To Bond, or Not to Bond, that is the Question

Stephanie Kelton, Professor of Economics and Public Policy, Stony Brook University
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UK MMT Conference, University of Leeds
July 15-17, 2024

Outline

1. What are the options?
2. MMT–Not to bond?
3. My cards on the table
4. De-weaponizations to avoid mass destruction
5. Adding MMT’s concerns
6. Conclusion

What Are the Options?

(1) Issue bonds and let central bank follow Taylor(ish) Rule

(2) Issue bonds and ZIRP (or keep $i < g$)

(3) No bonds and let central bank follow Taylor(ish) Rule

(4) No bonds and ZIRP

The MMT Project Started as Description of Option (1)

Soft Currency Economics

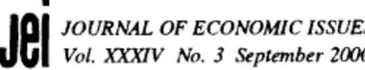
by

Warren B. Mosler

Government is monopoly supplier of the the currency (floating fx)

FUNCTIONAL FINANCE AND THE FEDERAL DEBT

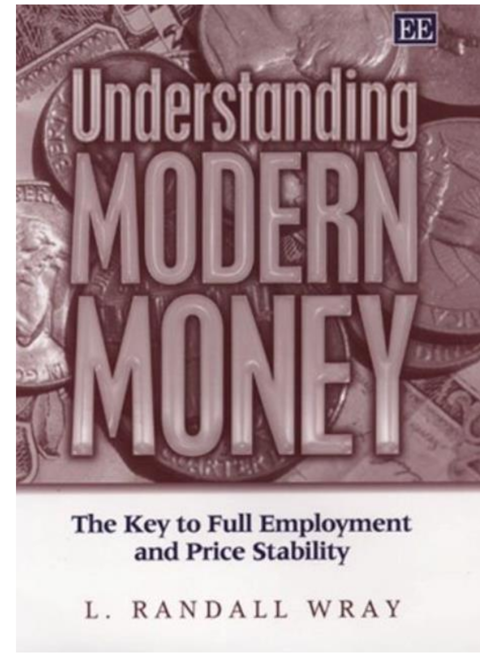
BY ABBA P. LERNER



Do Taxes and Bonds Finance Government Spending?

Stephanie Bell

Debates over the impacts of various ways of financing government deficits and about the relative impact of monetary and fiscal policy have, unfortunately, been carried out without recognition of the institutional process by which modern government spending, borrowing, and taxation are accomplished.[1] In the United States, close cooperation between the Treasury, the Federal Reserve System, and depository institutions makes the traditional distinctions between monetary and fiscal policy hard to use in describing actual processes and renders irrelevant many of the theories about the most appropriate mix of borrowing and taxation. Indeed, the entire treatment of taxation and of government borrowing assumes a monetary system quite unlike that of the modern U.S. system. My purpose in this paper is to describe, in some detail, the way in which the Treasury and the Federal Reserve coordinate policies that are neither purely fiscal nor purely monetary and to argue that theories of monetary/fiscal policy should incorporate more discussion of the issues of reserve management.



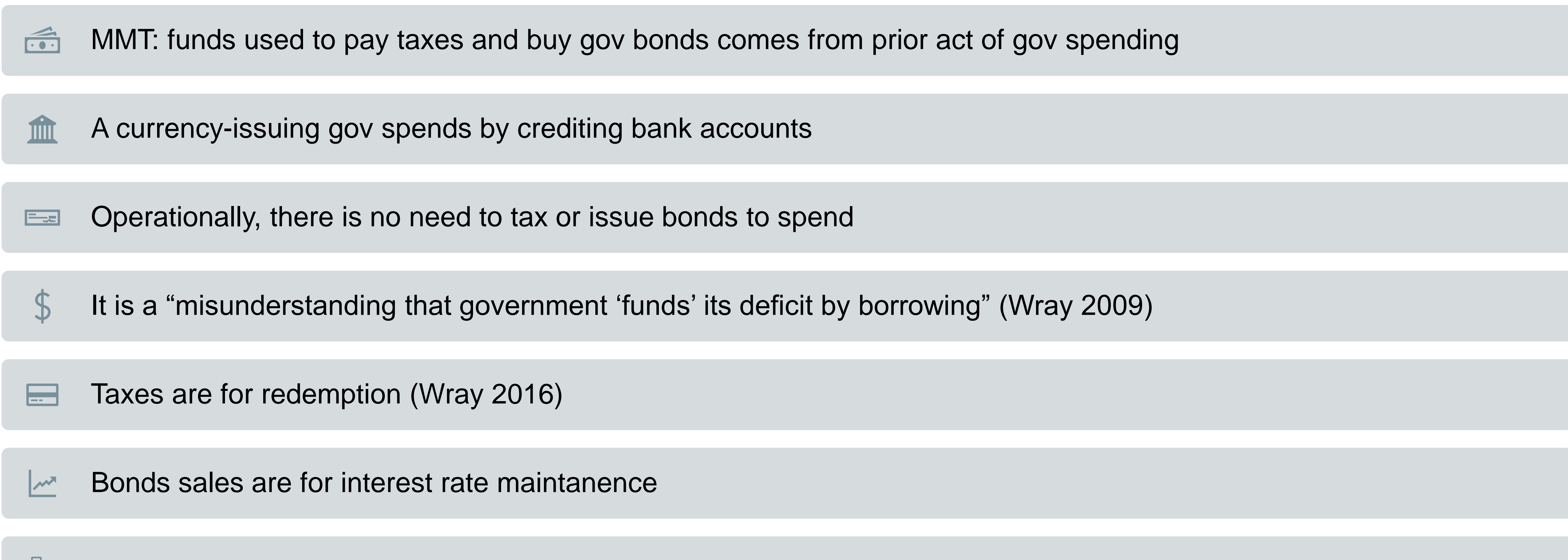
jei JOURNAL OF ECONOMIC ISSUES
Vol. XXXIX No. 2 June 2005

The Natural Rate of Interest Is Zero

Mathew Forstater
and
Warren Mosler

This paper argues that the natural, nominal, risk free rate of interest is zero under relevant contemporary institutional arrangements. However, as Spencer Pack reminded us, "[n]atural and nature are complex words, fraught with ambiguity and contradiction" (1995, 31). The sense in which we wish to employ the term *natural* here does not imply a "law of nature," which may be why "[Alfred] Marshall replaced the evocative label 'natural' with the more prosaic 'normal'" (Eatwell 1987, 598). Marshall may have clarified it the best when he wrote that "normal results are those which may be expected as the outcome of those tendencies *which the context suggests*" ([1920] 1966), 28, emphasis added). In this case, it is of the utmost importance to first clarify the context, to which we now turn.

