Modern monetary theory says that the state has the abil...

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I was bemused by two recent claims by so-called members of the left of centre economic community.

One of the confusing claims came from Ann Pettifor in this video. She made many almost incomprehensible claims in her presentation starting at 46.50 minutes in, but the one that I am noting now is her claim that modern monetary theory is not new.

This is, of course, true. MMT is in many ways horribly misnamed, and that's not helped it. But her claim was that we've understood money since 1705 and, apparently, there's no reason to reinvent the definition now. Her reference was to the work of John Law, which does not seem to be widely cited, but can be readily found on Wikipedia here. The FT adds some comment, here, and the RSA has an article as well.**

John Law's great idea was to introduce paper money created by the government. That was innovative, I admit. It's made a big change to the world. It was important. But there was a proviso. His requirement was that the promise to pay printed on the money be backed by precious metal holdings. In other words, this was gold standard paper money. And, according to Ann Pettifor, John Law explained all we need to know about money.

In other words, it would appear that, like far too many of the world's left of centre economists, she has not noticed that the gold standard has gone, finally being put out of its misery when Richard Nixon took the USA off it in August 1971.

Since then we have only had fiat money. And fiat money is money purely backed by government promise, given meaning by the ability of the government to tax. From experience I can tell you that Ann hates any discussion of tax, let alone giving any weight to it as an issue of economic significance, so I would not expect her to go near this definition, but John Weeks, another supposedly progressive economist who appears to be anything but that, had this to say in a tweet exchange with me on Thursday:

https://twitter.com/johnweeks41/status/1271113492410572800

So, bank notes are what fiat money is, and that's been true for 1,000 years. That's an interesting idea for three reasons.

First, this makes clear that John has no explanation for electronic money.

Second, it means that he too is fixed in history.

And third, like Ann that suggests that he too has failed to notice the end of the gold standard.

It literally beggars belief to think that those on the left who want to talk about money have failed to notice that what money was and what it is now are quite literally not the same thing.

In Ann's case it's even more staggering when she works with Geoff Tily of the TUC who is steeped in Keynes and yet she has not apparently noticed that Keynes' greatest contribution to WW1 was the introduction of what was called the Bradbury pound - or fiat money that was not convertible into gold, despite which it was readily accepted for exchange. These pounds were withdrawn in the twenties, of course. The rest, as is said, is history.

What I very strongly suspect is that this inability to think that money is no more than a promise and that tax is absolutely and completely central to its valuation is core to the challenge we face over money, and the resulting revolution that this understanding creates in economics.

It's also core to our understanding of the role of government. The 'hankering for value' that these, and many other economists, display is corrosive. They may say that they know that the gold standard has gone, but such is their desire to deny that tax alone underlines the value of the currency that they try to find substitutes. Most especially, they say that the pound (or any other currency) has value in exchange: it is worth what you can get for it. But in doing so they ignore three things.

The first is that this does not say why you can get things for it.

The second is that this provides no explanation of money as a store of value because the value is only implicit at the moment of exchange.

And third this ignores the fact that this makes government dependent on markets to determine the value of the money it makes which then makes something of a folly of the whole exercise of trying to control the value of that money which has been the core objective of their macroeconomics for decades past.

In effect, what the argument suggests is that not only is value determined by the market, but is created by it and therefore the government is dependent upon the market for its revenues before it can do anything. Every one of those is wrong.

I very strongly suspect that this will be denied, but from observation over a long time I think that these sentiments are commonplace, even if not often stated as boldly as Ann and John did. The hankering for 'there's got to be something more to money than a promise' is very, very strong. As J K Galbraith said:

"The process by which banks create money is so simple that the mind is repelled"

These economists are repelled. That money creation is just double-entry book-keeping just adds to the repulsion. How can it be that something so inferior, like accounting, might create anything of value, they ask?

And of course the answer is that it does not. But it is a fact that accounting alone can record the exchange of promises that creates money. And in the process accounting actually creates the current manifestation of what money is, which is entries in ledgers. That is what fiat money is now. Forget the farcical references to notes both John Weeks and Ann Pettifor rely on. Physical manifestations of the promises implicit in money are a dying residue of an old era and understanding, something I see almost daily when my sons refuse payment from me in cash because they have no use for it. This means that accounting alone can record both money's creation and destruction, which few economists can get their heads around.

As Galbraith so clearly understood, that something so important can be so simple is repulsive to the mind seeking complex answers.

That tax gives these records value, with an essential time component added as a consequence, which then means that this aspect of MMT necessarily contributes to a theory of inflation and provides an explanation as to how to address the issue, just adds insult to the injury.

That is, I think why MMT cannot get traction with these economists right now. Or rather it's that, and one either thing. Having spent so long learning how they think money and banking works, with asset backing, banks as intermediaries, and maybe in more radical moments accepting that if money is credit then it is the private sector banks who create that credit, the idea that money is in fact made by the state after all, and is also given its power by the state is something they just cannot accept because it requires them to rethink everything, and they have too much invested in what they have already learned to do that.

And so we suffer supposedly left wing economists who deny the power of the state to create money. And who would rather we retain the idea that the state is dependent on private sector generated revenue than accept that it is in fact the private sector that is dependent on government-created money to stimulate the demand it requires to thrive. And so would rather do anything to eliminate what they call debt - which is how the state injects value into the economy - than believe that value can be created by government action, working with private sector partners.

No wonder the left is in trouble. Most is its economists don’t believe in the power of the state. Which is pretty worrying.

** *Footnote added 1t 15.10: I have checked out Law in Galbraith 'Money, whence it came, where it went' and the story about the quest for gold (and land) backing for his currency is actually much more complicated than my summary above implies, but does not change the substance on my comment.*