CofFEE

Centre of Full Employment and Equity

Introduction to Modern Monetary Theory

Professor William Mitchell

University of Newcastle

Australia

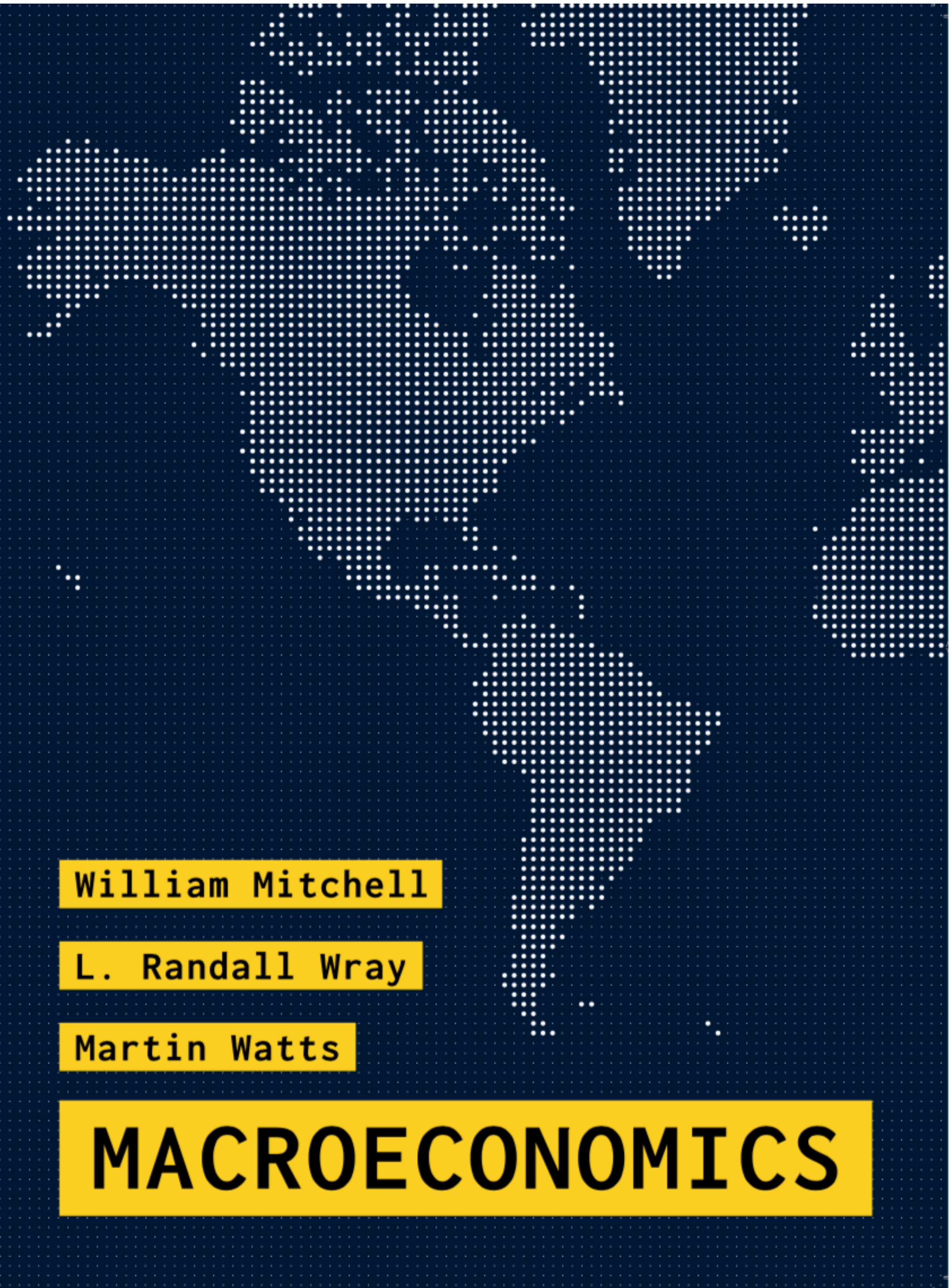
http://www.billmitchell.org

Modern Monetary Theory and Practice
An Introductory Text

A 13-week introduction to MMT

Published: February 2016

William Mitchell, L. Randall Wray and Martin Watts



33 Chapters

Two semester sequence in Macroeconomic theory and practice.

Available February 2019

Published by Macmillan-Palgrave

Its 2018 not 1971 - most of us do not live in Europe

- August 1971 – end of Bretton Woods system.
- Fixed-exchange rate macroeconomics no longer applicable.
- Meaning?
- Currency-issuing governments free from financing restrictions.
- They can buy whatever is for sale in that currency including all idle labour.

A fiat monetary system

- A fiat currency is not legally convertible into anything.
- Sovereign government has exclusive legal right to issue the currency which it also demands as payment of taxes.
- Currency viability ensured by its exclusive acceptability for tax payments.
- A floating exchange rate - frees monetary policy from the need to defend foreign exchange reserves.