The Role of Taxes and Bonds



MMTers Understand Bonds Are a Policy Choice

- “Issuing bonds is a **voluntary** operation that gives the public the opportunity to substitute their non-interest-earning gov liabilities—currency and reserves at the central bank—into interest-earning gov liabilities, such as T-bills and bonds, which are credit balances in securities accounts at the same central bank.” Wray and Nersisyan (2010)
- “But if one **believes** that the gov needs to borrow to spend, then who owns the bonds or who is willing to buy the bonds becomes an important issue.”
- “If one **understands** that bond issues are a **voluntary** operation by a sovereign government…then it becomes irrelevant…whether there are takers for gov bonds and whether the bonds are owned by domestic citizens or foreigners.”
- And we show most other concerns about debt/sustainability are based on myths/misunderstandings

8. The monetary policy outcomes curve: can the size and structure of public debt undermine policy objectives?

Stephanie Bell-Kelton and Rex Ballinger

1. INTRODUCTION

After decades (if not centuries) of attention, there remains scant agreement on many fundamental issues regarding monetary policy. Historically, the more hotly contested battles have centered on the issue of 'rules' versus 'discretion' – especially between monetarists and Keynesians. But aside from the battles over the relative merits of short- versus long-term policy objectives (that is, fine-tuning versus maintaining price stability and fiscal balance), the mainstream has generally agreed that monetary easing will, in the short run, have expansionary effects, while tightening will prove contractionary at the macro level.[1] This chapter challenges that common ground, arguing that when the government debt is large, and a significant portion of it is short-term or interest-variable, monetary easing (tightening) may well have contractionary (expansionary) effects, leading to perverse macro outcomes.

Thus our central question is whether raising (lowering) the interest rate is recessionary or expansionary. Our proposition is that it depends crucially upon the size, sectoral distribution and maturity of the government's outstanding debt. The question of whether the mix of public debt has any impact on the real economy through interest rate channels has recently been debated by an impressive cast of policymakers and academics (Chrystal, 1998). Our chapter addresses the subject matter of these debates, but it does so with reference to the work of Hyman Minsky, whose financial insights were not part of these recent discussions. Specifically, we consider Minsky's income, balance sheet and portfolio channels. We conclude with an empirical look at the relation between public debt structures and monetary policy outcomes in ten OECD countries.

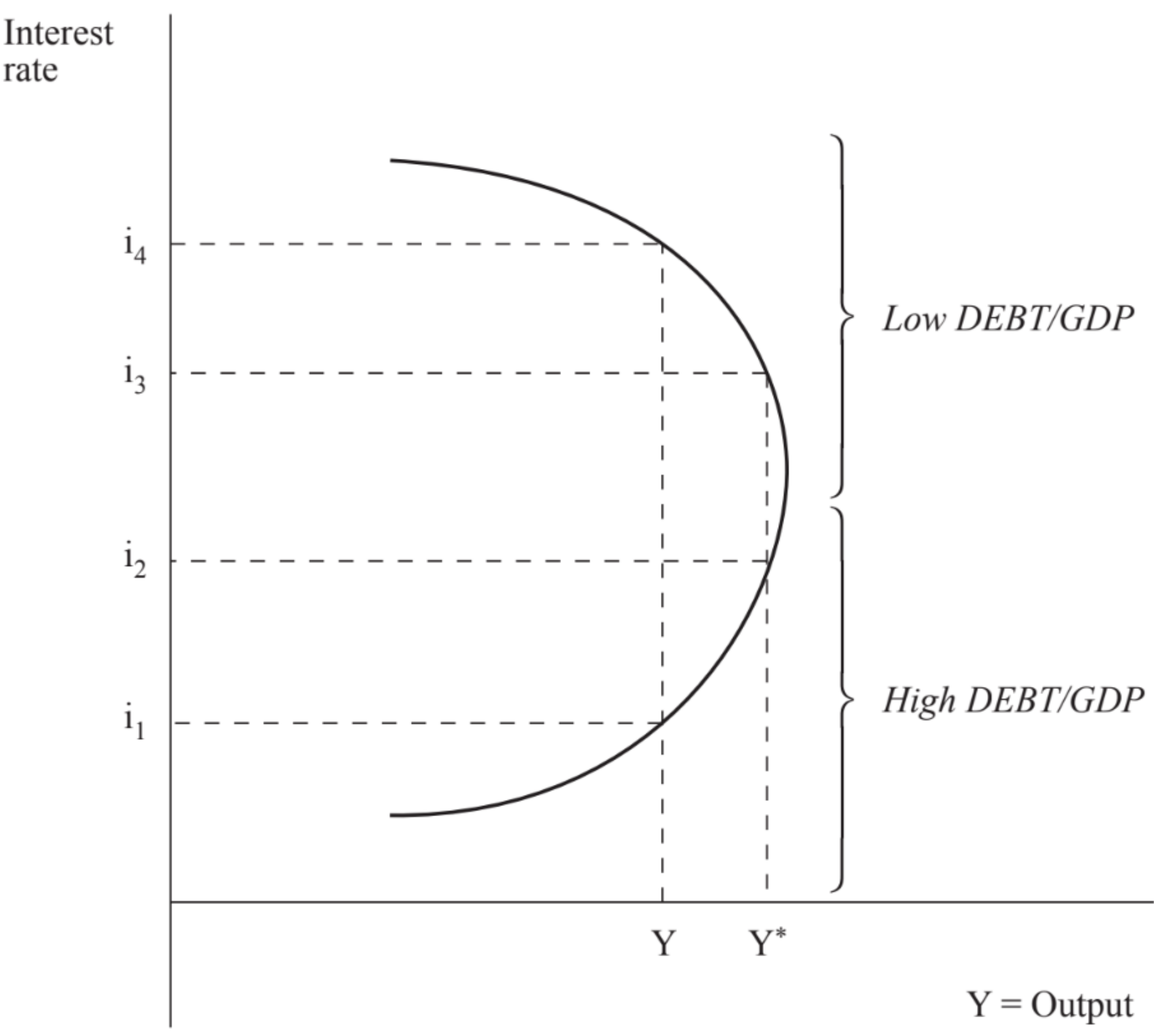


Figure 8.2 The monetary policy outcomes curve

Option 2: Issue Bonds and ZIRP (or i<g)

