



Centre of Full Employment and Equity

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Towards a Spatial Keynesian macroeconomics

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1. Introduction

What would a Post Keynesian economist see as being the appropriate macroeconomic policy goals of the State? We would argue that the types of models that we build and tools we use must ultimately be able to inform these policy goals.

If we were to take a poll of macroeconomists of all ideological persuasions, and asked them to outline the major objectives of macroeconomics policy then it is highly probable that the following consensus would emerge: (a) full employment; (b) price stability; (c) a robustly sustainable rate of economic growth; and (d) maintaining a sustainable (equilibrium) Balance of Payments.

While these goals are at such a level of generality that they are of little meaning 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 paper 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 accepted propositions that have no application in a fiat-currency monetary capitalism. For this reason, the differences within what might be loosely termed the Post Keynesian school of thought are almost as significant as the differences between neoclassical and heterodox economists at a somewhat broader level of analysis.

In Section 2, we characterise the macroeconomic goals that we consider constitute the core aims of policy for a Post Keynesian influenced State. We then seek to understand the basis of the power that the State has in a modern monetary economy. In Section 3, we contend that the possibilities available to the monopoly issuer of the fiat currency in this context are typically misunderstood by economists from the neo-classical supply-side, and, sadly, by many Post Keynesians macroeconomists. In this context an essential ‘progressive’ policy innovation must be to ensure that employment buffer stocks are created as the vehicle for price stability rather than unemployment buffer stocks (as with the neo-liberal 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 quantum demanded by the willing labour force), some of which will be delivered via an unconditional (and infinite) offer of employment by the State at a fixed wage to anyone who wishes to take advantage of the offer. This becomes the base level intervention required by the State upon which further public infrastructure investment or public service employment strategies can be introduced. Accordingly, we consider the “deficit-dove” approach to fiscal policy, which underpins much of Post Keynesian macroeconomics, to be untenable and unjustified. Moreover, we argue that much of the analysis purporting to explain the ‘open economy’, which is also accepted by Post Keynesian macroeconomics has no application in the ‘modern money’ paradigm.

In Section 4, we extend the argument and outline a case for the adoption of a spatial approach to macroeconomic analysis, but one that departs from more conventional understandings of regional policy that prevailed under the Keynesian paradigm that dominated in the early post-war period. Concluding remarks follow.

2. Goals of macroeconomic policy

In this section, we briefly outline what we see as being the goals of macroeconomic policy, which should underpin any discussion of a Post Keynesian macroeconomics.

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 World War II, the problem that had to be addressed by governments was how to translate the full employed war economy with extensive civil controls and loss of liberty into a fully employed peacetime model.

The first major statement addressing this problem came in the form of Beveridge's (1944) *Full Employment in a Free Society*. Consistent with the new Keynesian orthodoxy of the time, unemployment was constructed as a systemic failure to provide enough jobs and the focus moved away from the personal characteristics of the unemployed themselves and prevailing wage levels. Beveridge (1944: 123-135) 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 considered a major issue even though it was one of the stated policy targets of most governments. Beveridge defined full employment as an excess of vacancies at living wages over unemployed persons.²

2.2 Price stability

In the 1950s, economists sought to define the irreducible minimum rate of unemployment (see Bancroft, 1950; Dunlop, 1950). However, the introduction of the Phillips Curve shifted the terms of the policy debate onto trade-offs between unemployment and inflation. The concept of full employment as a sufficiency of jobs was further undermined with the development of the expectations-augmented Phillips curve of Friedman (1968) and Phelps (1967, 1968). This model spearheaded the resurgence of pre-Keynesian macroeconomic thinking in the form of Monetarism. Foremost was Friedman's (1968: 60) notion of the embedded Natural Rate Hypothesis (NRH), which argued that there was "no long-run, stable trade-off between inflation and unemployment." Full employment was assumed to prevail (with unemployment at the so-called 'natural rate') unless there were errors in interpreting price signals. This left little or no room for the discretionary management of aggregate demand. Related to the 'natural rate' was concept of the non-accelerating inflation rate of unemployment (NAIRU) (Modigliani and Papademos, 1975). The latter concept has received more attention in the modern policy debates than the natural rate although in practical terms the two concepts are equally pernicious for the attainment of full employment defined as a sufficiency of jobs.

Various theoretical structures can support the conclusion that levels of unemployment above a certain level will be associated with declining rates of inflation. It can equally arise within a simple excess demand model (where wage pressure builds as the labour market tightens and the firms pass the rising costs on in the form of higher inflation) as in Modigliani and Papademos (1975), or in the Marxist-inspired conflict-theory models of inflation (Rowthorn, 1977). In either case there is a defined unemployment rate, which is usually considered to be cyclically-invariant, at which price inflation

stabilises (see Mitchell, 1987 for discussion of the importance of the assumption of cyclical invariance). With the profession largely adopting the NAIRU concept (or its Marxist equivalent), full employment as initially conceived was abandoned.

In Section 4, we map the concept of full employment as a sufficiency of jobs into a practical policy environment which also embraces price stability. We argue that instead of the NAIRU approach, which uses a buffer stock of unemployed to control inflation, employment should always be available on an inclusive basis using publicly-created buffer stocks of employment, provided at the minimum wage. This approach, we suggest, achieves price stability through the provision of an anchor for the inflation rate.

