interests, capitalists promote a society where unemployment is the norm. There then must be a role for government to keep both capitalists in check, and pursue the interests of society as a whole. As part of this objective the chapter will end with a brief discussion of the current proposals of how the government could actively promote the goal of full employment, while at the same time, maintaining the interests of the capitalists. Before we get here, what follows is an introduction to Adolph Lowe's instrumental approach to political economics.

# 2 Instrumentalism

> Political economics, like traditional economics, is a theoretical science. As such it tries to derive a past state of the system or a future state from the knowledge of the given state and from some "law of motion" (Lowe, 1987a, 157).

[1]See for example: Holt, 2007; , Arestis, 1996; ; Lawson, 1994; and Hamouda and Harcourt, 1990.

For Lowe, the crucial distinction between traditional and political economics is that traditional (classical and neoclassical) theory rests upon rules, behaviors, and motivations that are exhibited in early phases of capitalism. These assertions are now losing realistic significance in today's economy where production is on a large scale. The modern production economy is composed of corporate enterprisers which brings together a complex matrix of inputs from numerous suppliers. These corporations have a high degree of technological and administrative organization, technical interdependence and can exhibit varying degrees of market power. The traditional approach to economics is neither a relevant nor a realistic approach to the theory of production or to the material provisioning process. Lowe's instrumental approach to economics is a more suitable methodology which coordinates the micro-behaviors of corporations and the macroeconomic goals of policy makers.

Underlying Lowe's instrumental approach to economics, which mirrors the overall theoretical approaches of the contributors to the Institutionalist school such as Thorstein Veblen and Karl Polanyi, is the fundamental importance of the inclusion of institutions, both formal and informal, and institutional adjustment as the central core of the analysis. Like Veblen, (1909) who refers to "settled habits of thought" and Karl Polanyi (2001), who make reference to "institutional mechanisms", Lowe (1965; 1976) refers to the importance of society's "behaviors and motivations." Lowe's economic framework, like that of the Institutionalists, calls for the reintegration of social institutions. Human societies and societal institutions are not static and should not be treated as such. The analysis must be dynamic to include institutional change (including structural and technical change) within the broader approach of political economy. Veblen describes these dynamics as normal features of the economic system. The motivations behind corporations engaging in technical innovations and investment are towards the generation of profits, a central fact in the Keynesian, Institutional, Marxian, and Neo-Ricardian literature. This is a central concept in the current study. A primary reason why capitalism fails to achieve, let alone maintain, full employment through the self-regulation of markets is because such a goal does not serve the independent businessman. As Veblen stated:

> The production of goods and services is carried on for gain, and the output of goods is controlled by businessmen with a view of gain. . . . The vital point of production with him is the vendibility of the output, its convertibility into money values (Veblen, 1904, 50-51)

Given the dynamics of the current state, the successful achievement of the macro-goal of full employment is of doubtful priority if left up to the market alone. The objective for the present work here (and of the new political economics which Lowe refers to as 'instrumentalism') is to determine organizational rules in the modern society which are appropriate for the fulfillment of the pre-specified macro goals. Instrumentalism assumes that actual forces that guide economic movements are not known a priori; rather they are in themselves categories of unknowns.

> It's the fundamental theorem of realistic theory that under the particular social conditions of the industrial system, data and process are involved in a regular and continuous

> interaction which makes any concrete constellation, and therefore the system as a whole, essentially unstable and liable to transformation. For this reason in any long period analysis concerning the industrial system, on the principle the data are to be handled as dependent variables (Lowe, 1935, 146-147).[2]

For Lowe, the major undertaking of instrumental analysis is to devise an analytical framework in which these unknowns can then be determined. This is precisely the opposite approach of the traditional neoliberal view. Under the neoliberal view, it is the macro goal which is treated as an unknown, and that the path that the economy is moving along is treated as a known. Lowe's instrumental analysis inverts the problem. It is the macro-goal of full employment that is predefined. Lowe's instrumental approach is used for prescription rather than prediction. It describes the direction of which the economy *should* move towards and the specific governmental regulations which are additionally required for the achievement and maintenance of pre-specified macroeconomic goals. The approach pre-specifies the "knowns" and then sets out to discover the required macroeconomic data, what Lowe calls the category of "unknowns". The methodology of instrumentalism is discussed in the following section.

## 2.1 Instrumentalism: The Knowns

The specific questions concerned are namely how production is to be maintained at a full employment level of output? An economic system which exhibits this feature is considered the final state (or terminal state) as defined within Lowe's instrumental approach. The final state of the economic system is predetermined and falls within the category of "knowns". Central to this is that the prescribed macroeconomic goal of full employment is outlined *irrespective of the current economic, political, or social makeup of the system.* Now, having clearly defined the macroeconomic goal which a good society desires to achieve, the task turns to an examination of where society is currently situated, the initial state of the economic system. The initial state of the economic system cannot be simply defined through an examination of economic and social relationships of the present day; rather a comparison has to be made between the end state and the initial state as both states need to exhibit the same properties so that the same variables can be compared against each other. To do this, there must be a realization of the specific features of a goal adequate final state, and then, through direct observation, one can select the relevant units of analysis of the current economic and social structure in order to devise an initial state of the economic system.

In the current context, the final state of the economic system is defined as a level of production in the aggregate economy which is consistent with the maintenance of a fully employed economy. The initial state is defined as an economy that exhibits persistent unemployment, and the technical and social relationships which govern the employment of labor. The social relationships of production, as

[2] This position taken by Lowe is similar to the position taken by Hyman Minsky's analysis of capitalism, specifically his financial instability hypothesis theory.

it involves the employment of labor, is divided between capitalists and workers.

As is discussed further, workers' employment decisions are affected first and foremost by the decisions of capitalists regarding hiring and termination. For capitalists these decisions are partly based upon the degree of labor physically required for any given level of output. A decision to increase output, and thus employment, is based upon the expected profitability of such an increase. It seems unreasonable to assume that the aggregate level of output, chosen based upon pecuniary gain, would coincide with full employment. Thus it is sensible to assume that in no way would there be conformity between the micro-goals of businesses and the macro-goals of society.