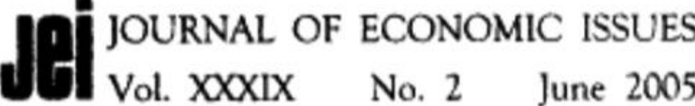
Interest Rates and Fiscal Sustainability

Scott T. Fullwiler*
Wartburg College and the Center for Full Employment and Price Stability

aby boomers reach retirement age, concerns over the future path of federa
rograms grows among orthodox economists. Researchers closely tied to the
literature (i.e., Kotlikoff, 1992) have been particularly prominent here. Th
ped a measure that they call the "fiscal imbalance"—which they claim
f an existing unsustainable fiscal path. They argue that the fiscal path of t
ourse compared to a "sustainable" path (Gokhale and Smetters, 2003a). Ot
noted the $44 trillion "fiscal imbalance" in numerous opinion pieces (e.g.
03b; Kotlikoff and Sachs, 2003) and in other publications (e.g., Ferguson
off and Burns, 2004). An essentially identical measure expressing the imbalan
P—the "fiscal gap" (e.g., Auerbach, 1994)—shows it to be about 7 percent (e.

- Also **Galbraith** (2011)
- Takes aim at the "sound finance" view of fiscal policy (**IGBC**)
- Orthodox "sustainability" is **applicable to fixed fx** not floating
- Interest rate is a **policy variable**
- **i<g has been the norm** already; Blanchard "discovered" this in 2019
- **"It's the interest rate, stupid!"**

Option 3: No Bonds and Follow Taylor(ish) Rule


JOURNAL OF ECONOMIC ISSUES
Vol. XXXIX No. 2 June 2005

Paying Interest on Reserve Balances: It's More Significant than You Think

Scott T. Fullwiler

*"With IBRBs eventually **the entire national debt could be held exclusively as reserve balances**…interest payment on reserve balances could both **simplify** monetary policy **operations** of the Fed and free the Treasury and the Fed from selling bonds to support the Fed's interest rate target. The more significant point is that consideration of interest payment on reserve balances demonstrates the accommodative nature of the Fed's operations and the offsetting (rather than —financing) nature of the Treasury's security operations."*

Option 4: No Bonds and ZIRP

Overt Monetary Financing – again

November 18, 2015 · bill · Central banking, Economics, Hyperinflation, Inflation

There is no need to issue public debt

September 3, 2015 · bill · Economics · 45 Comments

- The "**preferred option**, from an MMT perspective" is **No Bonds and PZIRP** (BM, 2016)
- "Governments should not issue any public debt [to the non-government sector] as the **benefits** of doing so **are small relative to the large opportunity costs**." (BM, 2015)
- Manage the spending cycle with **fiscal** initiatives

Bill Mitchell (2016)

Overt Monetary Financing would flush out the ideological disdain for fiscal policy

July 28, 2016 · bill · Central banking, Debriefing 101 · 33 Comments

- Discussing a BIS paper on ‘helicopter money’
- MMT always viewed QE as an asset swap with little/no transmission apart from placebo effects
- OMF – “central bank provides the monetary capacity to support much larger fiscal deficits with no further debt being issued to the non-government sector”
- “[T]he original MMT proponents …would characterize OMF as a highly desirable policy development…representative of the intrinsic monetary capacity of the government.”

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What Changes with No Bonds (3 and 4)?

- **Public perception**
- “No increase in public debt for the rabid financial commentators to beat up into a frenzy and push out **predictions of insolvency**.” (BM)
- Would get us all focused on **inflation risk** instead of solvency
- End the “**morality**” play
- End “Who will buy them?” **bid/cover**, etc.
- End “paying it back”, obsession with debt ratios and debt service, i vs g, etc.
- Neuter the **IMF**, **ratings agencies**, and other fiscal scolds
- “So, there are major **political advantages** in using OMF” (BM)

Damned if We Do, Damned if We Don’t

- If we continue to issue government bonds to the **non-government** sector, economists/press/policymakers/others will …
  - Weaponize Debt (burden grandchildren, who will buy it, etc.?
  - Weaponize IGBC (exploding debt service that doesn’t converge)
  - Weaponize bond vigilantes (lose control of rates on government debt)

- If we propose permanent ZIRP, they will then …
  - Weaponize r < r-star (inflation!! independence!!)

- If we propose no bond sales to non-government sector, they will
  - Weaponize “printing money” (inflation!!)

So, What’s an MMTer to Do????

	(1) Bonds + Taylor Rule	(2) Bonds + ZIRP	(3) No Bonds + Taylor Rule	(4) No Bonds + ZIRP
Weaponize debt?	Yes	Yes	No	No?
Weaponize IGBC?	Yes	No	No	No
Weaponize bond vigilantes?	Yes	Yes	No	No
Weaponize r < r-star?	No	Yes	No	Yes
Weaponize “printing money”?	No	No	Yes	Yes

So, it’s not so simple. What would Larry do?

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I Used to Be Indifferent on Bonds

- Taxes & Bonds (1998)
- Working on the Hill
  - Hearings
  - Magic wand
- TDM
- Truss/UK Labour/Blanchard/climate /etc.
- FT interview

Interest Rate Maintenance Account?

US Dollar Savings Clock?

If we're not going to eliminate Treasuries, then we must find a way to make peace with the national debt. Perhaps we should start by giving it another name. The national debt is nothing like household debt, so using the word *debt* just leads to confusion and unnecessary angst. We could just refer to it as part of our net money supply. I doubt *yellow dollars* will catch on, but hey, it's worth a shot! In Shakespeare's *Romeo and Juliet*, Juliet famously inquires, "What's in a name?" She wasn't troubled when she learned that Romeo was a Montague. For her, "A rose by any other name would smell as sweet." Love, as they say, is blind. On the political stage, words matter. It's time to come up with a new name for these interest-bearing dollars.

The UK Could Embrace Gilt-Free Spending

- Liz Truss debacle
- Labour Party’s fiscal rules in tension with “missions”
- Housing pledge is already fantasy
- Just spend to build public housing
- Leave pounds in the system
- Tell “the market” to pound sand

The self-financing state:
An institutional analysis of government expenditure, revenue collection and debt issuance operations in the United Kingdom

Andrew Berkeley
Independent researcher

Josh Ryan-Collins
UCL Institute for Innovation and Public Purpose

Richard Tye
Independent researcher

Asker Voldsgaard
UCL Institute for Innovation and Public Purpose

Neil Wilson
Gower Initiative for Modern Monetary Studies (GIMMS)

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But Everyone Will Ask: Isn't No Bonds "Just Printing Money" and Adding "Jet Fuel" to a Deficit?

