Against MMT

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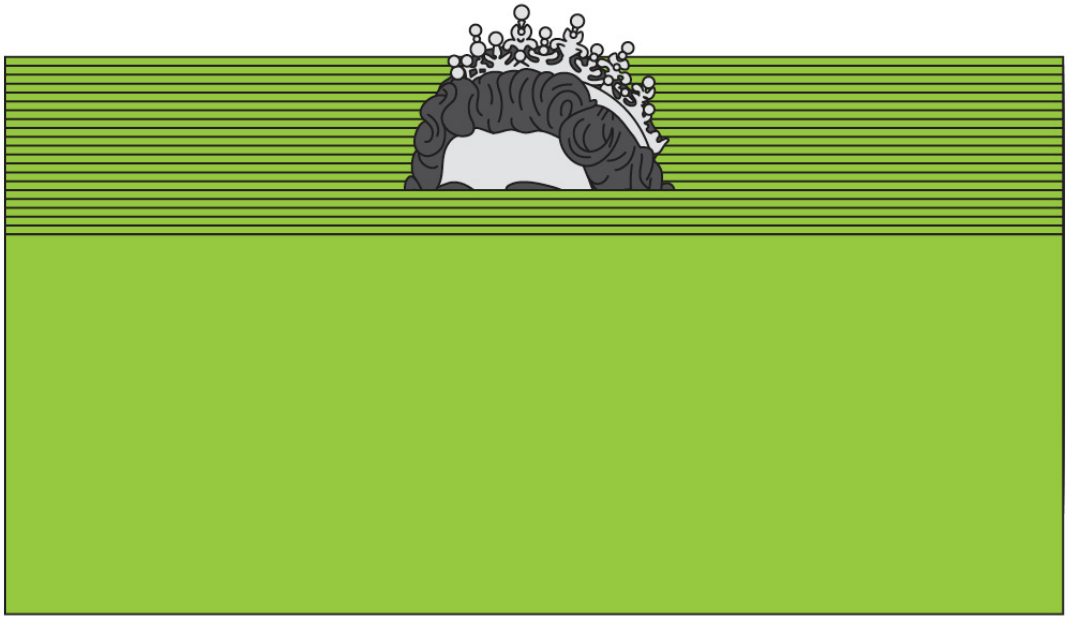

There is the prospect of electing, within the next few years, a government of the Left in Britain that is committed, in the words of Shadow Chancellor John McDonnell, to making an economy that is 'radically fairer, radically more democratic, and radically more sustainable.' These are fine words, but it leaves open the question — how? One answer, promoted by a band of enthusiasts on and offline, is Modern Monetary Theory (MMT), which claims to provide a new way of looking at the economy — and the policy prescriptions to match.

At its heart, MMT represents a return to a style of post-war Keynesian economics that the mainstream of the profession thought went out with the 1970s. Many of the insights of post-war Keynesianism, and especially those of the post-Keynesians who developed it further, like the late, great Wynne Godley, should never have been pushed aside by the profession. If more economists had paid attention to the potential consequences of rampant private sector borrowing in the run-up to 2007–8, fewer would have had so much egg on their faces when the debacle finally arrived. If more economists had warned about the impact of spending cuts after 2008, a lost decade across Europe might, perhaps, have been mitigated. To their credit, MMT economists have been on the right side of these debates.

Unfortunately, however, MMT's reassertion of a number of macroeconomic truths has been swamped by its distinctive contribution to theory — which is a rehabilitation of what is known as chartalism. Chartalism holds that money receives its value fundamentally as a result of its use to pay taxes — that, in the words of leading chartalist Georg Knapp, 'money is a creature of law'. This is dubious as a historical claim, since money has existed in many different forms throughout history, and only some of those forms have arrived with the stamp of the state — and dubious as a description of reality today, since most money is created by private banks when people take out loans, whose relationship to the state is (at most) indirect.

Others have dealt with MMT's weaknesses as a theory of economics, including Doug Henwood in the latest edition of *Jacobin.* I don't want to rehearse those arguments here, although it is worth keeping in mind that MMT's greatest theoretical failing — to provide any account of power and the state, or even (like neoclassical economics) to provide a reason why it doesn't need one — underlie the issues discussed. This article aims to concentrate instead on the practical and political implications, why they are wrong — and why Labour's own economic programme makes more sense.

MMT's belief that governments have the power to create valuable money virtually at a whim has the unfortunate effect of transforming online into One Weird Trick-style assertions about how the economy works. This is most obvious in the popular claim that MMT 'proves' governments don't need taxes to spend money and, it is argued, can spend whatever they wish up to the point that 'real resource constraints' kick in.