Regaining paid employment can be affected by the unemployed's social environment. As we will see below, unemployment can lead to depression, an increase in racial and ethnic tension, and an increase in criminal activity. As the duration of unemployment prolongs, the possibility of reemployment are weakened.

## 2.2 Earlier Approaches of Instrumentalism

Lowe's separation of macroeconomic goals and microeconomic objectives, (and the conflicting nature between the two) developed in the early to mid 1930s is seen earlier in the works of Marx and Veblen, and was famously developed in Keynes' *General Theory*. The attainment of full employment would surely be an accident. Given technological innovation, businessmen would strive to lower their cost and increase their productivity through the substitution of machinery for labor. Thus given the structural dynamics of the economic system, the maintenance of full employment cannot be achieved by the private sector alone.

For Marx the micro goal of the capitalist class is profit generation, achieved through accumulation of capital. Capital is the means which generates surplus value. The surplus value is then appropriated by the capitalist class between revenue and additional capital. Additional capital, especially labor-saving capital accumulation, achieves even greater amounts of surplus value while generating the 'reserve army of labor'. The reserve army of labor is further necessary in Marx as it serves to keep wages at subsistence while serving as a disciplinary device for workers. Capital accumulation increases the mass of the 'laboring poor'. Increases in mechanical specialization in production further limits the wage-laborer as simply a disposable unit to the production process. The worker is enslaved to the machine he/she uses. Capital accumulation is 'Moses and the Prophets' because it benefits the capitalists two fold: 1) it increases capitalist's revenue, and 2) reproduces and extends an exploitative system which is controlled by the capitalist class for the benefit of the capitalist class in terms of their own incomes and power relative to that of the working class. It is because workers do not own the means of production that they are forced to sell their labor power for wages. The capitalists, the owners of the means of production, do not produce wealth, the workers do. However the capitalists control the wealth, and take wealth from the working class to ever greater extents. Capitalism, for Marx, is incapable of providing full employment. Given that the system is controlled by capitalists, a macro-goal of full employment clearly conflicts with the micro-goals of the capitalist class.

The argument is also addressed in Veblen and Keynes:

> The production of goods and services is carried on for gain, and the output of goods is controlled by business men with a view to gain. ...by the sale of output the business man in industry 'realizes' his gain. To 'realize' means to convert salable good into money values. The sale is the last step in the process and the end of the business man's endeavor. when he has disposed of the output, and so has converted his holdings of consumable articles into money value, his gains are as nearly secure and definitive as the circumstances of modern life admit. ... *The vital point of production with him is the vendibility of output, its convertibility into money values, not it's serviceability for the needs of mankind* (my emphasis) (Veblen, 1904, 50-51).

> An entrepreneur is interested, not in the amount of product, but in the sums of *money* which will fall to his share ... The firm is dealing throughout in terms of money. It has no object in the world except to end up with more money than it started with. That is the essential characteristic of an entrepreneur economy (Keynes, 1988, 82).

Having defined the "knowns", the task then turns to the discovery of the particular set of causes that are applicable for the realization of the macroeconomic goals (Lowe, 1965, 264).

## 2.3 Instrumentalism: The Unknowns

The purpose of instrumental inference is to determine organizational rules which are appropriate for the fulfillment of pre-specified macro goals. It is a "discovery procedure", and is the heart of Lowe's political economics. Political economics for Lowe assumes that the actual forces that guide economic movements are not known a priori; rather they are in themselves categories of unknowns. Having now identified the initial state as an interdependent system of production and the movements which are guided by businessmen for the expectation of profit, and given the predefined macroeconomic goals, the task then becomes that of discovering suitable technical paths by which these goals can be achieved, and the behavioral and motivational patterns capable of setting the system in motion along such paths.

The structural model allows for an investigation of the adaptability of the production system to structural changes such as an increase in the labor force or a change to the availability of some natural resources, and the adaptability of technological changes, or to changes in final demand (Forstater 2003b: 60). Lowe (1952, 1965, 1976) identifies that the production system is characterized by structural and technological unemployment, and structural rigidities and bottlenecks. Through a three-sector hierarchical horizontalist framework, Lowe was able to identify the bottlenecks which prevent the transformation to a full employment level of production. Lowe's concern was with the elasticity of the productive process to technological innovation and structural change towards his macro-goal of full resource utilization. There is always going to be a trade-off between system flexibility and full employment (Forstater 2002; 2003b; Lowe 1952; 1976) Furthermore, Lowe (1965; 1976; 1987b) points out that 'spontaneous conformity' of independent businessmen in the direction of full resource utilization was a fantasy. Given the inadequateness of laissez-faire policies, a requirement for the achievement of the goals must be government regulation (what Lowe termed 'public control'). The purpose for government regulation is to align the otherwise conflicting micro-behaviors of businessmen and the macro-objectives of policy makers.

# 3 The Problem of Unemployment

Lowe's instrumental approach has now been defined, I now turn to investigating the problem of unemployment and the goal of full employment. Full employment refers to the full employment of labor. The unemployed are defined as *any and all laborers whom are without paid employment and would accept a paid position if one were to become available*. Also included in the definition is the full-time employment for those who are employed part-time but would prefer full-time work. Full employment is meant to mean that there is no unemployment due to skill mismatch of workers nor due to cyclical fluctuations of output. Full employment, as defined, does allow for a moderate level of frictional unemployment. A fully employed economy includes the whole of the labor force that are willing and able to work in a capitalist market economy. It does not leave out involuntary part-timers nor discouraged workers. As of April 2009 there were 2.4 million workers marginally attached to the labor force. Of these 1.2 million are discouraged workers.[3] By definition, true full employment does not leave out productive members of society who consider themselves unemployed, and would accept employment if it became available. As defined by Keynes:

> Men are involuntarily unemployed if, in the event of a small rise in the price of wage-goods relatively to the money-wage, both the aggregate supply of labour willing to work for the current money-wage and the aggregate demand for it at that wage would be greater than the existing volume of employment (Keynes, 1936, 15)

True full employment corresponds to the absence of involuntary unemployment.