- "**What would happen** if a sovereign, currency-issuing government (with flexible exchange rate) ran a fiscal deficit without issuing debt at all (or sold the debt to the central bank instead of to the non-government sector, which is an equivalent act)—that is, the **OMF option**?" Bill Mitchell 2016

- With a fiscal deficit and no bond sales, you get excess reserves in the 'cash system' and the **overnight rate falls to zero or to the support rate**

- Only difference between this and issuing bonds to drain reserves is that the central bank must use a **different procedure** to hit its interest rate target

Fullwiler (2005) Wouldn’t it Be Inflationary?

- “Deficits unaccompanied by bond sales are disapprovingly **labeled ‘monetization**’ although there is **no meaningful difference** from when bonds are issued”
- Deficits always create **NFAs** in direct proportion either way
- What matters is not whether bonds are sold but whether the deficit is too large given the non-government’s **desire to net save**
- Once you have payment of interest on reserve balances, it becomes “obvious that bond sales are offsetting, **interest-rate maintenance operations**, not financing operations”
- “With IBRBs eventually the **entire national debt** could be held exclusively as **reserve balances**.”
- Or, as Abba Lerner envisioned, bond sales would occur only in keeping with **FF**
- Paying **IOR** simplifies monetary policy and **frees the Treasury and the Fed from selling bonds** to support the Fed’s interest rate target

Fullwiler/Kelton 2013.

Guest post: The helicopter can drop money, gather bonds or just fly away

- Fundamentally **no difference** between issuing government debt to the non-government sector and the central bank paying IOR at target rate
- Doesn’t make it less **inflationary** to issue the bonds
- Doesn’t alter the **quantity of NFAs** in the non-government sector
- Doesn’t make the spending more **stimulative**
- Because there is **no difference** between bond and money-financed government deficits…there is **no reason for the government to sell bonds at all**. We can stop today. No further increases in the debt and no unnecessary and counterproductive debt ceiling drama.”

The reality is "printing money" **merely cuts out the "middle man"** rather than adding "jet fuel" to a deficit

Standard Practice

UNITED STATES FEDERAL RESERVE SYSTEM

Loan

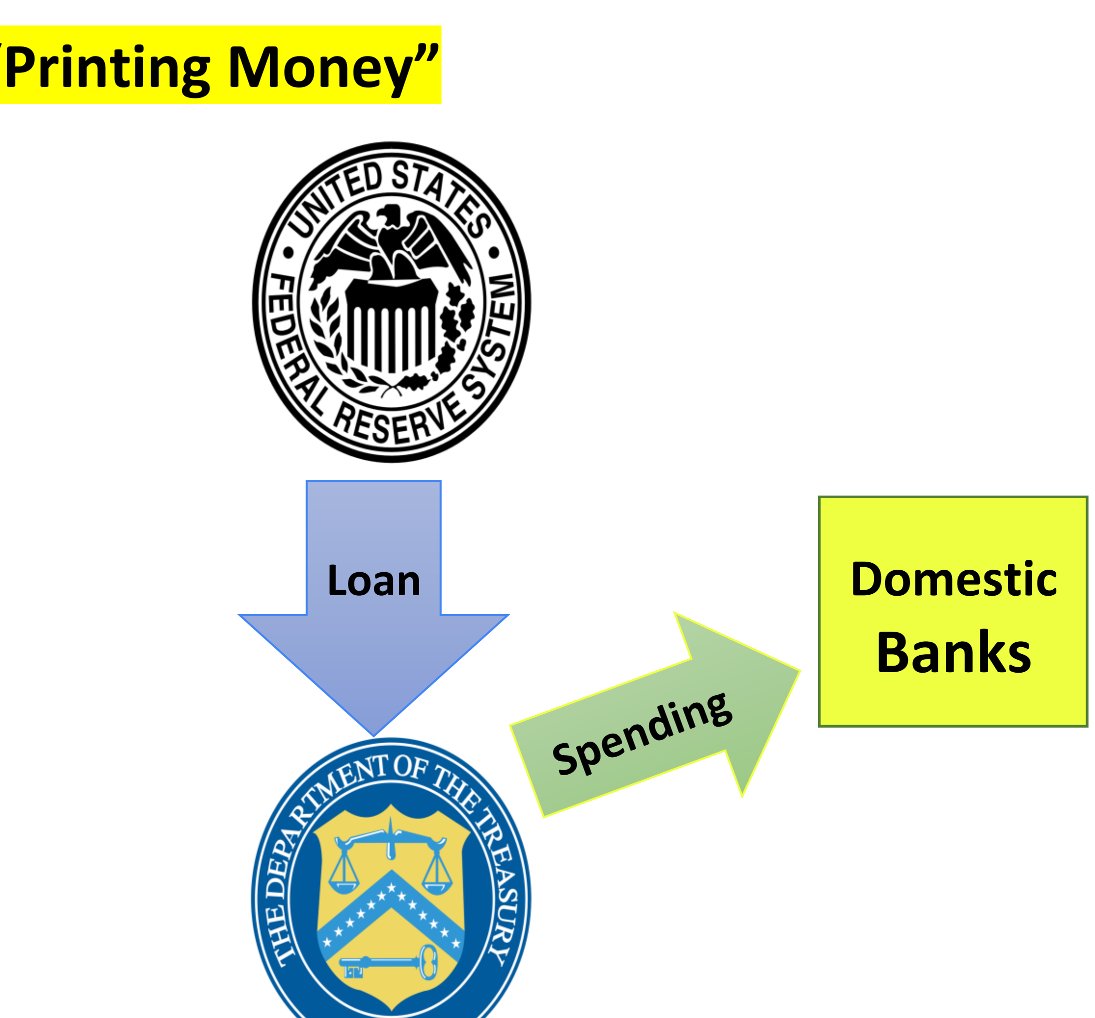
Primary Dealers

Domestic Banks

Loan (Bond purchase)

THE DEPARTMENT OF THE TREASURY 1789

Spending



Fullwiler (2005) on Paying IOR

- Would stopping bond issuance undermine **CB independence**? No
- With IBRBs, CB still has **iron-clad control** over ffr (a floating rate)
- **Gov agency securities and swaps could emerge as benchmarks** for pricing private assets as bond issuance was phased out
- “The **transmission** of monetary policy via IBRBs **is identical** to that with non-interest bearing reserve balance (NIBRBs) and bond sales to drain excess balances.”
- “All **Treasury securities could eventually be replaced**; the interest rate on the national debt would then be the rate paid on IBRBs.”
- “There is no inherent reason for Treasury liabilities to exist across the entire term structure except as **support** operations for **longer-term rates**.”

