A brief introduction to Modern Monetary Theory

What is ‘the economy’? If you listened to any Chancellor since the late 70s, you would be forgiven for gaining the impression that it is all about ‘debt’ and ‘deficit’ and how the country has to ‘live within its means’ and ‘pay down its credit card’. But under these conditions inequality has soared, public services have been defunded, the UK failed to recover its living standards post-2008-crash, and it has suffered the biggest drop in average real wages of any OECD country except Greece.

Whilst accepting that living within your means may be a good rule for households, the reality is that a government like ours, with its own currency and its own central bank, is not at all like a household. The economy is a far broader subject, covering not just what the government spends but what we spend too, as private individuals and the wider non-governmental sector, including how much debt we get into. After all it was private debt, not public, that caused the 2008 crash.

It is time for the public to have a better understanding to replace the clichés about the government ‘having no money of its own’. A sovereign currency nation like the UK with its own central bank is, in fact, the sole currency issuer. Its spending is not limited by its ability to tax.

MMT is not a political theory, but a description of how money creation works and why missing it out of the economic equation leaves classical economic thinking disconnected from the real world; while the real world suffers from that disconnect in terms of unemployment, loss of key services and environmental degradation. The conventional view is that public spending must be paid for through taxation, government sales of assets, and issuing government bonds – in other words, through taxes now, ‘selling off the family silver’ now, or borrowing money now at interest which will have to be repaid in the future, which is presumed to create a burden of additional taxation for future generations.

A right-wing response to this conventional position might be an austerity programme to keep government spending down, and privatisation, in order to keep taxes low; or a left-wing one, which is to say tax the rich and the multinationals much more highly, because the Government needs more money from the rich so it can pay for our public services.

Both the right and left-wing reactions are wrong, or at least misleading. They are based on the conventional view of public sector finance which is accepted as being valid by many people on all shades of the political spectrum. It is a view which a majority of highly credentialed economists, including Nobel Prize winners, knows to be incorrect, but which many of them justify as a mechanism for imposing some restraint on politicians. They believe that if politicians knew the financial options which are actually available to them, they would abuse these freedoms, spend like drunken sailors, and wreck the economy.
The sets of conventions and rules which have been applied down the last few decades, particularly since 1979, have, to a greater or lesser extent, obscured the truth which can be summarised in two ‘laws’ of public finance.

1. A government with its own currency (e.g. sterling), its own central bank (e.g. Bank of England), floating exchange rate, and no foreign currency debt, faces no financial budget constraint at all.

2. Such a government faces real and ecological constraints. As a society, we cannot run out of pounds, but we can run out of – or misuse – people, skills, technology, infrastructure, natural and ecological resources. There are limits, but the limits are ‘real’ and not financial. Governments should therefore focus their policies on human and ecological resources not the deficit.

We have to be clear that nothing in the above restricts any policy choices that any government may make. A party intent on low state intervention, allowing private sector providers to compete for public service contracts and a low tax regime has as much right to their political stance as a statist one or one which promotes subsidiarity or full public ownership. However, all should be obliged to argue their case on grounds other than ‘affordability’, ‘sustainability’ and ‘how are you going to pay for it’.

At a talk as part of the lecture series between UCL Institute for Innovation and Public Purpose (IIPP) and the British Library in 2018, Professor Stephanie Kelton explained why a government budget should not be looked at in the same way as a household budget - https://youtu.be/6lBEoWSiTHc