2.3 Importance of social settlement

Full employment in the way we have defined it in the previous section invokes a spatial dimension if we introduce another policy priority – that of the sustainability of social settlements. Economic geographers such as Jessop (1999) have charted the development of a Schumpeterian Post-National Workfare State (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 the Keynesian welfare state with a system promoting international competitive advantage, often at the expense of declining ‘old industrial areas’.

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. We would argue that 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 and growth rates. It will become clear in the discussion that is to follow that an approach of this kind departs markedly from the pursuits of those who would merely supplement the SPWS with policies to promote ‘social capital’ (see Fine, 2001).

Our concerns are motivated by evidence that differentials in regional employment growth rates and regional unemployment rates have persisted in most countries since the early 1990s despite being a decade of growth in most countries. In Australia, for example, despite the relatively robust growth in the economy overall 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; Mitchell and Carlson, 2005).

While Keynesians typically argues that regional employment variations are a function of variations in the distribution of industries across space and that the impact of aggregate factors is largely uniform within those industries (see Arestis and Sawyer, 2004), Mitchell and Carlson (2005) found regional factors to be independently significant. Even after controlling for industry composition, low growth regions experience stagnant labour markets and negative shocks appear to endure for a long time. Neoclassical explanations for the 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 determines the health of regional labour markets.

There is strong evidence in various countries to support the proposition that low rates of job accessibility combine with patterns of local interactions (Durlaf, 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; Akerlof, 1997; Jensen *et al.*, 2003; Durlauf, 2003) and spatial spillovers (Anselin, 2003) is relevant to Post Keynesians who want to design full employment strategies (see also 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 (Niehbuhr, 2001). These spill-over effects ensure the spread of local shocks to neighbouring regions (Molho, 1995). Topa (2001) argues that neighbourhood stratification and widening inequalities accompany these endogenous spatial dependencies.

2.4 Environmental sustainability

Full employment and the continuity and health of the social settlement are necessary conditions for the achievement of economic and social sustainability, which is the overarching aim. However, they are not in themselves, sufficient conditions. Without a balance being achieved between these elements and the natural (physical) environment, we cannot claim that the macroeconomic situation is sustainable. As a consequence, the final policy goal, which we argue should be an integral aspect of 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 the design of macroeconomic policies: (a) the level of production (and consumption) must be consistent with the demands of the physical environment; and (b) locally- or community-based production should be encouraged.

Neoclassical approaches to environmental sustainability focus on the need to augment or maintain appropriate stocks of ‘environmental capital’. More radical critics highlight the continuing importance under capitalism of the three-fold alienation of workers from their conditions of production (especially land), the production process, and their products (Burkett, 2003). This alienation is driven by the commodification of labour power and of natural conditions. Accordingly, prices become regulated by abstract labour and workers are obliged to sell their labour power to purchase what is necessary for their survival and reproduction. From this perspective the concept of ‘natural capital’ both reifies and masks exploitation, viewing the environment through the lens of the functional requirements of capital.

3. The role of State in Post Keynesian macroeconomics

3.1 Mediation between competing classes

In the context of the policy goals outlined in Section 2, we construct the role of the State as providing mediation between the conflicting classes – workers and capitalists. In this respect, we firmly situate our understanding of the dynamics of power in the modern monetary system within the authority relationships (classes) defined by

property ownership. We posit that the two sides of property ownership (owning or not) generate specific and conflicting ‘class interests’. The structure of political relations emerges from this conflict and the balance of political power at any particular time will reflect the class struggle.

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. However, whether that fiscal presence generates full employment depends on the State mediating the class conflict rather than reinforcing one side or another.

3.2 Government as issuer of fiat currency and sectoral balances

This section summarises the recent work of Mitchell and Mosler (2002, 2005) (see also Mitchell, 1998; Wray, 1998). Modern monetary economies use fiat currencies within a flexible exchange rate regime. The currency of issue is the only unit which is acceptable for payment of taxes and other financial demands of the government of issue. The currency supply monopoly presents the Government with options it would not otherwise have under alternative currency arrangements.