Managing Credit Conditions Without Taylor

THE BLOG BUSINESS FEDERAL RESERVE FDIC

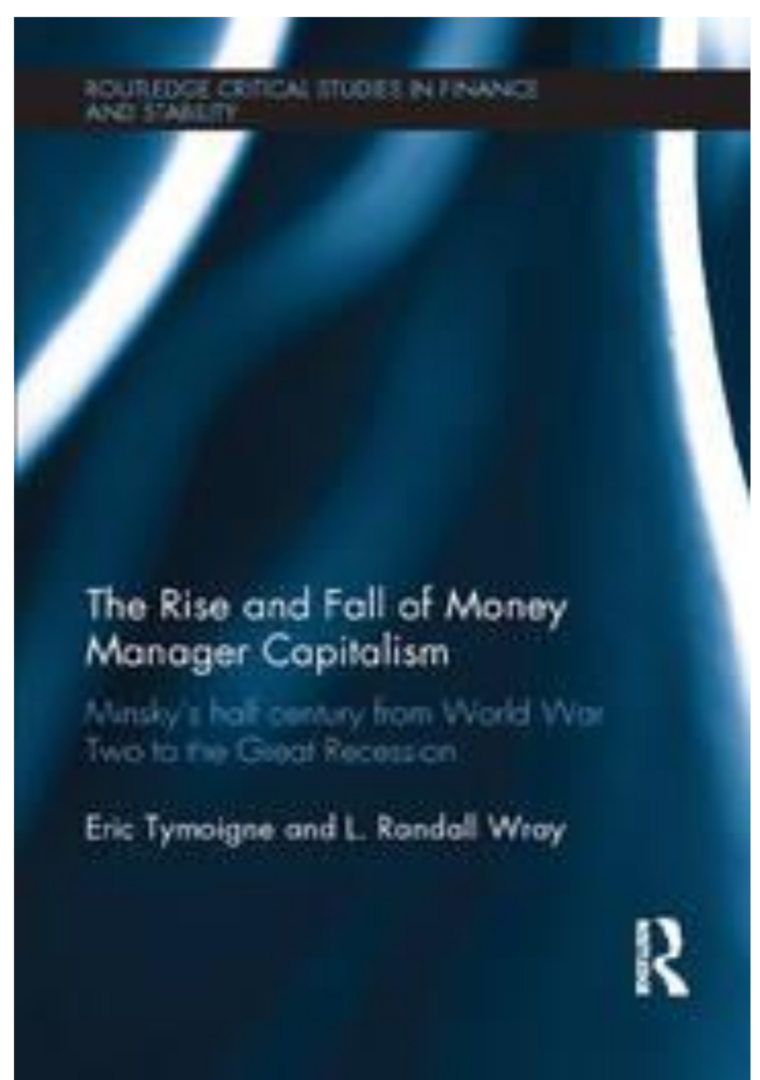
Proposals for the Banking System

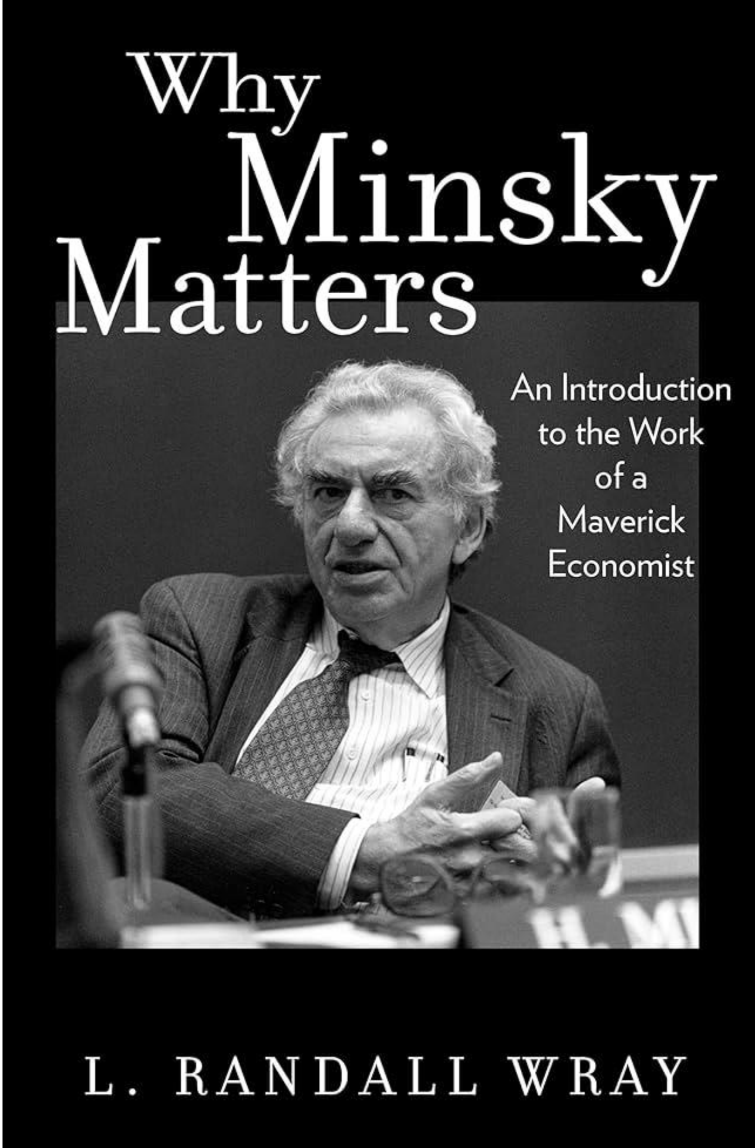
Now that the President is looking at banking reform, here are a number of proposals for the banks, the FDIC, Federal Reserve, and Treasury.

