Modern Monetary Theory (MMT)

White Paper

The Gower Initiative for Modern Money Studies

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The purpose of this white paper is to outline the fundamentals of MMT and its application to the United Kingdom

What is MMT?

MMT began largely as a description of Central Bank monetary operations, which are best thought of as debits and credits to accounts as kept by banks, businesses, and individuals[1].

Warren Mosler independently originated what has been popularised as MMT in 1992. And while subsequent research has revealed writings of authors who had similar thoughts on some of MMT's monetary understandings and insights, including Abba Lerner, George Knapp, Mitchell Innes, Adam Smith, Wynne Godley, and former NY Fed chief Beardsley Ruml, MMT is unique in its analysis of monetary economies[2], and therefore best considered as its own school of thought.

[1] What is Money?
[2] Soft Currency Economics

What's different about MMT?

MMT alone recognises that the UK Government and its agents are the only suppliers of that which it demands in payment of taxes

That is, the currency itself is a simple public monopoly.

The UK Parliament levies taxes payable in pounds sterling.

The pounds to pay those taxes or purchase gilts can only originate from the Bank of England which is wholly owned by the UK Government[3].

The non-government sector has to sell goods, services or assets to the UK government (or borrow from the Bank of England, which is functionally a financial asset sale) or it will not be able to pay its taxes or purchase gilts.

Ramifications

The UK government and its agents, from inception, necessarily spend (or lend) first, only then can taxes be paid or Gilts purchased

This is in direct contrast to the rhetoric that states the UK government must tax to get pounds to spend, and what it doesn't tax it must borrow from ‘financial markets’ and leave ‘debt’ to our grandchildren.

MMT, therefore, recognises that it's not the UK government that needs to get pounds to spend, but instead, the driving force is that taxpayers need the UK government’s pounds to be able to pay taxes and purchase gilts.

Crowding out private spending or private borrowing, driving up interest rates, government funding requirements and solvency issues are not applicable for a government that, like the UK, from inception spends first, and then borrows[4]

[3] Who owns the Bank of England?
[4] A General Analytical Framework for the Analysis of Currencies and Other Commodities

How are you going to pay for it?

For all practical purposes, the UK government spends as follows:

After spending is authorised by Parliament, HM Treasury instructs the Bank of England to credit (change the number to a higher number) the recipient's bank’s settlement account in the books of the Bank of England.

For MMT, the ‘Money Story’ applicable to the UK today begins with a state that desires to provision itself**.**

MMT recognises that taxation, by design, is the cause of unemployment, defined as people seeking paid work, presumably for the further purpose of the UK Government hiring those that its tax caused to become unemployed, and thereby provision itself with labour.

1. The UK Government imposes tax obligations payable in pounds sterling.

2. Consequently goods, services and assets are offered for sale to get the pounds sterling required to pay the taxes.

3. The state can then buy those goods and services.

4. Taxes can then be paid.

5. If people, on average, want to earn more than what is required to pay taxes, goods, services and assets will be offered for sale in sufficient quantities to obtain those extra pounds.

6. State spending in excess of taxes (deficit spending) provides the pounds desired to be saved.

7. **The National Debt equals the pounds spent by the state that haven't yet been used to pay taxes.**

8. ***After*** the state has spent those extra pounds, Treasury bills and gilts can ***then*** be purchased, which depletes the accounts containing the pounds the state has already spent.

9. Payments by the UK government are added to the settlement accounts of banks at the Bank of England.

10. When gilts and Treasury bills are purchased, the Bank of England debits settlement accounts which simultaneously credits the securities accounts within CREST.

How is the National Debt repaid?

When gilts mature, the Bank of England debits securities accounts within CREST and credits the appropriate settlement accounts at the Bank. Gilt interest accrues over time and, on the coupon dates, HM Treasury instructs the Bank of England to credit holders’ bank accounts with the accrued interest.

There are no taxpayers or grandchildren in sight when that happens.

What is the Relevance of MMT Today?

An understanding of MMT puts policy options on the table that were not previously considered viable.

Interest Rates

MMT recognises that a positive policy rate results in a payment of interest that can be understood as “basic income for those who already have money.”

MMT recognises that with the government a net payer of interest, higher interest rates can impart an expansionary, inflationary (and regressive) bias through two types of channels - interest income channels and forward pricing channels. This means that when the Bank of England tightens monetary policy by increasing rates, it may increase total spending and foster price increases, contrary to the advertised intended effects of reducing demand and bringing down inflation. Likewise, lowering rates removes interest income from the economy which works to reduce demand and bring down inflation, again contrary to advertised intended effects. Furthermore, forward pricing is a direct function of the Bank of England’s policy rate, and with a policy of a positive term structure of interest rates, the forward price level increases continuously at the policy rate, which is the academic definition of inflation.

MMT understands that a permanent 0% policy rate is the base case for analysis for a floating exchange rate policy[5].

MMT understands that with a permanent 0% policy rate[6] asset prices reflect risk-adjusted valuations, and do not “continuously accelerate” as presumed by the term “asset price inflation.”

The MMT understanding of interest rates is at times in direct conflict with the understandings of central banks and the large majority of academics. We see those “mainstream” views as at best applicable to fixed exchange rate regimes, but in any case not applicable to today’s floating exchange rate regimes.

[5] http://moslereconomics.com/wp-content/uploads/2007/12/Exchange-Rate-Policy-and-Full-Employment.htm
[6] http://moslereconomics.com/wp-content/graphs/2009/07/natural-rate-is-zero.PDF

Inflation

Only MMT recognises the source of the price level. The currency itself is a public monopoly[7]. Monopolists are necessarily “price setters”.

Therefore:

The price level is necessarily a function of prices paid by the government’s agents when it spends, or collateral demanded when it lends.

In what’s called a market economy, the government needs to set only one price[8], as market forces continuously determine all other prices as expressions of relative value, as further influenced by institutional structure.

The Job Guarantee

Residual unemployment is caused by the government not hiring all of those that its tax liabilities have caused to become unemployed. That is, we have a monopolist, the government, restricting supply, which in this case refers to net government spending.

Current policy is to utilise unemployment as a counter-cyclical buffer stock to promote price stability. The alternative policy option is for the government to use an employed buffer stock to promote price stability.

The Job Guarantee is a policy proposal that the UK Government uses an employed buffer stock policy and funds a full-time job for anyone willing and able to work at a fixed rate of pay.[9] A £10 per hour wage has currently been proposed. This wage becomes the numeraire for the currency, the price set by the monopolist that defines the value of the currency while allowing other prices to express relative value as further influenced by the institutional structure.

The Job Guarantee works to promote price stability more effectively than the current policy of using unemployment, by ***better facilitating the transition from unemployment to private sector employment***, as private employers do not like to hire the unemployed.

It also provides for a form of full employment, and at the same time as a means to introduce minimum compensation and benefits “from the bottom up,” as private sector employers compete for Job Guarantee workers[10].

[7] Monopoly Money: The State as a Price Setter
[8] Maximizing Price Stability in a Monetary Economy
[9] Full Employment AND Price Stability
[10] The 7 Deadly Innocent Frauds of Economic Policy