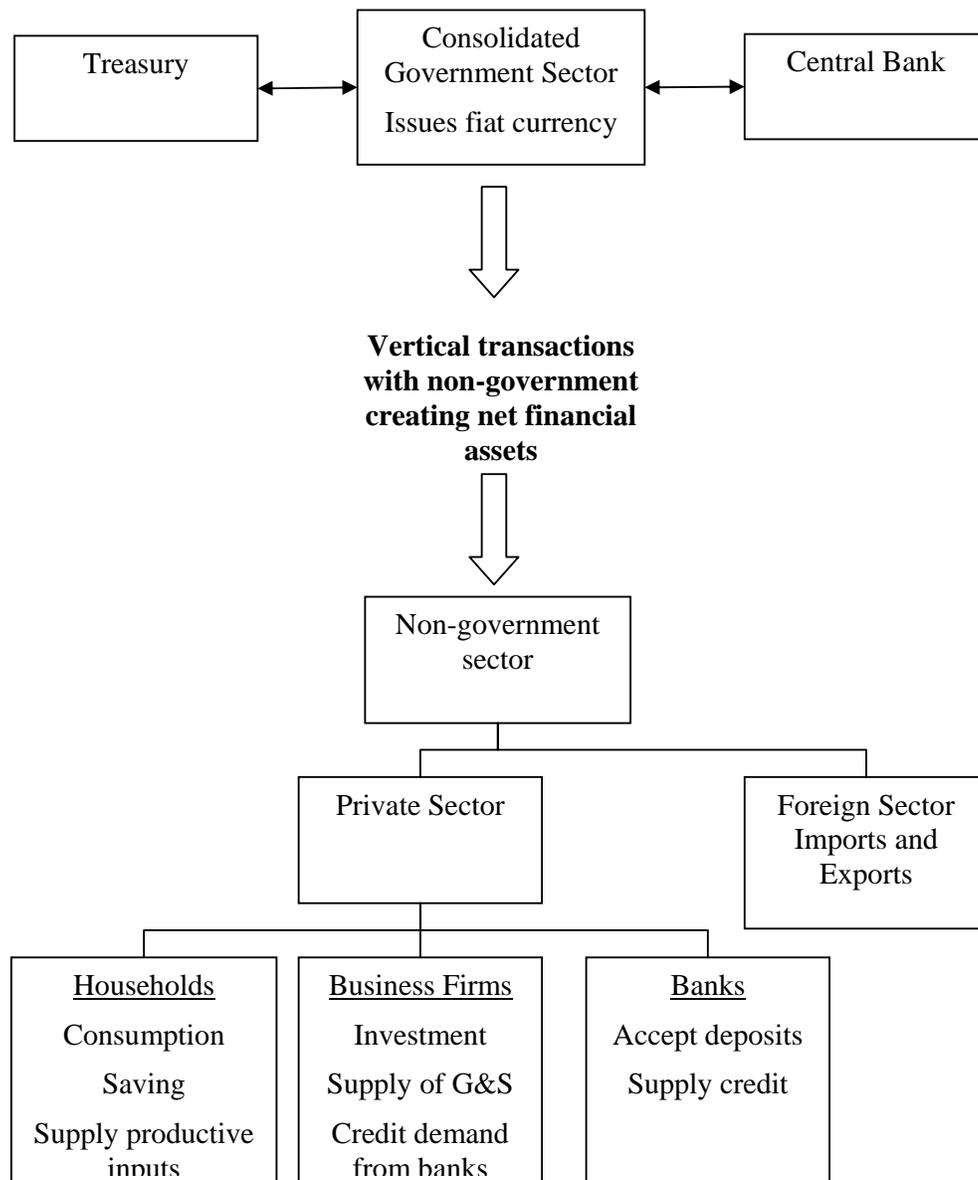
Figure 1 sketches the essential structural relations between the government and non-government sectors. First, we combine Treasury and Central Bank operations because ‘within government’ transactions are of no importance to understanding the ‘vertical’ relationship between the government and non-government sectors. Second, the private domestic and foreign sectors can be consolidated into the non-government sector without loss of analytical insight.

At the heart of national income accounting is an identity - the government deficit (surplus) equals the non-government surplus (deficit). Cumulative government deficit spending is required for the non-government sector to accumulate aggregate net savings of financial assets. Net government spending therefore 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 the non-government sector is dependent on 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) private disposable income falls; and (b) the stock of financial assets (money or bonds) held by the private sector falls. 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 slow-down in real activity.

Figure 1 Government and Non-Government structure



3.3 Vertical and horizontal relationships in a monetary economy

The currency-issuance monopoly means that the government is never inherently revenue constrained. Government typically spends by crediting private sector bank accounts at the central bank. Operationally, this process is independent of any prior revenue. Such ‘spending’ does not diminish any government asset or government’s ability to further spend.

Alternatively, when taxation is paid by the private sector cheques (or bank transfers) that are drawn on private accounts in the 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.

In Figure 1, we depicted a vertical relationship between the government and non-government sectors, which we characterised as being injections/withdrawals of net financial assets between the sectors. In Figure 2, the juxtaposition between vertical and horizontal relationships in the economy is shown. Vertical arrows depict transactions between the government and non-government sectors and horizontal arrows depict transactions between agents within the non-government sector.

The two arms of government impact on the stock of accumulated financial assets in the non-government sector and the composition of those assets. 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 notes and coins (cash), bank reserves (clearing balances) and government bonds.