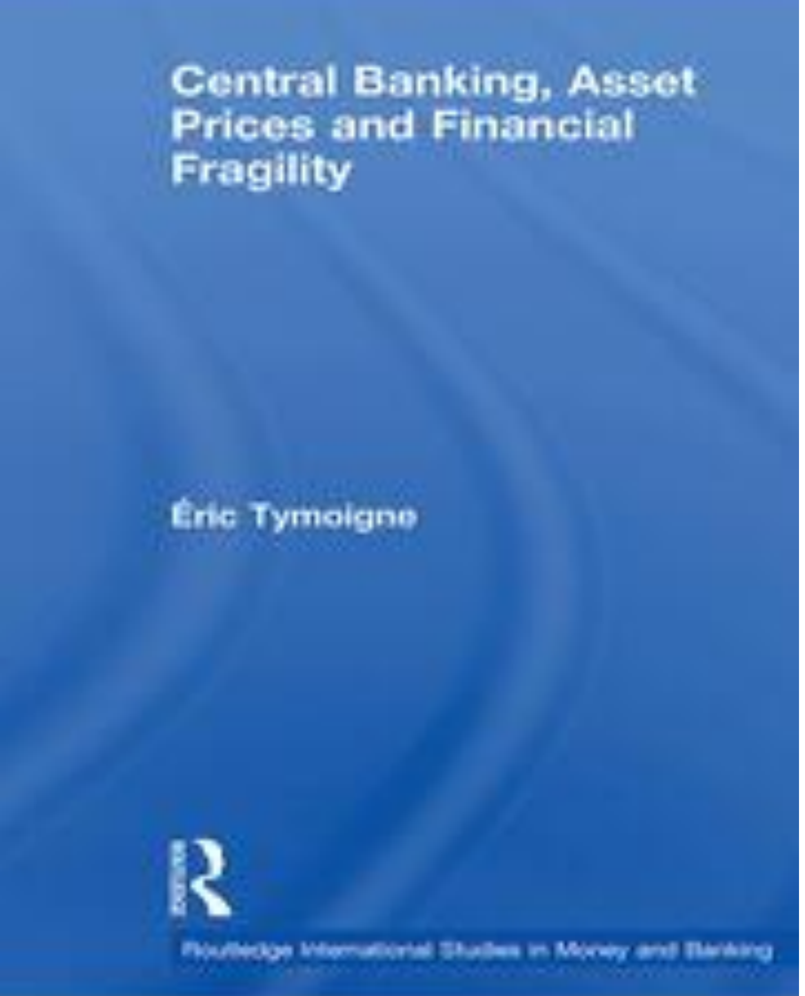
By Warren Mosler, Contributor

Fixed income fund manager specializing in monetary policy; Founder, MMT

Mar 23, 2010, 05:12 AM EDT | **Updated** May 25, 2011


ROUTLEDGE CRITICAL STUDIES IN FINANCE AND STABILITY
The Rise and Fall of Money Manager Capitalism
Minsky's half century from World War Two to the Great Recession
Eric Tymoigne and L. Randall Wray


Why Minsky Matters
An Introduction to the Work of a Maverick Economist
L. RANDALL WRAY


Central Banking, Asset Prices and Financial Fragility
Éric Tymoigne
Routledge International Studies in Money and Banking

Asset bubbles and the conduct of banks

October 2, 2009 bill Debriefing 101, Economics 10 Comments

This is the first of a few blogs that I will write about asset bubbles and modern monetary theory (MMT). The point came up this week in a comment posted by Sean Carmody in response to my blog – Operational design arising from modern monetary theory. It was also raised in the current debate about MMT and debt-deflation, which I will return to on Sunday. The proposition is that if the the central bank maintains a zero target interest rate then lending rates will be so low that there will uncontrollable asset bubbles. As long as fiscal policy is used sensibly I disagree that a zero interest rate policy is destabilising.

Among other interesting things. Sean said this:

* Side-stepping the "natural" label for interest rates for the moment, you argue that having a cash rate at 0% would be very beneficial. Would that not lead to

Finance and Economics Discussion Series
Divisions of Research & Statistics and Monetary Affairs
Federal Reserve Board, Washington, D.C.

