Funding the Future

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It would appear that the anti-modern monetary theory brigade are keen to appear in the comments section of this blog at present. In that case I think I need to be clear what MMT says, as I understand it. What follows is an interpretation, in a nutshell.

First it says governments can make money out of thin air, at will. This is now an acknowledged fact. The Bank of England agrees now. QE proves it.

MMT then says all government spending is in fact funded by money created in this way, created by central banks on the government's behalf. As MMT, correctly in my opinion, points out, if this was not the case then government created money required to make payment of tax could not exist.

MMT logically argues as a consequence that there is no such thing as tax and spend when considering the activity of the government in the economy; there can only be spend and tax.

What this also means is that the capacity to tax, and indeed to borrow, cannot constrain government spending. Tautologically this has to be true: since neither payment of tax or lending to the government would be possible unless government created money was put into circulation as a result of government spending that spending cannot be constrained by either of them.

But what this means is that there is no requirement per se to balance the government's books. Indeed it is not just illogical but completely economically perverse to seek to do. A government with a balanced budget necessarily denies an economy the funds it needs to function. That is hardly a measure of economic responsibility.

In that case more responsible measures have to be adopted as the goals for economic policy. MMT suggests that full employment is the alternative goal.

As a result it is seen that MMT is located firmly within the constraints of the real economy, and not those of the finance sector. What is possible in the MMT view of the world depends upon available resources, and most especially on labour and its productivity. Since the goal is to maximise use of available labour at the highest level of productivity possible this is a policy that inevitably, and unavoidably, seeks to increase median pay.

There are, of course, constraints on available labour and the supply of investment capacity to consider. However it is important to note that given that MMT will always seek to increase labour productivity it must at the same time seek to minimise the cost of capital i.e. the real interest rate. Low rates are not an accident within MMT. They are there by design. That goal is achieved by balancing the mix of government deficit funding covered by bonds (which are issued as a favour to financial markets and depositors) and money creation, currently mainly through QE. We know that this process can now deliver the desired outcome.

But of course low real interest rates are vulnerable to inflation so MMT has a quite clear interest in constraining (but not eliminating) inflation. Elimination would constrain investment unnecessarily by encouraging its deferral so a low and moderate interest rate is required, which is achieved by taxing sufficient government created money out of existence in a period to secure this goal.

How much tax does this require? Broadly speaking experience in recent years has suggested that total tax revenues should be less than total government spending or additional money supplies required to ensure the liquidity to permit growth is not present in the economy. The differential expressed as a percentage of GDP might well be close to the desired inflation rate but overshoots and undershorts (and both will inevitably happen) might alter this.

The differential is not the same as the total tax bill though. The total tax bill is determined by the amount that must be spent to deliver full employment. This will permit ample capacity for the private sector, to the limit of its animal spirits.

The capital expenditure to deliver growth in earnings resulting from increasing capacity can be funded either by borrowing or money creation. The goal of low real interest rates will determine the mix.

The only tool not available for the purpose of economic management in MMT is the interest rate. This cannot be used because to do so might result in less than full employment, lower than optimal investment, a loss of international competitiveness and a long term loss of median wages growth due to an above optimal rate of interest being used to constrain inflation in an economy where it is presumed that all government deficits must be funded by borrowing, which we now know to not be true.

This in a nutshell is what MMT is, says and does. It is a complete, coherent economic logic that ensures liquidity, employment, growth that benefits the majority, financial stability, modest inflation, always affordable tax because the money to pay it has always been created by government in advance of settlement, and the availability of sufficient government debt to meet market needs at the low rates of interest the economy requires to prosper.

What is there not to like?