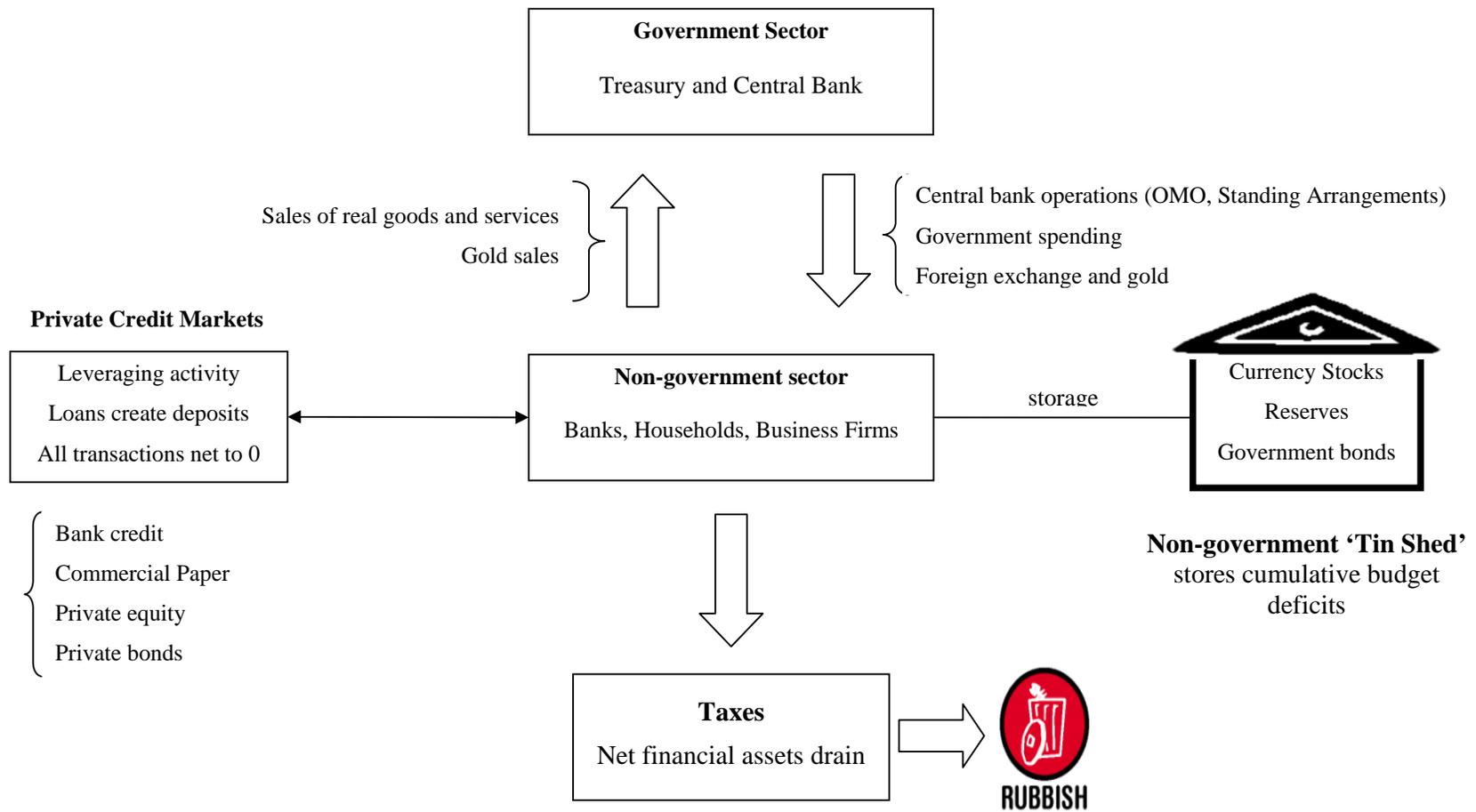
Taxes lie at the bottom of the ‘exogenous vertical chain’ (and are ‘scrapped’) as they reduce balances in private sector bank accounts. The Government doesn’t actually ‘get anything’ – the reductions are accounted for but ‘go nowhere’. There is no relevance to the concept of a fiat-issuing Government ‘saving’ in its own currency. 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 consider to be endogenous circuits of money. The crucial distinction is that horizontal transactions do not create net financial assets – all assets created are matched by a liability of equivalent magnitude and net to zero.

Figure 2 also shows what we term the ‘Non-government Tin Shed’ which stores fiat currency stocks, bank reserves and government bonds. Following our earlier discussion, any payment flows from the Government sector to the Non-government sector that do not ‘finance’ the taxation liabilities remain in the Non-government sector as cash, reserves or bonds. So Tin Shed stocks reflect cumulative budget deficits.

The other important point is that private leveraging activity, which nets to zero, are not an ‘operative’ part of the ‘Tin Shed’ stores of currency, reserves or government bonds. The commercial banks do not need reserves to generate credit, contrary to the popular representation in standard textbooks.

Figure 2 Vertical and horizontal macroeconomic relations



3.4 Idiocies of the Government Budget constraint framework

Mainstream macroeconomics errs by blurring the differences between private household budgets and the government budget. This errant analogy is advanced by the popular government budget constraint framework (GBC) that is now a standard exposition in most standard macroeconomics textbooks. While in reality the GBC is just an *ex post* accounting identity, orthodox economics claims it to be an *ex ante* financial constraint on government spending.

The GBC leads students to believe that unless the government wants to ‘print money’ and cause inflation it has to raise taxes or sell bonds to get ‘money’ in order to spend. But the household is a user of the currency and must finance its spending, *ex ante*, whereas government is the issuer of the currency and necessarily spends first before it can subsequently debit private accounts, should it so desire.

The GBC myth is expressed in erroneous discussion about ‘debt monetisation’ that frequently dominates fiscal and monetary policy chapter in macroeconomic text books. Debt monetisation 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. This logic underpins the orthodox justification for the government selling bonds to the public to ‘finance’ net spending.

In exposing the myth that public bond-issuance ‘finances’ government spending, we will also undermine the debt monetisation fable.

3.5 Government debt sets interest rate

In reality the central bank does not have the option to ‘monetise’ any outstanding federal debt or newly issued federal debt. As long as the central bank 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 necessarily administers the risk-free interest rate and is not subject to direct market forces. While the funds that government spends do not ‘come from’ anywhere and taxes collected do not ‘go anywhere’ there are substantial liquidity impacts from net government positions.