Implications …

- Government issues the currency.
- Private citizens use the currency.
- Government is not like a household.
- There is no financial constraint on government spending - it can never run out of money.
- It can purchase anything that is for sale in its own currency.
- Voluntary constraints are ideological in motive.
- Available real resources pose limits on government spending.

Currency-issuance …

- Typically, the government spends its currency into existence in exchange for goods and services from the non-government sector.
- This allows the non-government sector to relinquish its tax obligations to the state.
- Public spending comes before taxes can be paid!
- Concept of ‘taxpayers funds were used’ - erroneous.

Taxes create unemployment …

- The imposition of a tax deprives the non-government sector of liquidity (purchasing power).
- Output would fall and unemployment would rise if the government spending failed to fill the spending gap.
- But, taxes do not fund the government spending – rather they create real resource space to allow it to spend without causing inflation.

Our first macro National Accounts equation …

- Simple economy.

Period 1:

Spending, Taxes	Fiscal State	Non-govt saving	NFA	Bonds
G = 100, T = 100	Balance	0	0	0

Period 2 …

Spending, Taxes	Fiscal State	Non-govt saving	NFA	Bonds
G = 100, T = 100	Balance	0	0	0
G = 120, T = 100	**Deficit**	**+20**	**20**	**0**

- Government deficit spending adds exactly that amount to non-government savings and income.

Period 3 …

Spending, Taxes	Fiscal State	Non-govt saving	NFA	Bonds
G = 100, T = 100	Balance	0	0	0
G = 120, T = 100	Deficit	+20	20	0
G = 120, T = 100	**Deficit**	**+20**	**40**	**40**

- Cumulative deficits = total non-government assets
- Fiscal deficits are the only way the non-government sector can simultaneously accommodate a net desire to save overall and eliminate unemployment.
- Bonds allow for diversification of risk-free assets.

Period 4 …

Spending, Taxes	Fiscal State	Non-govt saving	NFA	Bonds
G = 100, T = 100	Balance	0	0	0
G = 120, T = 100	Deficit	+20	20	0
G = 120, T = 100	Deficit	+20	40	40
G = 80, T = 100	**Surplus**	**-20**	**20**	**20**

- Fiscal surpluses reduce private savings overall.
- Government surplus is funded by an equal drop in Non-government savings and wealth.

Period 5 …

Spending, Taxes	Fiscal State	Non-govt saving	NFA	Bonds
G = 100, T = 100	Balance	0	0	0
G = 120, T = 100	Deficit	+20	20	0
G = 120, T = 100	Deficit	+20	40	40
G = 80, T = 100	Surplus	-20	20	20
G = 80, T = 100	**Surplus**	**-20**	**0**	**0**

- Cumulative fiscal position in balance:
- Non-government NFA zero.

Insights …

- Government deficits add exactly that amount to private savings and income.
- Fiscal deficits are the only way the non-government sector can simultaneously accommodate a net desire to save overall and eliminate unemployment.
- Fiscal surpluses destroy Non-government wealth.
- A fiscal surplus is not national saving – does not enhance government capacity to spend.

Government borrowing is corporate welfare …

- Currency-issuing government do not need to borrow.
- Government can control all yields if it wants.
- Bond markets are powerless if the government chooses.

How does Government spend?

- Credits private bank accounts
- This operation is not revenue dependent
- There is no such thing as the Government ‘running out of money’

Interest rates and reserves …

- The central bank sets the interest rate.
- Fiscal deficits put downward pressure on interest rates.
- Bank loans create deposits.
- There is no scarcity of saving.
- Financial crowding out is a nonsensical notion!

How large should the deficit be?

- Full employment fiscal condition.
- Government can always maintain full employment by ensuring its net spending is sufficient to meet the desire to net save by the Non-government sector.
- Unemployment is always a choice of government.

Open economy

- Current account deficits are not intrinsically undesirable.
- A current account deficit ‘finances’ the desires of foreigners to net save in financial assets of the deficit nation.
- There can be sudden reversals.
- Less likely with stable government, rule of law, contractual certainty, skilled labour force and growing economy.
- A nation’s well-being determined by real resources available.
- A sovereign currency will not make a poor nation rich.

Open economy

- Exports incur costs and imports bring benefits.
- Depreciation brings inflation risk.
- Enhances export attractiveness.
- Depreciations are typically finite.
- Oil and food dependency issues.
- Foreigners do not fund the spending of a sovereign government.

Fiscal rules

- Numbers that appear in fiscal statements are not costs!
- Fiscal outcome is largely determined by the non-government sector.
- Thus, fiscal ratios should never be a policy target.
- Aim of fiscal policy is to advance well-being.
- Fiscal space is defined by available real resources.
- Fiscal sustainability is about context.
- Fiscal rules as stand-alone goals are meaningless or ideological and have led to disastrous outcomes.

Applications …

- Health services.
- Education.
- Transport.
- Precarious employment.
- Climate change.
- Ageing society.
- etc.

End of Talk