The History of Cyclical Macroprudential Policy in the United States

Douglas J. Elliott, Greg Feldberg, and Andreas Lehnert

2013-29

THE NEW MONETARY POLICY

REIMAGINING DEMAND MANAGEMENT AND PRICE STABILITY IN THE 21ST CENTURY

Produced by Modern Money Network, Our Money & Public Money Action

Lead Author: Nathan Tankus

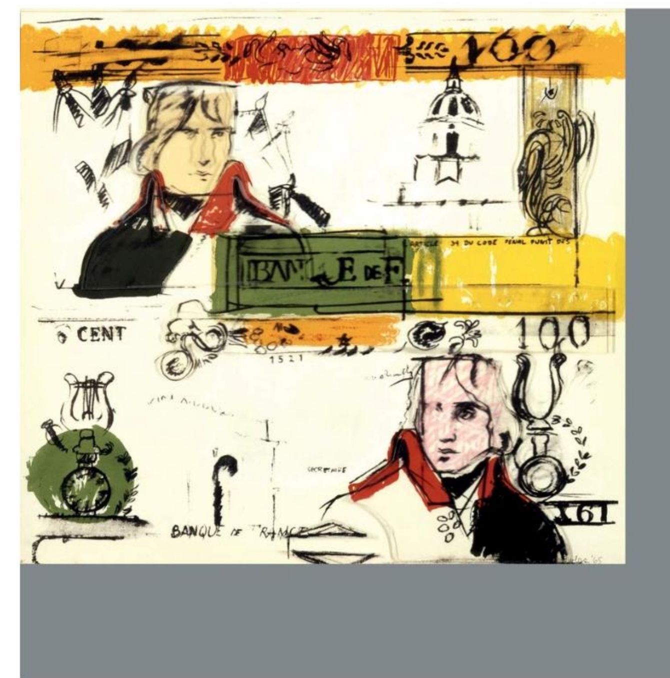
Editor: Michael Brennan

January 2022

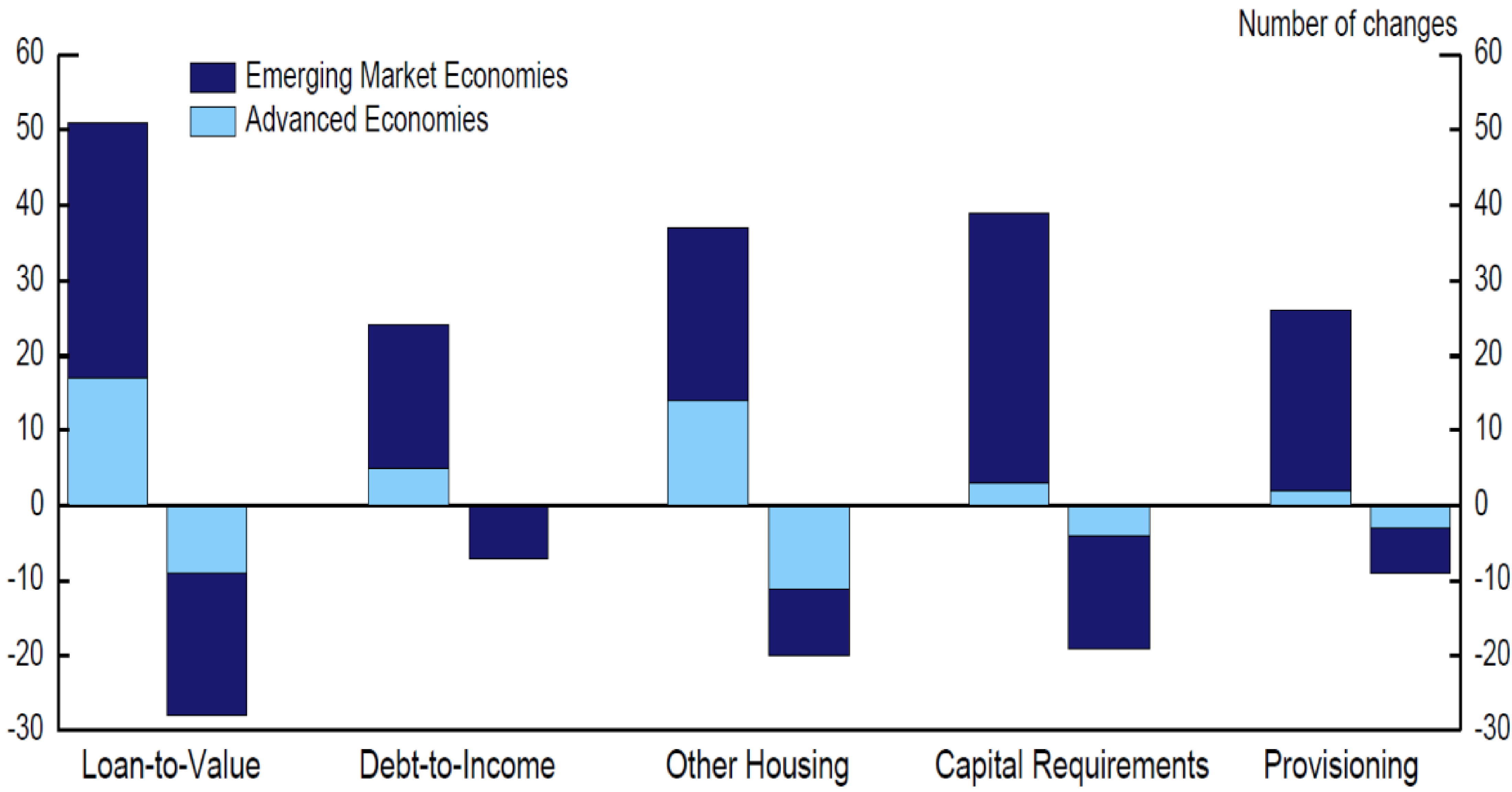
Controlling Credit

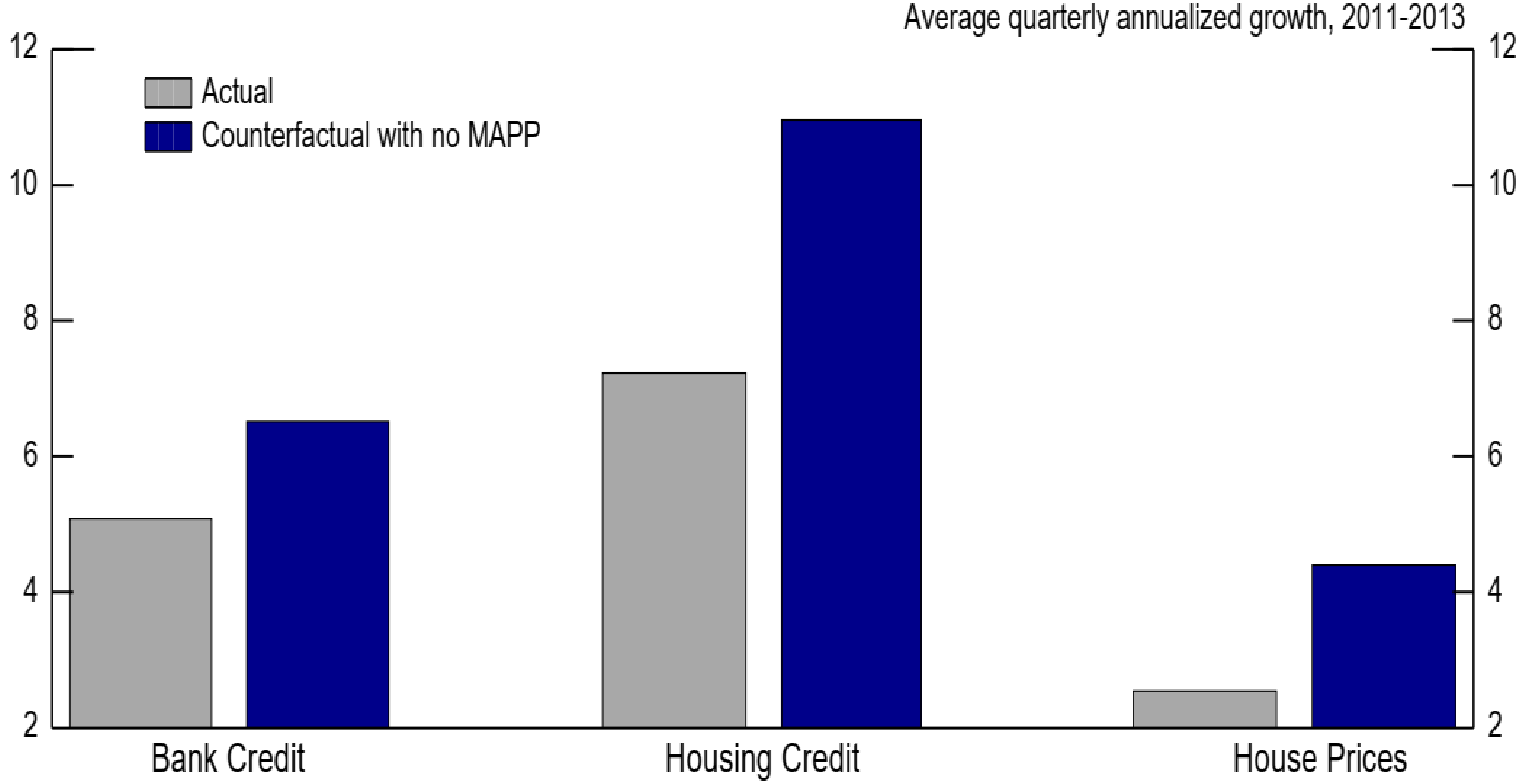
Central Banking and the Planned Economy in Postwar France, 1948–1973