Only vertical transactions change the system balance. Government spending and purchases of government securities (treasury bonds) by the central bank 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 has crucial implications for central bank ability to target the short-term interest rate level and influences its use of open market operations.

Fiscal deficits result in system-wide cash surpluses, after spending and portfolio adjustment has occurred. The commercial banks try to loan these excess funds and thus put downward pressure on the cash rate. The money market cash position is unchanged by exchanges between clearing accounts because they are horizontal transactions. If the central bank desires to maintain the target cash rate then it must ‘drain’ this surplus liquidity by selling government debt.

The central bank’s lack of control over the quantity of reserves underscores the impossibility of debt monetisation. If the central bank purchased securities directly

from the treasury and the treasury 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. The central bank would be buying securities from the treasury and selling them to the public. No monetisation 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 the financial crowding out argument inherent in standard IS-LM analysis used by many Post Keynesians is also erroneous. 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 the government spent. Nugent (2003) says that “in other words, deficit spending creates the new funds to buy the newly issued securities.” To use the language of central bankers, government securities function to ‘offset operating factors that add reserves’, the largest ‘operating factor’ being net spending by the Treasury. In this sense, the purchase (or sale) of bonds by (to) the non-government sector alter the distribution of the assets in the ‘Tin Shed’ shown in Figure 2.

If the funds that purchase the bonds come from government spending as the accounting dictates then any notion that government spending rations finite ‘savings’ that could be used for private investment is a nonsense. Nugent (2003) says “since the supply of treasury securities offered by the federal government is always equal to the newly created funds. The net effect is always a wash, and the interest rate is always that which the Fed votes on. Note 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 would happen 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 the target cash rate. For the central bank running a default support rate, the ‘penalty’ would be that the interest rate would fall to its support rate. Importantly, any economic ramifications (like inflation or currency depreciation) would be due to lower interest rates rather than any notion of monetisation.

Ultimately, private agents may refuse to hold any more cash or bonds. It is clear that 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 and lower the required budget deficit as long as savings desires remain low. Clearly, there would be no desire for the government to expand the economy beyond its real limit. Whether this generates inflation depends on the ability of the economy to expand real output to meet rising nominal demand. That is not compromised by the size of the budget deficit.

3.6 State money implies possibility of unemployment

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

government to the government sector, which in turn, facilitates the government's economic and social program.

The funds necessary to pay the tax liabilities are provided to the non-government sector by government spending. Accordingly, government spending 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 (whether actual income generated in production is fully spent or not each period). 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, other things equal. The primary cause of this state is that net government spending is too low to accommodate the need to pay taxes and the 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. Keynesians have used the term demand-deficient unemployment. In our conception, the basis of this deficiency is at all times inadequate net government spending, given the private spending decisions in force at any particular time.

We argue that Post Keynesians are united in terms of their explanation for the existence of unemployment – that it is a systemic failure resulting from inadequate aggregate demand. We would also suggest that Post Keynesians would 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 in the way we have constructed it above. We identify two broad approaches: (a) generalised expansion predominantly driven by investment together with mechanisms whereby individual nation can manage structural imbalances between trading nations; and (b) spatially-targeted expansion with buffer employment stocks. Section 4 compares and contrasts these approaches.

3.7 Opposition to Chartalist macroeconomics

There are two camps in economics that oppose this type of macroeconomic analysis: (a) 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 on the western economies since the mid-1970s; and (b) the progressive 'deficit-doves' (for example, Glynn, 1997) who believe that federal net spending provides the underpinnings for increased economic activity and employment but fail to understand the essentials of modern money. They erroneously consider that net spending be 'financed' by debt-issuance and then construct the viability of any particular fiscal stance (erroneously conflating debt-issuance into fiscal policy) through a comparison between the respective levels of national debt and national wealth. They also decompose the deficit into structural and cyclical components and define the 'full employment budget' (for example, Eisner, 1989). There is also a tendency for them to propose a balanced budget 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 have fallen prey to this logic (see for example, Palley, 1996). They appear to be comfortable with using deficit spending to increase economic activity, but couch their recommendations in conservative logic bounded by appropriate movements in the debt to GDP ratio. As long as the ratio is stable there is no problem.

A Post Keynesian framework for analysing the relation between deficits and the debt ratio is provided by Bispham (1988) and Glynn (1977). Glynn (1997: 226), an advocate of expansionary fiscal policy to reduce unemployment, claims this literally means the higher is the debt ratio the higher sustainable deficit as long as the real interest rate is below the GDP growth rate. He also argues that “financial markets, the ultimate arbiters of such matters, may look simply at the size of the deficit.” The Bank of International Settlements (1994: 88) concur that “it is difficult to persuade markets that low inflation is sustainable in the presence of large budget deficits.” Glynn (1997: 227) concludes 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 to understand the relationship between fiat currency, public debt and taxation in a monetary capitalist economy.

They fail to understand the priority of government spending and misconstrue the role of debt issuance as interest rate maintenance. What if there were no bond issues? The spending would still have occurred and the excess reserves would be held somewhere in the banking system earning zero return (or whatever support rate the particular Central Bank paid). If the Treasury offers too few or too many bonds relative to the holders of reserve balances at the Central Bank, the Central Banks ‘offsets’ those operations to balance the system. In any case, the ‘money’ is in one account or another at the Central Bank. We then ask the question - why should government care if the holders of the excess balances chose the one that doesn't pay interest as opposed to the ones that do (buying bonds)? The answer is simple - they would be indifferent.