Using an instrumental method to studying the problem of unemployment was not unique to Lowe. Isolating the microeconomic objectives of firms and the macroeconomic objectives of policy makers shares commonalities with the Institutionalist tradition of Thorstein Veblen, particularly Veblen's view of industry and business enterprise. For Veblen "The material framework of modern civilization is the industrial system, and the directing force which animates this framework is the business enterprise (Veblen, 1904, 1)." Veblen separated out business from industry. Thus the goal of the business enterprise is towards pecuniary gain, and:

[3] *BLS News Release USDL-10-0589*, Bureau of Labor Statistics, May 7th 2010.

> "industry is carried on for the sake of business, and not conversely; . . . The adjustment of industry takes place through the mediation of pecuniary transactions, and these transactions take place at the hands of the business men and are carried on by them for business ends, not for industrial ends (Veblen, 1904, 25-26)."

Veblen focused his attention on the linkage between the industrial corporation and business enterprise as a means to explain market competition. The industry is there to serve the businessman to exploit in terms of higher revenue. However the primary objective of the businessman is not towards the short-run acquisition of profits, rather the businessman's primary objective is oriented towards survival and growth (Parada 2008, 7; Baskoy, 2003, 1128). Veblen pointed to the "aquisition of gain through taking advantages of those conjectures of processes in the industrial system (Veblen, 1904, 49)."

An Institutionalist approach to the explanation of the motivations which guide business behavior explains the existence of unemployment in capitalist societies. The Institutionalist theory of the business enterprise explains only half of the behavior of the market participants. The other half which still requires explanation are the motivations guiding the behavior of workers, especially those workers who are unemployed. It will be suggested that the unemployed's personal attitudes, and their social environment affects whether the unemployed regain employment. But to understand these motivations requires the analysis to move beyond economics into psychology, sociology, and even criminology.

> "[Economic sociology] tries to ascertain all the social factors and influences which form and modify the "data" of the economic order and it's evolution. Thus economic sociology deals on the one hand with the social institutions of the economic system, and their specific local and historical structure (Lowe, 1935, 31)."

All economic processes have a social aspect. Mark Granovetter (2005) argues that weak social ties, gained through employment, helps expand one's social network. Then, the greater an individual's social network the greater an individuals prospects of maintaining employment throughout their lives. Now take the opposite extreme. The literature on the sociological effect of unemployment puts forth the argument that unemployment is both circular and cumulative in nature. This spiral results in the long-term unemployed to become unemployable.

The sociology of unemployment has it's roots in Marie Jahoda's (1933) *Marienthal* study. Marienthal is an Austrian village where the livelihood of the community was dependent upon the local factory. When the factory closed in 1929 this begun a wave of prolonged unemployment in the village (Feather, 1990). The conclusions of the Marienthal study found that there are four basic attitudes of the unemployed: 1) *unbroken* high hopes, plans for future employment, children and household maintained 2) *resignation*, all loss of hope, no plans for the future, but children and the household are maintained; 3) *in despair*, greater feeling of resignation, including a feeling of depression and a continuous comparison to the present state and a previous higher state of well being during employment; 4) and an *apathetic* state. The apathetic state is the most severe psychological state of the unemployed. It is defined as:

> " ... state of complete passivity, the absence of any effort. Home and children are dirty and neglected, the mental outlook is not desperate but simply indifferent ... Nobody plans for a more distant future, not even the days or hours ahead (Jahoda, 1933, 54); quoted in: (Feather, 1990, 13)."

As the period of unemployment becomes prolonged, the unemployed's psychological state regresses towards that of an apathetic state. This is a generalization for the most part and every individual response to unemployment is different based upon their unique circumstances. But broadly speaking the state of mind of the unemployed will regress as the duration of unemployment lengthens.

The downward psychological spiral of the unemployed is further evidenced in Browman et al. (2001) study. This is a study of the unemployed in Michigan following the General Motors plant closings in the late 1980s found similar results. Browman's study is important as it links social and personal effects such as: increase in crime, increase in divorce rates, deterioration of mental and physical health, etc. as all consequences of stress. This is true, however the causality is not simply one step. Rather economic conditions such as unemployment is the cause of stress (Brenner, 1973). It is thus high stress which leads to both social and physical/psychological consequences. This clarification becomes important as it is the response to unemployment that becomes imperative to the overall level of stress which the unemployed are subjected to. It is not surprising that the response to unemployment is different for different individuals. One's support network at the time of unemployment plays an important role, as does the current financial situation, and the original reason for unemployment. Browman et al. (2001) finds evidence that unemployment due to mass layoffs (such as plant closings) is not an initial stressor in workers' lives. This group of the unemployed tend not to fault themselves for circumstances which, in their minds, are beyond their control.

What is more important is the circular, cumulative, and causative nature of unemployment and stress. Sources of exposure to stress cause additional stressful situation (as unemployment as an initial stressor causes financial hardship) which in turn leads to anxiety, hostility, and depression, which is then turn opens the door for further exposure and vulnerability to additional stressors (Browman et al., 2001, 11). As Browman concludes:

> "Simply put, to have become unemployed and hence distressed–depressed, anxious, whatever–is to less likely gain reemployment or more likely to lose a subsequent job. Unemployment deals a double whammy because its consequence, distress, has further consequences–reduced employability–which make it harder to get back to square [one], unemployment leads to family stress and disruption, this too can have consequences for future employment, if only because it feeds the spiral of distress.(Browman et al., 2001, 10-12)."

If the initial cause of unemployment is of no fault of the worker, as time passes, workers' inability to become re-employed are a major cause of stress in their own lives. Worker's now see themselves as being at fault for the inability to acquire employment. This causes great stress in the unemployed workers lives, especially as financial hardship continues to mount. This then leads to lower self-worth, anxiety, depression, family disruption, increases in drinking and drug use to cope with the stress, poor physical health of the unemployed and their families, and increased thoughts of suicide. Furthermore stressful situations simply do not pass, these are life altering situations. As unemployment is prolonged these symptoms progress. This further impedes the possibility of re-employment. Soon the unemployed become unemployable.