There is a sliver of truth here. As a technical detail, modern governments do not have to collect taxes before they can spend: they can also borrow the money, or create and spend that money directly. On a day-to-day basis, these three things can (and often do) all happen at once. Unfortunately, what holds as a technical description of how governments pay for their daily operations does not apply over the longer term. The grave danger from issuing money, in particular, is that it will lead to a general rise in prices, known as inflation, something readily acknowledged by academic MMT supporters. They often argue that governments should use taxes to deal with this problem: taxes take money out of wider circulation, and by reducing the amount of money chasing goods and services, you reduce the pressure on prices.

In this scenario, far from the transformative claims made by its online fans, we have ended up in a place remarkably similar to the hated mainstream of economics. Mainstream economics also acknowledges that inflation is an issue, but instead of saying taxes should be used to control it, its adherents, known as neoclassical economists, propose interest rates as a remedy. When these go up, it becomes more expensive to borrow, people borrow less, and this in turn reduces the amount of money in circulation — so the theory goes. But as two left-wing economists sympathetic to MMT, Arjun Jayadev, and J. W. Mason, have recently

argued, this means that the only meaningful difference in policy terms between MMT and the mainstream on the central issue of managing inflation is whether the government should use taxes or interest rates.

The MMT solution has another problem, especially in relation to democratic politics. The implication of using taxes to control inflation is that governments will see prices rising and then choose to raise taxes as well. But only a government unconcerned with elections could possibly tell the public, 'prices are rising so we are going to raise VAT too.' This fact was tacitly acknowledged by three pro-MMT academics writing recently in the *Financial Times,* who called for an 'administrative agency' to take responsibility for managing inflation via 'aggregate demand'. So whilst the mainstream wants central banks to be 'independent' of democratic government when setting the interest rate, MMT expects an 'administrative agency or agencies' to do the same thing when setting taxes. Either way, democracy misses out.

MMT's grand claim is that money derives its value from its ability to pay taxes and, therefore, governments can exercise 'monetary sovereignty' by setting the value of money as they see fit. But the economy is not an island, it cannot be isolated from others in this way. Trade matters, as do the financial relationships between different economies — and both of those will depend on the value of the different currencies that economies use. MMT understates the amount these relative values can vary over time. As anyone using the pound since the Brexit referendum will have seen, these variations can be quite large. Countries running a deficit on their current account (meaning, broadly, that they import more than they export, counting goods, services, and flows of income) like the UK — which has a deficit funded from abroad — will always be vulnerable to demands for foreign currency that they cannot immediately meet. This is a significant impediment to sovereignty.

The stability of currencies over time isn't a matter of chance. The different currencies operating in the world today form a hierarchy — just like states. At the top of that hierarchy are the most powerful states and their currencies. Dominating the entire system is the US dollar, which is used in over half of all cross-border trade and makes up over 60 per cent of all currency reserves held by central banks. Almost 40 per cent of the world's debt is dollar-denominated. In other words, demand for the dollar is always exceptionally high, relative to any other currency, which gives the US government extraordinary leeway in its economic policies.

Its government can choose to run enormous deficits, and the whole economy can sustain extraordinary trade deficits, secure in the knowledge that the rest of the world will continue to demand dollars and treat its government debts as close to the safest financial assets available. MMT's proponents sometimes acknowledge this hierarchy of currencies, but tend to assume that non-dollar currencies enjoy at least some 'monetary sovereignty'. But the problem for non-dollar currencies is not simply that they aren't as useful as the dollar — it's that the dollar dominates them.

Since the collapse of the Bretton Woods system of fixed exchange rates, the result of a unilateral US decision in 1971, successive US governments have exploited their 'exorbitant privilege' (as one former French finance minister called it) to run up $22 trillion of government debt. This has happened particularly under the Republican governments of Reagan, Bush Sr and Jr, and now Trump to allow the huge expansion of US military spending while slashing taxes for the wealthy. That should alert us to the reason why the dollar retains its privilege. It is backed, ultimately, by the most powerful state and military on the planet. For as long as this power holds, the dollar will hold — and an MMT-compatible policy will be viable in the US. It should be no surprise that MMT was developed and has its deepest roots there. It makes most sense as a theory of how to exploit US power, via the dollar. If you can't issue the dollar, MMT isn't going to work.