4. Current ‘progressive’ approaches to unemployment

4.1 Introduction

All Post Keynesians would agree that the orthodox unemployment buffer stock approach (NAIRU) to inflation control is costly and unacceptable. It is clear that inflationary pressures can be controlled by persistently high levels of unemployment and income losses. The neo-liberal solution to this problem is to pursue supply-side policies including labour market deregulation, retrenchment of the welfare state, privatisation, public-private partnerships, and general cut backs in public provision as the way in which the economy can gain ‘room’ to expand without cost pressures emerging. Post Keynesians, in general reject this strategy on the grounds that the

sacrifice ratios are high and the distributional implications (creation of under class and working poor and loss of essential services) are unsavoury to say the least.

However there is no consensus when it comes to an alternative. Some Post Keynesians, following closely the policy recommendations of Keynes himself advocate what we will term ‘generalised expansion’, where the national government ensures that spending is sufficient to purchase all the 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. We argue that this strategy ignores the role for a buffer employment stock, which allows the government to guarantee full employment using automatic stabilisers by purchasing at fixed prices and thus provides a nominal anchor to the economy. But significantly, it also distributes jobs across geographic space and underpins a regional safety net for all communities. Finally, it can assist in the redirection of productive resources from environmentally damaging to environmentally sustaining activities. In this section, we compare and contrast several so-called ‘progressive’ approaches to the problem of unemployment.

4.2 Generalised expansion

Many Post Keynesians advocate what we term generalised fiscal and monetary policy expansion, perhaps mediated by incomes policy and controlled investment as a solution to unemployment (Ramsay, 2002-3; Seccareccia, 1999; Kadmos and O'Hara, 2000; Sawyer, 2005). Davidson (1994: 79) who we regard as being representative of the mainstream Post Keynesian approach to macroeconomic policy 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.”

An (indiscriminate) Keynesian expansion in isolation is unlikely to lead to the employment of the most disadvantaged members of society and does not incorporate an explicit counter-inflation mechanism.

A generalised expansion also fails to address the spatial disparities in labour market outcomes. Arestis and Sawyer (2004: 11) argue correctly that “the industrial structure of a region and from variations in productive capacity as well as in aggregate demand of the region” drive these disparities. After citing several studies, they suggest that this comes down to a failure of investment. Arestis and Sawyer (2004: 18) 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 the regions that are failing? 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 ‘generalised expansion’?

4.3 Buffer employment stocks and spatial Keynesian

In this section, we briefly map out our preferred approach to macroeconomic policy. We base it on the proposition that full employment and price stability requires a nominal anchor combined with an infinitely elastic labour demand function. In this context, we argue that an employment buffer stock approach, which we term the Job Guarantee (JG), outlined by Mitchell (1998), Wray (1998) and others is a superior way to pursue the macroeconomic goals we articulated in Section 2.

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 regular public sector). By directly eliminating demand-deficient unemployment the JG also addresses the single most significant source of income insecurity.

The JG is juxtaposed with what we term 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 pursuit of budget surpluses reinforces the overall restrained demand environment. 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 is consistent with our construction of persistent unemployment as systemic failure driven by erroneous policy. Persistent unemployment is a product of persistently inadequate budget deficits. The State can resolve this demand gap in two ways: (a) by increasing net spending via purchasing goods and services and/or labour at market prices as explained in the previous sub-section; and/or (b) by using its power as the currency issuer to provide a fixed-wage job to all those who are unable to find a job in the private sector. The government would thus be 'an employer of last resort' and provide a buffer stock of jobs that are available upon demand. The resulting net spending is the minimum required to bridge the demand deficiency and restore full employment. We term this approach the JG. Clearly, and emphatically, a mixture of (a) and (b) is likely to be optimal although (a) alone is not preferred.

The JG absorbs and hence minimises the real costs of private sector demand swings (Berger and Piore, 1980). 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.

The JG differs from a Keynesian expansion because it represents the minimum stimulus (the cost of hiring unemployed workers) rather than relying on market spending and multipliers. The JG also provides an inherent inflation anchor missing in the generalised Keynesian approach.

Kadmos and O'Hara (2000: 10-12) criticise the focus on government consumption of low-skilled services by the JG advocates, including Wray (1998) and Mitchell (1998), because 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 to achieve specific social and economic objectives then employment levels will rise. In fact, Mitchell, Cowling and Watts (2003) strongly argue for the JG to be accompanied by social wage spending to increase employment in education, health care and the like. 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 with an increasing likelihood of inflation (Forstater, 2000).

