Funding the Future

Scotland has to choose modern monetary theory

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As is, I think, known by most readers if this blog, Larry Elliott, who has been the economics editor of The Guardian for decades, has been a member of the Green New Deal Group since its inception. The result is that he and I have worked quite closely on occasion over the years. And we have as a result discussed MMT many times.

I was, as a result pleased to see Larry's review of the economic options now facing an independent Scotland in yesterday's Guardian. Framed in the aftermath of GERS, Larry notes:

[T]he Gers data suggest that those campaigning for independence will eventually have to come clean on what sort of macroeconomic policy regime they intend to run. Saying there are plenty of small, successful independent countries is true but beside the point because there are plenty of small unsuccessful ones as well.

He then notes that:

Scotland has four options, three of which have been touted in the past and a fourth, the most radical of the lot, which has not.

Of these he notes (and I have shortened his arguments):

Option one is for an independent Scotland to continue using the pound and to have its interest rates set by the Bank of England. This is perfectly feasible.

But as he observes:

David Cameron's government said it would not go along with this sort of arrangement back in 2014 and there is no doubt Johnson would say the same in the event of another referendum. Even if Westminster did agree, the downsides are obvious: if the Bank of England decided to raise interest rates, Scotland would simply have to suck it up. Sticking with the pound does, though, seems to be the SNP's preference.

I think we can presume he is a befuddled as anyone as to why this should be so. He is not much more impressed by the second option:

Option number two — leave the UK and join both the EU and the monetary union bloc — would mean Scotland is no longer a vassal state of England, but it also has its problems. Monetary policy would be set in Frankfurt and be even less attuned to Scotland's needs.

So he moves to option three:

The next possibility is for Scotland to create its own central bank, issue its own currency and set its own interest rates. For those who think (as Theresa May might put it) that independence means independence this is the only meaningful option. But it would not be cost free, at least in the early years.

That's because — traditionally at least — it takes time for newly formed states to establish their credibility with the financial markets and they do so by keeping interest rates higher than they otherwise would be and squeezing public spending in order to reduce the budget deficit.

He astutely observes:

Were Sturgeon to appoint a big international figure — Mark Carney, let's say — to run an independent Scottish central bank this would be the sort of policy he would undoubtedly suggest. The alternative would be capital flight, a run on the currency, a ratcheting up of interest rates and an even more severe dose of austerity.

Maybe, I would say: I think Larry ignores Scotland's strengths. But the surprise is in Larry's option four:

The only conceivable way for an independent Scotland to avoid pain would be if it adopted modern monetary theory which proved to be the magic bullet its supporters claim. Boiled down to basics, MMT says that countries operating below full employment and with their own central bank should not be deterred from spending money to create jobs because the central bank can be relied upon to print the readies necessary to cover the cost. Only when inflation rises to an unacceptable level should policy be tightened, and then by raising taxes or reining in spending.

I would usually place the emphasis on tax. So what are the problems? Larry says:

Opponents of MMT say this is the road to hyperinflation, and cite Weimar Germany and Robert Mugabe's Zimbabwe every time the idea is floated. This infuriates MMT supporters, who insist the idea would work but really need a small, newly formed country to give it a try.

Here Larry and I differ. This infuriates MMT supporters because the comparison is invalid. MMT makes clear it describes a type of economy. Despite its opponents' claims, it has never said it reveals a universal truth. It describes what happens in a country with an accountable government, with its own currency, that borrows in that currency, which has a stable tax system and so enjoys the rule of law, and a functioning central bank. That rules out Zimbabwe and the Weimar Republic, excepting that MMT explains why neither could ever work.

And, just for the record, MMT never says that spending can be without limit. It's obsessed with the real limits in spending, and inflation come to that. But Larry continues:

Scotland would tick a lot of boxes. It has plenty of spare capacity and unfulfilled needs. It runs a sizeable structural budget deficit that is being made worse by low oil prices. Sturgeon is respected and Scots might trust her to know when rising inflation required remedial action.

And then Larry lets reality creep in:

It is a fantasy, of course. MMT is too radical and risky for the SNP, which is pretty conservative when it comes to the big picture economic stuff. There's no chance of Sturgeon embracing MMT, which means that she will have to choose one of the other three options.

Or, as Larry makes clear, Scotland has a chance of really making it. Or the SNP could, with its current policy platform, really blow independence. Scotland has a lot to decide upon. The influence of Andrew Wilson, who will drive Scotland to austerity, is one of those things. It's time for the SNP to smell the coffee.