Not only does regular employment provide a basic income for individuals, but it sets up a much needed social environment that is important and necessary for individuals. Employment has formal and informal social relationships. Losing one's regular job decreases their level of social activity that they were previously engaged in (Kelvin and Jarrett, 1985). Workers become friends, and they engage in social activities inside and outside the workplace. Unemployment causes dependency issues within families. Inside and outside the family structure, the unemployed, especially the long term unemployed, are seen as second class citizens (Kelvin and Jarrett, 1985, 6). Being viewed by society in this manner disrupts the normal functioning of the family, and in addition the normal day to day functioning of the unemployed within society.

## 3.1 Unemployment, Inequality, and Crime

Thirty-four percent of Americans claim minority status in the United States in 2008. Of these Hispanics make up the largest contribution with 45.5 million Hispanics residents, accounting for 15 percent of the U.S. population, and African Americans comprising of the second largest minority group with 40.7 million, accounting for 13.5 percent of the U.S. population.[4] However the distribution of unemployment in the United States is disproportionately skewed towards that of minorities. The two largest minority populations (Hispanics and African Americans) consistently have high unemployment rates as compared to whites.

The official U.S. unemployment rate from 1980 - 2007 for Whites, African Americans, and Hispanics is illustrated in Figure 3. The unemployment rate for African Americans is consistently over one and a half times that of whites. Hispanics overall fair better. Since 1980 Hispanics have been able to close the unemployment gap between themselves and whites, whereas for African Americans, the unemployment rate has consistently been about twice that of whites.

Even though the overall trend in the rate of unemployment has gone down for all groups, the disproportional effect that unemployment has on minorities, notably to the African American population has not improved with time. Figure 4 demonstrates the trend from 1980 - 2007 of the Black/White

[4] David Minkler "U.S. Minority Population Continues to Grow", May 14, 2008, U.S. Department of the State (http://www.America.gov) Accessed: September 30, 2008

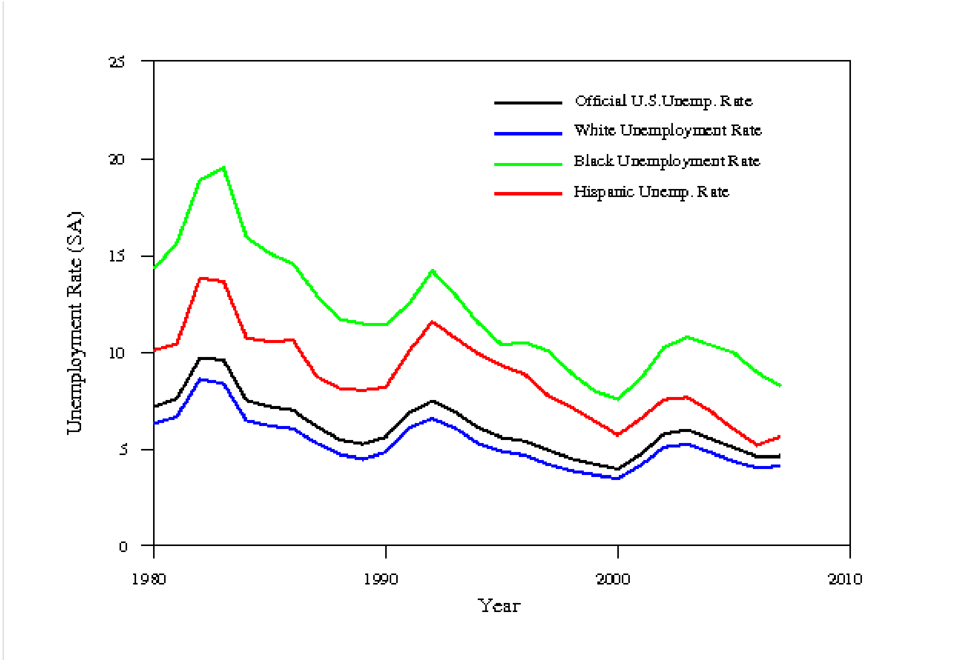


Figure 1: Unemployment Rate in the United States, 1980 - 2008

and Hispanic/White unemployment ratio. The ratio can be used as a measure of inequality between that of minorities and whites. The ratio is calculated by dividing the minority unemployment rate over that of the white unemployment rate. Equality would be a ratio of one. African Americans continually are disproportional affected by unemployment. The ratio has been between 2.0 and 2.5 since 1980. Hispanics have always had an unemployment ratio below that of African Americans, and has been steadily improving since 2000. The illuminating feature of Figure 4 demonstrates that while the overall trend improved, whites have been disproportionately favored. The economic boom of the 1990s benefited the white population over minorities. It is seen that during this period of economic expansion the Black-White and the Hispanic-White ratios actually grew over the expansion, peaking at the height of the expansion, and having the smallest ratio during recessions (as is illustrated in 1991, 2001). This demonstrates that it is not that minorities are becoming better off, but rather that in general whites are worse off during periods of economic downturn, which closes this gap. The two figures together demonstrate that previous economic expansions, even in the 1990s, overwhelmingly favors the white majority population, while the minority population still struggles with unemployment rates devastatingly high. Furthermore it also demonstrates that even current economic policies have been unable to solve the problem of unemployment and it's disproportional distribution skewed against minorities, notably African Americans.