Crucially, public investment is unlikely to impact positively on the most disadvantaged workers in the economy. The JG is designed to explicitly provide opportunities for them. By way of example, during the golden age in Australia (1945-1975) when public capital formation and social wage expenditure was strong, full employment was only achieved because the Australia public sector (implicitly) acted as an employer of last resort for the least-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 argue that the creation of low-wage service employment under the JG means that the skills gained by workers will be of little benefit to the private sector (see also Sawyer, 2003). Kadmos and O'Hara (2000) suggest the importance of structural unemployment by claiming that, when the labour market tightens, firms drive up wages for the employed in the attempt to retain skilled staff, thereby maintaining unemployment in the context of wage/wage inflation. But the concept of structural unemployment is itself somewhat loaded 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 by discriminating firms from the chance to receive paid employment and the requisite training as economic growth ensues because they are deemed to possess 'undesirable' personal characteristics. The question that progressives should focus on is why these groups are excluded from these training/paid employment offers by private employers rather than perpetuating the idea that there are 'structural' impediments in the labour market.

The JG can redress this discrimination that many wrongly call structural unemployment. Further, via regionally-based job creation programs, the JG can also productively employ all workers who cannot find a private employer. Significantly, the JG does not preclude training initiatives (see Mitchell, Cowling and Watts, 2003). Clearly, appropriately structured training within a paid employment context will help overcome the endemic problem of churning the unemployed through training programs, 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 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.

Seccareccia (1999) 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-minimising strategies are not specific to the implementation of the JG, however, and under current labour market legislation are available for most employers.

While environmental constraints militate against generalised Keynesian expansion, JG proponents emphasise the regional dispersion of unemployment. Ramsay (2002-3) fails to acknowledge this point. Gorz (1992) argues that regenerating the concept of community and providing access to work in the public sphere is essential to economic

citizenship and participation in the social processes of production. Further, healthy communities are spaces that encourage and enable participation in social and democratic life.

Higher levels of output are required to increase employment, but the composition of output remains a pivotal policy issue. The 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 stabilisation, and river valley and erosion control. Much of this work is labour intensive requiring little in the way of capital equipment and training; and will be of benefit to communities experiencing chronic unemployment (Mitchell, Cowling and Watts, 2003: 9). We denote this form of spatially targeted employment policy as spatial Keynesianism, in contrast to the blunt instrument of orthodox Keynesianism which fails to take account of the spatial distribution of social disadvantage.

4.4 Balance of Payments constraints

Some Post Keynesian economists focus on alleged ‘stop-go’ constraints on economic growth emerging from current account problems (Davidson, 1994). The alleged balance of payments constraint has often been used to justify curtailing economic growth. This made sense under a fixed exchange rate because the current account influenced central bank reserves and made domestic expansion dependent on the needs to defend the external parity. The economy is freed from this constraint under a floating exchange rate which means that domestic policy can pursue full employment targets with the exchange rate taking the adjustment. In claiming that a flexible exchange rate regime is a “liberal notion”, Ramsay (2002-3: 275) shows a complete misunderstanding of these options facing a government in a fiat currency economy. It is hard to construe these options as liberal. The neo-liberal practice of denying these options is the reason there is persistent unemployment.

From the monetary perspective outlined in Section 3, there are strong grounds for doubting the relevance of Post Keynesian and Post Kaleckian analysis to a floating exchange rate world. In effect, those Dow (1988) calls the Post-Kaleckian’s have indirectly bought into the orthodoxy’s notion of government-budget constraints, through the medium of the balance-payments constraint. Regional policy interventions are then privileged to the extent that they *alleviate* rather than *aggravate* the national balance-of-payment constraint (McCombie and Richardson, 1987). This will only happen if extra-regional export activity is promoted. Import substitution policies, by definition, will have less impact on this national constraint. However, we would argue that the demise of the Gold standard and the general adoption of floating exchange rates, these ‘sustainability’ concerns are no longer applicable.

Post Keynesian developments in macroeconomic modelling seem to have confirmed this Chartalist position. For example, Taylor (2004) has recently constructed a two-country open-economy portfolio balance model with full stock/flow accounting. While this model can determine home and foreign interest rates, the exchange rate is itself undetermined. Under the conventional Mundell-Fleming approach, the balance-of-payments equation is not sufficient to determine the exchange rate. An alternative approach to the construction of a two-country IS-LM model could account for exchange-rate dynamics by predicating movements in the spot rate on expectations

about its future value (Taylor, 2004: 223). Here, uncovered interest parity (UIP) is the ‘usual suspect’ for anchoring the otherwise shifting sands of expectations, but Taylor readily admits that it does not seem to fit the empirical data.

Nevertheless, in a model incorporating UIP, if stability of the debt-to-capital ratio is imposed (which requires that, on average, the rate of capital accumulation exceeds the real rate of interest), Taylor demonstrates that the economy is likely to go through cycles. And the addition of Ramsey-style dynamic optimisation, he observes, would not guarantee stability—saddle-point or otherwise (Taylor, 2004: 226).

The Chartalist take on these findings is simple: balance-of-payments considerations should not be allowed to get in the way of deficit spending to achieve full-employment. A deficit on the current account merely indicates that the foreign sector wishes 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 after all 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.

4.5 New Regionalist supply-siders

The persistently high unemployment since the mid 1970s in many OECD countries has motivated ‘solutions’ that purport to steer a route through the ‘extremes’ of Keynesianism and neo-liberalism. These so-called progressive Third Way movements include what has become known as New Regionalism (NR), which has appealed to many so-called progressive economists. We argue that they adopt a characterisation of unemployment, albeit somewhat blurred, that is hard to distinguish from the NAIRU hypothesis (Lovering, 1999; Peck, 2001; Cook, Dodds and Mitchell (CDM), 2003).

