

Funding the Future

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It has been suggested to me that my support for the issue of savings bonds to the public to fund socially useful investment, with government guarantees attached, does in some way conflict with my understanding of MMT. I have to say that I disagree. But then, I have always applied my own twist to MMT and have never apologised for doing so. That is because I have long felt that its focus on a limited part of the fiscal cycle has meant that it has underestimated the important role the government has as borrower of last resort and the vital role of tax. To this I would now add a third omission, which is the absence of concern for the inequality that government deficits, including those created by MMT, can create in society.

As a result I have revisited the summary of MMT I wrote in November 2018. This was a time when I was quite disenchanted with what the likes of Bill Mitchell were claiming for MMT. Many of the views that he, and others of the more fundamentalist MMT inclination, promote seem to me to undermine MMT's credibility. I have never shied from saying so, and quite fairly those who have disagreed with me have done likewise in response. But if MMT cannot survive debate as to its meaning its not worth having.

This, then is my revised summary. I have highlighted more significant changes in italics.

The first thing that modern monetary theory (MMT) suggests is that in a country with a fiat currency (which means that there is no asset backing to the money that its government puts into circulation, which money does as a result only get value as a consequence of a government's promise to pay) there is, at least in theory, no limit to the amount of money that a government can create.

Second, a government in such a country creates money every time that it spends because when it does so it instructs its central bank to extend to it the credit required to make the payment. It is not constrained by the availability of tax revenues or borrowed funds when doing so: money can always be created by a bank on demand and a central bank will always create money when instructed to do so by the government that owns it.

The necessary conclusion from these first two observations is that because money spent by the government and the revenue it raises are not directly related to each other then there is no reason why a government should not run a deficit if that deficit suits its policy objectives and there are resources available for it to buy or to put to use within that economy.

Third, to prevent this new money creating excess inflation it is very likely that a government will have to tax to withdraw at least some of the currency that it has created from circulation. This is the primary fiscal purpose of taxation in such an economy, although tax also has other, as significant, purposes as noted below.

Fourth, this need to tax may increase as the economy approaches full employment. That is because at that point labour, and maybe other resources, will become scarce and will as a consequence be subject to upwards price pressure. *In that case MMT suggests that increased tax charges might be required for two potential reasons. One is simply to control inflation. The other is that if a government still wishes to pursue what it thinks socially desirable activity in that situation then tax can be used to reduce private sector demand in the economy so that economic capacity is made available to ensure that delivery of the government's own objectives is possible without over-inflation of the economy resulting.*

Fifth, social obligation to the population it serves means that a government should not be indifferent to the way in which such taxation is levied. Nor should it be indifferent to the non-payment of tax, even if sufficient tax is collected to secure the fiscal balance required to control inflation within the macroeconomy that it desires. Tax might have a primary goal of controlling inflation, with the secondary advantage that the tax charged for this reason provides the government created currency with its value because the 'promise to pay' that the government makes is fulfilled by only accepting that currency in settlement of tax liabilities, but tax also has the other deeply significant social purposes to play within society. One of these is its use in addressing income and wealth inequality within a society. It can also be used to reprice market failure, which means that it has a key role in addressing the externalities that market economies create. In addition, its function in delivering fiscal policy by incentivising or penalising certain activities and by reinforcing the social contract that exists between a government and its electorate is well known. *As a result tax is a reflection of the values of a society and is a primary mechanism for reinforcing many of them. MMT has, in that case, to actively promote the positive role of tax within society. It has also promote a tax system that actively tackles tax abuse. That is partly to tackle the inequality tax abuse creates within society. It is also essential to ensure that the delivery of government policies that depend upon tax as their delivery mechanism is effective. MMT and tax justice are necessarily related in that case.*

Sixth, a government does not need to borrow if it runs a deficit. Partly that is because it can, at least in theory, always run an overdraft at its central bank, on which no interest need be charged. As a matter of fact this appears to negate the need for borrowing. In

addition, government borrowing appears to make little apparent economic sense in an economy that uses the fiat money created by the national government because the money that the government supposedly borrows has already been created by it when injecting cash into the economy through its spending. However, that does not mean that a government should not appear to borrow. A government has a social duty to be the borrower of last resort to its population and financial system. That is the true function of government borrowing, and it is vital to the efficient operation of any fiat currency using economy. *Savers want a secure place to save for a great many reasons, and for the sake of financial stability the government must supply it. All that is implied is that the government must manage its cost of borrowing so that there is an overall acceptable price to society at large for supplying this borrower of last resort facility to deliver financial stability.*

Seventh, the fact that a government spends first and taxes second, as the second point makes clear is what happens in a fiat economy, means that the answer to the question 'how are you going to pay for it?' is always available to anybody who understands this process. A government decision can always be paid for, presuming the actual resources required to deliver it exist within the economy, simply by commanding the central bank to pay for it and then arranging, if necessary, for the additional tax due on the income that has been generated (because all government expenditure is, by definition, somebody else's income) to be collected.

Eighth, if the government does run a deficit then MMT makes clear that private wealth is created as a result. That is the necessary consequence of a government deficit: such deficits necessarily transfer resources from the government to the private sector. MMT does as a result require a mechanism to address the resulting potential for growing inequality in the economy as that arises as a consequence. Tax is one of those mechanisms, but others are possible, requiring the regulation and direction of saving within an MMT directed economy.

Ninth, a government that only borrows in its own currency cannot, as a result of the understanding in MMT, ever default on its own debt because it can always issue the instruction to its central bank that the payment of that debt be settled. Such a government cannot ever in that case be beholden to financial markets.

There are issues in this list that some within MMT would not prioritise. And there is one omission they may note, which is the job guarantee. I think I this covered by the full employment and fiscal policy objectives and so I do not disagree with it, I just think it covered elsewhere.

I am, of course, happy to receive comments for changes and improvements.