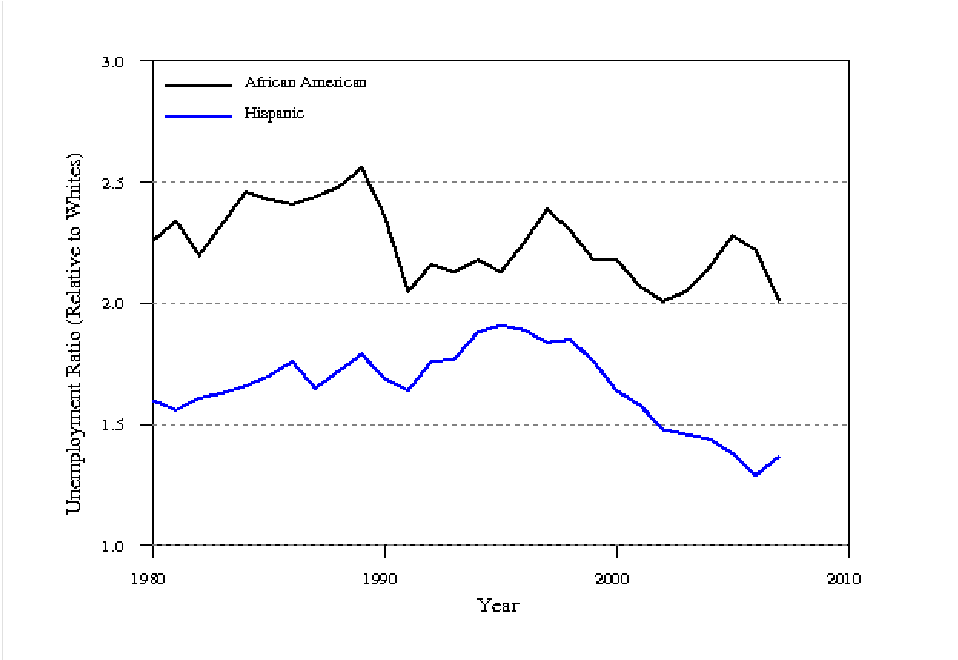


Figure 2: Black/White, Hispanic/White Unemployment Ratio 1980 - 2000

# 4 Unemployment, Inequality, and Crime

The relationship between unemployment, racial inequality, and crime should also be considered. Thirty-four percent of Americans claim minority status in the United States in 2008. Of these Hispanics make up the largest share with 45.5 million Hispanics residents, accounting for 15 percent of the U.S. population, and African Americans comprising the second largest minority group with 40.7 million, accounting for 13.5 percent of the U.S. population.[5] However the distribution of unemployment in the United States is disproportionately skewed towards that of minorities. The two largest minority populations (Hispanics and African Americans) consistently have high unemployment rates as compared to whites.

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[5] David Minkler "U.S. Minority Population Continues to Grow", May 14, 2008, U.S. Department of the State (http://www.America.gov) Accessed: September 30, 2008

[6] All data collected that is detailed in this Figure 1 and in Figure 2, below have been obtained from the *Bureau of Labor Statistics*. Data is publicly available and can be found online at *http://www.bls.gov*.

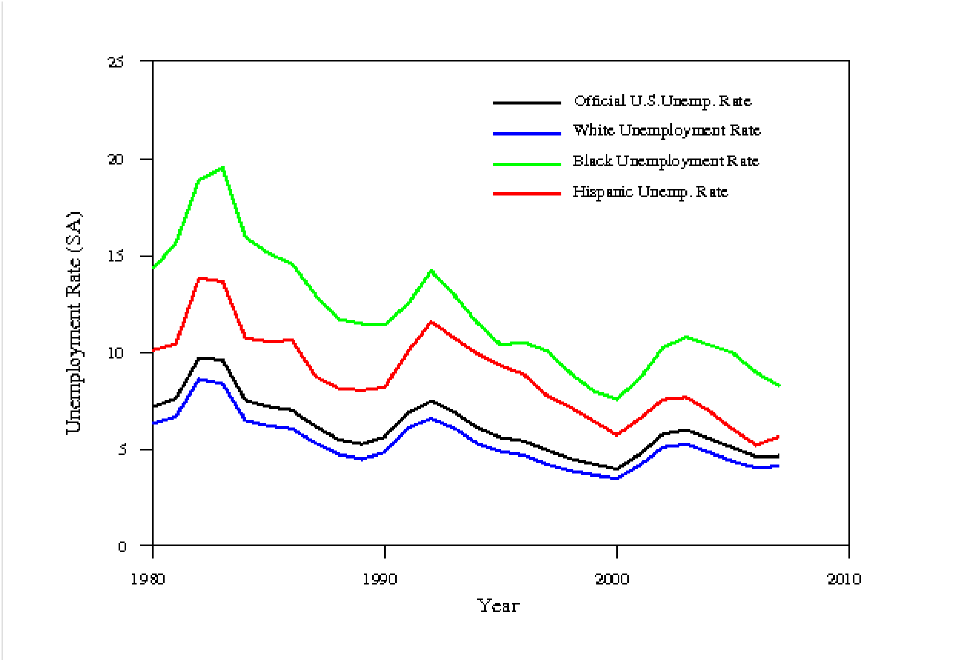


Figure 3: Unemployment Rate in the United States, 1980 - 2008

and Hispanic/White unemployment ratio. The ratio can be used as a measure of inequality between that of minorities and whites. The ratio is calculated by dividing the minority unemployment rate over that of the white unemployment rate. Equality would be a ratio of one. African Americans continually are disproportionately affected by unemployment. The ratio has been between 2.0 and 2.5 since 1980. Hispanics have always had an unemployment ratio below that of African Americans, and has been steadily improving since 2000. The illuminating feature of Figure 4 demonstrates that while the overall trend improved, whites have been disproportionately favored. The economic boom of the 1990s benefited the white population over minorities. It is seen that during this period of economic expansion the Black-White and the Hispanic-White ratios actually grew over the expansion, peaking at the height of the expansion, and having the smallest ratio during recessions (as is illustrated in 1991, 2001). This demonstrates that it is not that minorities are becoming better off, but rather that in general whites are worse off during periods of economic downturn, which closes this gap. The two figures together demonstrate that previous economic expansions, even in the 1990s, overwhelmingly favors the white majority population, while the minority population still struggles with unemployment rates devastatingly high. Furthermore it also demonstrates that even current economic policies have been unable to solve the problem of unemployment, and current policies have been unable to solve the disproportional distribution of unemployment which has been historically skewed unfavorably towards minorities, notably African Americans.