In this section, we argue that the individualistic and market-based constructs inherent in neo-liberalism have been adopted by NR, an “emerging orthodoxy in urban and regional scholarship” (Jones and MacLeod, 2002: 5) and, as a consequence, have obscured the neo-liberal failure to achieve full employment. Unemployment has been desensitised and rendered an individual problem – the ultimate ‘privatisation’. A series of ‘solutions’ or separate policy agendas begin with individualistic explanations for unemployment and accept the litany of myths used to justify the damaging changes in the conduct of macroeconomic policy. 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 largely driven 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 had displaced nation states as sites of successful economic organisation. This arose as a result of changing technological and organisation dimensions of production and the downfall of ‘Fordism’ as a production mode (Piore and Sable, 1984; Storper, 1995). Following the deindustrialisation of many regions (the decline of Fordism in the 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 provided the best platform to achieve flexible economies of scope that were required to adjust to increasingly unstable markets. These socio-spatial processes involve localised knowledge creation, the rise of inter-firm (rather than intra-firm) relationships, collaborative value-adding chains, the development of highly supportive localised institutions and the training of highly skilled labour: players who remained loyal to an area due to supportive social relations (Lovering, 1999; Granovetter, 1985; Ohmae, 1995). These dynamics required 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 emphasised new knowledge-intensive activities encouraging local participative systems (Mayer, 1992; Sassen, 1994). By achieving critical mass of local collaborators, a region could be dynamic and globally competitive (Castells 1997; Cooke and Morgan, 1998).

Most 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.” There is also dispute about whether some of the examples used to advance the case for NR actually represent successful demonstrations of the approach. For example, Staber (1996) argues that the Baden Württemberg region does not fit the NR model; Markusen (1996) criticises the applicability of the Silicon Valley; and Jones and MacLeod (2002) and Lovering (1999) challenge the empirical claims concerning regions in the UK. As an example of the dangers in generalisation outside of context, 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 a something which is almost entirely ignored in New Regionalist thought ... It is the national (British) state.

While there are many criticisms that can be levelled at the NR agenda the major weakness is that it is predicated on 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. In that regard, the major flaw is that it begins with the neo-liberal orthodoxy that alleges that government fiscal and monetary policy is impotent or crisis ridden and therefore individuals have to be empowered with appropriate market-based incentives. Lovering (1999: 387) says that “NR reproduces neoliberalism’s methodologically individualist myopia and forgets Marx’s and Keynes’ discovery that the economy is not the sum of its parts.”

Further, NR fails to construct mass unemployment in macroeconomic terms represents what CDM (2001) called its “first false premise.” The emerging paradigm highlight local schemes or initiatives (for example, Henton *et al.*, 1997), but fail to

understand that in a constrained macroeconomy the scale of job creation required is beyond the capacity of local schemes. This specific-to-general logic also pervades neo-liberal logic and formed the basis of the Keynesian attack on orthodoxy during the Great Depression.

So while NR rejects economic rationalism as a way forward and argues that they are neither Keynesian nor rationalist, the reality is different. As a consequence of blindly accepting the erroneous notion that there are binding financial constraints on federal governments and these solutions fail to deliver a policy framework that will achieve full employment (Ohmae, 1995; Danson, 2000; CDM, 2001; Lovering, 1999). As a consequence, the neo-liberal position is left unchallenged and is actually reinforced.

A new style of Says Law emerges with claims that post-Fordist economies need to focus on the 'supply-side architecture'. By disregarding the centrality of the Federal government as the monopoly supplier of fiat currency, and the powers and responsibilities that that status brings (outlined in Section 3), the NR agenda betrays a total lack of comprehension of how monetary capitalist economies operate.

There is no escaping the basic national accounting relationships between spending and inventories. The central government is always powerful if it spends its own currency as long as it can enforce basic tax obligations. Its spending decisions have a significant influence on the aggregate level of activity and, in turn, the performance of regional economies. While distributional changes between regions can occur at a given aggregate level of activity, it is a compositional fallacy to assume that all regions can lift themselves without a buoyant aggregate climate. Furthermore, innovation and skill development is more likely to develop when the national economy is strong. Mass unemployment is a symptom of the central government's unwillingness to spend sufficient amounts of currency given the non-government sector's propensity to save. Its solution requires this deficiency to be reversed. While increasing indebtedness within the non-government sector can temporarily bridge a spending gap, it ultimately is not a sustainable path to full employment growth. Minor changes in exchange rates and interest rates can drive a heavily indebted private sector into multiple bankruptcies.

5. Conclusion

In this paper, we have adopted a Chartalist perspective on the monetary system in arguing for a new kind of Spatial Keynesian policy 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 generalised expansion, especially those muted by unnecessary concerns about either the sustainability of public sector debt or the resilience of the balance of payments situation.

In advocating these policies we have emphasised the importance of preserving social settlements both on equity grounds and on the basis of arguments about social networks and spatial spillovers. However, this demand-driven spatial focus remains firmly distinguished from supply-side interventions, which are aimed at boosting regional competitive advantage. Throughout, we have highlighted the activist role of the nation 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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² Similarly, Vickrey (1993) said "I define genuine full employment as a situation where there are at least as many job openings as there are persons seeking employment, probably calling for a rate of unemployment, as currently measured, of between 1 and 2 percent."