Eric Monnet



Akinci, Ozge, Olmstead-Rumsey, Jane (2015). How Effective are Macroprudential Policies? An Empirical Investigation. International Finance Discussion Papers 1136.





Note: The gray bars show actual average bank and housing credit growth and house price inflation across all countries in our sample that had at least one macroprudential policy (MAPP) in place from 2011 to 2013 (or at least one housing-related MAPP measure for housing credit and house price estimates). The blue bars show, for each dependent variable, our re-estimated average growth, under the counterfactual assumption that no (housing-related) macroprudential policies were in place.

MMT Has an Answer for Each Weaponization

- Operations shows “printing money” **isn’t a thing**
- No debt means **no IGBC**
- ZIRP or IOR means **no bond vigilantes**
- Mosler/Minsky/Mitchell/Wray/Tymoigne + research on macroprudential shows there are **many options for controlling credit** beyond short-term interest rates
- **Functional finance** means fiscal policy has a strong role to play in **countercyclical macro policy**

** Still, we need to recognize and be prepared for the fact that no matter which option we choose, *something* will be weaponized against us

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Many MMTers have long had their own, additional reasons for favoring no bonds and/or ZIRP

	(1) Bonds + Taylor Rule	(2) Bonds + ZIRP	(3) No Bonds + Taylor Rule	(4) No Bonds + ZIRP
Risk rate hikes inflationary?	Yes	No	Yes?	No
Financial fragility?	Yes	No	Yes	No
Corporate welfare?	Yes	No	Yes	No

“Why Issue Public Debt at All?”

- There is “**no compelling case** to issue public debt” (BM 2015)
- Some have argued:
    - Desire for an instrument that kicks off a **risk-free return** (for savings)
    - Support a yield curve with **risk-free rates** that can be used **to price riskier securities**
    - Needed to **manage risk, hedging, maturity matching, safe haven, etc**.

- Wray 2024 raises some questions:
    - Can no bonds really satisfy public’s **portfolio preferences**?
    - Will no bonds create stress on **the business model of banking**?

- Does a modern financial sector need **risk-free collateral for liquidity**?

- Important to **deal with these questions** if you’re advocating “no bonds”

	(1) Bonds + Taylor Rule	(2) Bonds + ZIRP	(3) No Bonds + Taylor Rule	(4) No Bonds + ZIRP
Weaponize national debt?	**Yes**	**Yes**	**No**	**No**
Risk rate hikes inflationary?	Yes	No	Yes?	No
Financial fragility?	Yes	No	Yes	No
Corporate welfare?	Yes	No	Yes	No
Savings vehicle issue?	No	No?	Yes?	Yes?
Bank costs vs profits issue?	No	No	Yes?	Yes?
Liquidity & collateral issue?	No	No	Yes?	Yes?

Another Option: What if the CB issues “bonds” instead?

- CBs have many options if the govt stops issuing bonds
  - CB securities, reverse repos, time deposits, accounts at the CB for biz & households
  - It’s obvious *to everyone* that CBs can never run out of money
  - Could issue its own liabilities at any maturities it desires

- Could/can issue its liabilities on demand, announcing rates at each maturity
  - If no ZIRP, then set rates across the term structure for private rates to price from
  - If ZIRP, then could set very slightly higher rates at longer maturities–or not
  - On demand (or “on tap” securities) would mean risk-free collateral is plentiful
  - Avoids stupid current approach that assumes desired increase in collateral = deficit

- Mainstream would say this is infringing on CB independence
  - Reality is CBs already backstop bond markets to maintain monetary transmission and stability
  - CB “bonds” as described here gives CB *more* tools

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Why Does a Currency-Issuing Government Issue Bonds?

	(1) Bonds + Taylor Rule	(2) Bonds + ZIRP	(3) No Bonds + Taylor Rule	(4) No Bonds + ZIRP	(5) CB “Bonds” + Taylor Rule	(6) CB “Bonds” + ZIRP
Weaponize national debt?	**Yes**	**Yes**	**No**	**No**	**No**	**No**
Risk rate hikes inflationary?	Yes	No	Yes?	No	Yes	No
Financial fragility?	Yes	No	Yes	No	Yes	No
Corporate welfare?	Yes	No	Yes	No	Yes	No
Savings vehicle issue?	No	No?	Yes?	Yes?	No	No?
Bank costs vs profits issue?	No	No	Yes?	Yes?	No	No
Liquidity & collateral issue?	No	No	Yes?	Yes?	No	No

Conclusion

- Anything we propose will be attacked
- MMT is about making choices using the correct framework
- Following Lerner, we should avoid choosing one option over another simply to avoid criticism

Thank You

Secular Stagnation? The Future Challenge for Economic Policy

KEYNOTE *at* Human After All

APR 11 | 03:15—05:00 | Canadian Room | **ENVIRONMENT** | **GOVERNMENT & POLITICS** | **HISTORY** | **LAWS** | **FINANCE** | **MICROECONOMICS** | **TECHNOLOGY & INNOVATION** | **TRADE**

You can't believe that money-financed fiscal policy … is better than bond-financed fiscal policy …. <u>It's exactly the same thing</u>

Bank

Assets	Liabs+Eq
Vault Cash	Deposits, Savings, Short-Term Borrowings, Long-term Borrowings, etc
RBs @ CB	
Loans & Bonds	Equity

Earn CB target at most

Weighted ave cost near CB target

Interest payments from these are the primary source of bank revenue

Cost is higher than interest earned loans & bonds

Bank balance sheet with no government bonds sales

Squeezes profitability

Too much to be viable???