The relationship between unemployment and crime shows that for all crimes, but especially income generating crime, that crime rates and unemployment are positively correlated. A large literature on

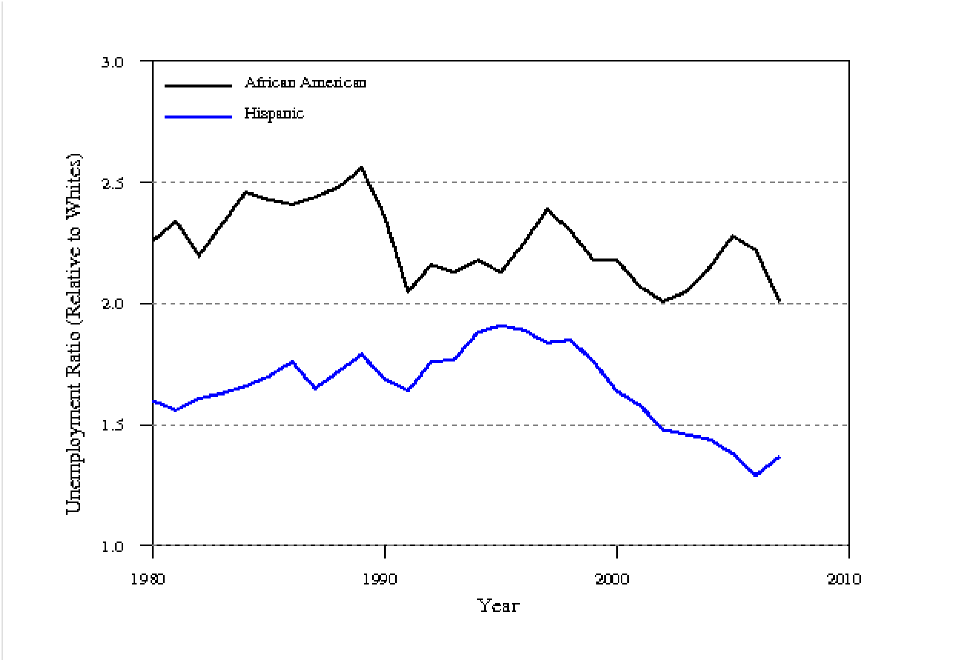


Figure 4: Black/White, Hispanic/White Unemployment Ratio 1980 - 2000

the subject occurred following the economic boom and the concurrent drop in overall crime in the 1990s. Between 1992-1997 the unemployment rate fell to a thirty year low to 4.5 percent while the crime rate dropped thirty percent (Raphael and Winter-Ebmer, 2001, 259). Politicians would like to claim that this drop in the crime rate was due to their 'war on crime'. But in actuality, what is more likely the case is that the crime drop was a result of the decade long economic expansion (Wallman and Blumstein, 2005, 319-348).

Turning to criminal behavior, just as minorities experience higher rates of unemployment than their white counterparts, so do they experience higher rates of criminal behavior. Using incarceration rates as a proxy for criminal behavior,[7] Figure 5[8] illustrates that minorities, especially African Americans have overwhelmingly higher rates of incarceration than whites. By population, African American's are the second highest minority group, yet their incarceration rates are not proportionate to their population relative to Hispanics and whites.

Figure 5 illustrates obvious disparity in incarceration rates between whites and non-whites. In addition, there is disparity in the length of incarceration. African American offenders lengths of incarceration is almost twice that of whites (Spohn, 2001, 433). "Racial disparity in the criminal justice system exists when the proportion of a racial or ethnic group within the control of the system is

[7] I have used incarceration rates as a proxy for criminal behavior because this is the best variable which there is accurate data for by race. There is accurate data for arrest rates but arrests do not imply guilt. Whereas, incarcerations occur only after the defendant has been proven guilty of criminal behavior. For this reason incarceration rates are used as a proxy for criminal behavior. However there are problems with this measure, especially as it concerns race, and these problems are discussed in the present section.

[8] Source: U.S. Department of Justice, Bureau of Justice Statistics

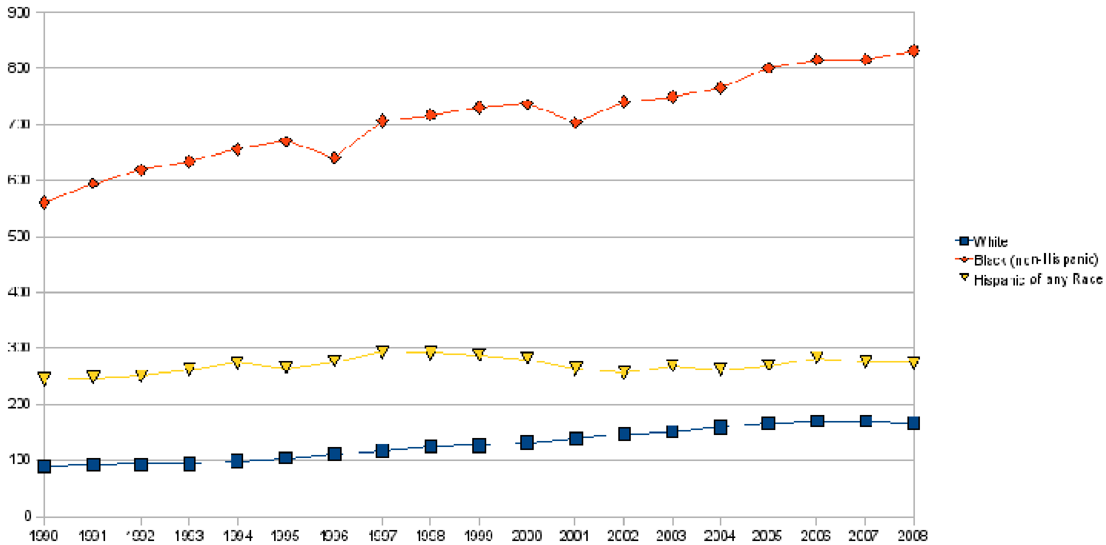


Figure 5: Incarceration Rates by Race per 100,000 Residents

greater than the proportion of such groups in the general population (Nellis et al., 2008, 1)." However disparity is distinct from discrimination. Discrimination "is a difference that results from differential treatment based on illegitimate criteria, such as race, gender, social class, or sexual orientation (Spohn, 2001, 432)." Disproportionate rates of incarceration and lengths of prison sentences by race is evidence for racial disparity, however it does not imply racial discrimination. The disparity in the length of sentences of offenders may be due to differences in criminal activity between whites, blacks and Hispanics. Offenders who commit more serious offenses, use a weapon to commit their crime, cause injury or death to their victim, or have a prior criminal record receive harsher sentences. The longer length of prison sentences for black and Hispanic offenders could be because blacks and Hispanics commit harsher crimes, or are more likely to be repeat offenders than their white counterparts Spohn (2001). This is not to imply that discrimination does not exist. The differences could be result of economic discrimination between whites and non-whites as was presented in Figure 1. Blacks and Hispanics are more likely to be unemployed. Those who are unemployed may be sentenced more harshly than those who are employed (Spohn, 2001, 433). Thus while economic discrimination is not explicitly racial discrimination there is indirect racial discrimination (Spohn, 2001, 433), which has consequences in sentencing offenders.

> It is certainly possible that offenders with stable, well-paying jobs may be perceived as less dangerous and threatening than those with unstable, poorly paid, secondary sector jobs, who may be viewed as less dangerous and threatening than those who are unemployed. If this is true, the effect of race or ethnicity on sentence outcomes may be conditioned not only by the offender's employment status (i.e., employed or unemployed), but also by the quality of employment for those who are employed (Spohn and Holleran, 2000,

303).

Racial discrimination may not be disguised at all. Overt racial discrimination exists within the criminal justice system. As evidenced by Figure 5 Hispanics and blacks have higher incarceration rates than whites. Hidden in the figure is the fact that young black males have the highest incarceration rates than any other demographic (Steffensmeir et al., 1998). If, at least part of this was due to overt discrimination in the criminal justice system this implies:

> ...that judges who are confronted with black, Hispanic, and white offenders convicted of similar crimes and with similar prior criminal records impose harsher sentences on racial minorities than on whites. It implies that judges, the majority of whom are white, stereotype black and Hispanic offenders as more violent, more dangerous, and less amenable to rehabilitation than white offenders (Spohn, 2001, 433).

The stereotyping of minorities, especially young minorities is a result of *moral panic*, defined as "a condition, episode or group of persons emerges as a threat to societal values and interests; its nature is present in a stylised and stereotypical fashion by the mass media (Cohen, 2002, 1)." The evident stereotyping of blacks, especially young black males is given by Steffensmeier et. al (1998).

> Other evidence suggests that the crime-prone stereotype is apparently applied by some whites to blacks as a whole, but the most widespread aspects of this stereotype are evoked in reference to black males and particularly to young black males. Black males are portrayed by the mass media in a limited number of roles, most of them deviant, dangerous, and dysfunctional. However, the brunt of the stereotyping falls most heavily on young black males, whom the media and others refer to by a variety of labels: "dropouts," "delinquents," "dope addicts," "street-smart dudes," and "welfare pimps" (Steffensmeir et al., 1998, 769).

Racial discrimination does not stop with the media, but societies perception of minorities is also overt in the courtroom. A study by Carole Wolff Barnes and Rodney Kingsnorth (1996) sets out to test the hypothesis of judicial system racism. There conclusions are that judicial system racism does exist, and it serves as another reason why minorities have higher incarceration rates and longer prison sentences.

> African Americans are significantly more likely than Caucasians or Latinos to have their cases rejected or dismissed by prosecutors; Caucasians are more likely to be placed on diversion and to have their charges reduced to a misdemeanor; African Americans are more likely than Latinos who are more likely than Caucasians to receive a prison term; and, when sentenced to prison, African Americans and Latinos receive substantially longer terms than Caucasians (Barnes and Kingsnorth, 1996, 39).

Judicial discrimination may be a result of economic discrimination. Poor defendants are more likely to be unemployed and are less likely to have a private attorney and are less likely to be released prior to trial Cohen (2002). Detention prior to trial further increases the likelihood of incarceration.

> All of these factors may be related to sentence severity. Defendants represented by private attorneys or released prior to trial may receive more lenient sentences than those represented by public defenders or in custody prior to trial. Defendants who are unemployed may be sentenced more harshly than those who are employed. Since black and Hispanic defendants are more likely than white defendants to be poor, economic discrimination amounts to indirect racial discrimination (Nellis et al., 2008, 13).

Criminal behavior, and incarceration rates is not a simple functional relationship with a single variable. There are many factors that contribute to the disparity between white and minority incarceration rates. However this further substantiates the argument that the study of human behavior, here criminal behavior, can not be investigated from a single lens. There are many contributing factors. But economics, specifically income and employment, plays a factor in incarceration rates. Income and employment, or lack there of, for the minority population (specifically young black males) contributes to the negative perception of these groups by society and reinforces preconceived stereotypes. It is perhaps not a coincidence that young black males have the highest unemployment rate of any demographic, the highest incarceration rate of any other demographic, and young black males create moral panic. This was addressed by Steffensmeir et al. (1998) in the above quote, that young black males are considered "deviant, dangerous, and dysfunctional" by whites.

Unemployment has been addressed as the key social problem. Unemployment contributes to poverty, psychological and mental anguish, criminal activity, and racism. So public policy put towards alleviating unemployment could be a large stepping stone to solve many other social problems, *including* criminal behavior. After the unemployment problem is addressed, it may be surprising the number of other social problems that are simultaneously addressed.

# 5 Employer of Last Resort Approach: Solution to Unemployment

It has become clear that the free market, left to its own devices does not result in a "good society." The exact opposite is seen to be true. The neoliberal agenda of Hayek and the Chicago School has created a society where unemployment is persistent, the unemployed can suffer devastating psychological effects, and criminal behavior is an unintended consequence. Since the era of neoliberalism, what has happened to the macroeconomic goal of full employment over the previous decades? Clearly this was not the result.

By taking an instrumental approach, we have through empirical evidence realized the deficiencies of the free market process in achieving this goal. As economists we must accept this as fact. Individuals can promote their own self interests, but this does not translate into promoting the interests of society. To promote these interests we need proper government intervention. I say "proper" because the type of government program devised to promote full employment must also be considerate of, and work with, interdependent firms operating in a capitalist society. The goal of any appropriate government policy is to align the incentive of businesses and consumers, with that of the full employment. Businesses are interested in their own pursuit of profit, (and thus indirectly to hire the most skilled and productive workforce). If the government were to create a buffer stock of the employed through a direct jobs program two dynamics would occur. First aggregate demand will not fall if the private sector chooses to lay off some workers. Second, a government jobs program helps maintain the skill set of the workforce (or can allow for retraining). The private sector will always be able to hire a productive workforce thus allowing themselves to gain higher margins.

The main issue is that the unemployed are viewed as what they are not. Since they are not employed, and in the official definition, sometimes not even part of the labor force, they are viewed in a negative light. Not only is confidence lost but important skills are lost as well. Nell (2000) gives a simple definition of why unemployment exists. There are simply not enough jobs. He states that in the aggregate businesses do not need to produce more goods and services than they are already producing. It is simply a demand problem. Therefore many skilled workers who would like a job simply can not find one. If lower income individuals have a higher tendency to be unemployed, then employing this group of workers will have a greater impact on the demand for goods and services because they have a higher marginal propensity to consume. This will cause employers to increase production, hire more workers, which will increase spending, which will then have multiplier effects in the economy until the economy reaches true full employment.

This Keynesian argument then raises the question of how to spur effective demand. As was previously addressed, Keynes focused his attention on government spending as the catalyst to push the economy towards full employment. But instead of simply tax decreases or government spending on goods and services, what if government spending is used on direct job creation? This may not eliminate, but it will decrease the effects of insufficient effective demand. In addition it can promote racial equality by providing employment to minorities and other disadvantaged groups which have historically higher unemployment rates than that of whites.

This is where the Employer of Last Resort (ELR) program comes in. The nature of the ELR program is to guarantee public employment for those who are willing to work. The ELR approach to full employment has taken on renewed interest. Stemming from the earlier work of Hyman P. Minsky (1986) the government job guarantee approach to full employment is to hire off the bottom, hiring the workers who are unable to find private-sector employment. As Minsky argued:

> The policy program is two develop a strategy for full employment that does not lead to instability, inflation, and unemployment. The main instrument of such a policy is *the creation of an infinitely elastic demand for labor* at a floor or minimum wage that does not depend upon long- and short run profit expectations of business. Since only government can divorce the offerings of employment from the profitability of hiring workers, in infinitely elastic demand for labor must be created by government (Minsky 1986, 307).

Much focus in discussions of the ELR approach involves affordability and feasability. Concerning affordability the main proponents of the ELR approach take a functional finance perspective, positing "...that any nation that operates it's own currency, and which adopts a floating exchange rate, can implement an ELR program, each nation might formulate the specifics of its program in accordance with it's own political and economic situation (Wray 2000, 1)." In making the case for an ELR program takes the functional finance perspective of government debt (see for example, Wray 2000; 1998, 155-176).

The functional finance approach to the ELR program is built upon Abba Lerner approach to government debt and deficits. This approach of Lerner (1943; 1947) is the theory of functional finance. The crux of his argument is that there can be no financial constraint on a government which operates a sovereign currency. The first law of functional finance states that the main financial responsibility of the government is to control the printing of money, so the supply of money in the economy is just sufficient to buy the whole of the output, at the full employment level, at current prices. In other words there is no financial constraint on a government, who is the monopoly issuer of its own currency to provide for both full employment and price stability. The ELR approach to full employment is a direct means of the government providing for full employment (and printing the money to do so) rather than providing fiscal stimulus and waiting for multiplier to kick in so that the private sector can provide jobs.[9] The second law of functional finance states that the government should borrow when it is desirable for the public to have less money to maintain positive interest rates. According to the functional finance view the government debt could just be considered the amount of bonds which needed to be sold to maintain positive interest rates. The government debt is not really a "debt" in the conventional term, rather the government debt can be considered the interest rate maintenance account Wray (1990)

It is the personal view of the author that regardless of one's perspective on budget deficits, the functional finance perspective or otherwise, it is still important to devise estimates as to the cost of such a program. The 2000 estimate of the cost on the implementation of the ELR stood at 100 billion dollars (Wray, 2000).

Employing workers from "off the bottom" has obvious stimulus effects. Employment provide stimulus for individuals to increase their spending in the private sector. Given that lower income people,

[9]Do not make this to mean that there are not additional advantages to the ELR sector than just being able to provide immediate unemployment. The major advantage to the ELR over regular fiscal stimulus is that the ELR maintains full employment even when the private sector is unable to do so. This point will be detailed and formalized in chapter 4

under a Keynesian framework, have a higher marginal propensity to consume, this will provide the necessary initial boost in demand for employers in the private sector to increase investment, and increase output to satisfy the additional demand. Increased production in the private sector will then cause an increase in the demand for workers. Workers will then move from ELR employment to private sector employment (see Forstater 2000, Tcherneva and Wray 2005, Carlson and Mitchell 2002). The ELR program will move countercyclically to the business cycle. Government spending on an ELR program will then also be countercyclical.

An ELR program is an improvement upon unemployment insurance because instead of the government paying unemployed individuals to not work through the issuance of unemployment checks, they are paying workers to work. Keeping this group of workers employed maintains skill-levels, reduces the previously discussed social costs of unemployment, and quickly alleviates the insufficient effective demand problem as addressed by Keynes (Wray, 1998). Not only does an ELR program address these concerns, but it has been proposed that the ELR program can also provide education and training for workers. Keeping workers trained and employed will increase their productivity thus lowering costs to private sector production. It also fully addresses the unemployment problem from all sides because an ELR job would be offered to anyone with the willingness to work, regardless if they were structurally or technologically unemployed or if their unemployment was simply due to a stagnate economy. The ELR program leaves out only the voluntary unemployed, and those who are unable to work due to age or health issues. In these latter case, existing government programs can still provide for these individuals even with an ELR program.

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