Labour under a socialist leadership has deliberately taken a different route. John McDonnell as shadow chancellor made clear the party's commitment to ending austerity. But to turn that into something that can work in practice, Labour has adopted a strict set of rules for how a future government will manage its finances. The 'Fiscal Credibility Rule' says, first, that Labour will commit to removing the deficit on day-to-day government spending at the end of a five-year period. This means that it will be free to borrow to invest in capital, like new schools and hospitals, infrastructure like renewables and railways, and scientific research. Second, that Labour will commit to seeing the level of government debt relative to the size of the economy lower at the end of five years than at the start. Third, if some sort of adverse shock hits the economy, this rule will be suspended to allow government to spend as required.

MMT's proponents have criticised this rule continuously, but it is not always clear why. After all, this rule was the backbone of the 2017 manifesto, with its commitments to nationalisation, £250 billion of investment, and what the Institute of Fiscal Studies called the 'the most radical tax and spending plans placed before the electorate by one of the main parties in more than 70 years.' The idea that in some way this rule supported austerity is absurd. Seeking to close a government deficit is not in itself 'neoliberal'. As we've seen, impeccably neoliberal governments like Ronald Reagan's can deliberately run enormous deficits. There's no necessary relationship between cutting the government deficit and neoliberal policies.

Leading MMT advocates like Richard Murphy ask why bother with a rule at all? There are three main reasons. First, a commitment to the Fiscal Credibility Rule allows Labour to put together a coalition of support for its programme from across the economics profession. The party can't expect every economist to agree with every dot and comma, but the impact of having well-respected experts onside for at least some of that programme is significant. If we want to not only form a government, but make a difference in government, these alliances are essential.

The second reason is that clarity and planning help cut through some of the more obvious challenges to Labour's programme — from journalists demanding to know Labour's plans for the debt and the deficit, and then, later on, as a guide for civil servants expected to implement its policies. The third reason, however, is the most important. The world economy today is not that of the 1970s, or even the 1990s. For a government contemplating transformative change, three decisive factors stick out. First, for forty years government borrowing costs have pretty consistently fallen — despite the increase in the total volume of debt. The rate at which the UK government can borrow today is close to the lowest level in human history. Indeed, so low are government borrowing rates that, after allowing for inflation, they are negative: investors will, in real terms, pay the government to borrow money.

Second, related to this, the threat of so-called 'bond vigilantes' — speculators betting against governments to drive up the price of their borrowing — is reduced. In a low interest rate environment, it is harder to mount a speculative attack on a government. Under current international conditions, there is no reason why a government with clear and credible targets for its own borrowing should not be able to meet them at minimum cost. And with government borrowing rates as low as they are, even a substantial increase in the cost of borrowing would still leave it at historically low levels. If fear of the bond markets could be used to justify New Labour's accommodation to neoliberalism in the 1990s, it cannot be now.

But these two easings of restraints are joined by a third decisive feature of the global economy. Adam Tooze's exceptional history of the last decade, *Crashed*, describes the situation when, in the depths of the financial crisis, British banks faced huge demand for dollars — the result of their massive dollar liabilities — that not only could they not meet, the Bank of England itself could not meet. Instead, 'swap lines' were opened from the Federal Reserve in the US to supply dollars at rock-bottom (but still notably profitable) rates to financial systems in countries like the UK that were suddenly grossly overstretched. This is a critical moment in the economic history of the previous ten years, since it reveals in dramatic fashion the real lines of power and command in the world economy today — as Tooze notes, the decision to provide that support was political and taken at the highest possible level in the US. Our huge, internationalised financial system is dependent, ultimately, on political support from elsewhere precisely because it is huge and internationalised.

Reducing that dependency should be a key aim of any future left-wing government. To the extent that banks are better capitalised and somewhat more regulated it is reduced, but remains a problem for as long as the UK is running a major deficit on its current account. A government following an MMT-type prescription runs the risk of increasing the UK's dependency on international financing. And that, in turn, increases the potential political dependency on US agencies.

Worse, the very existence of a large financial system, vulnerable to shocks, creates a domestic pressure to reduce public spending. The logic is simple, as described by the former Chief Economist of the IMF Maurice Obstfeld: if we have a bloated financial sector, it is at increased risk of the kind of crash that will require bailouts in one form or another — either directly to financial institutions, or indirectly through vast deficit spending by government. The risk of this future crash drives austerity today, which is what the Tory chair of the Public Accounts committee meant when he said there was not enough 'national borrowing capacity' to cope with our 'exposed and vulnerable' financial system.

To end austerity permanently, we have to transform how our financial system works, reducing its exposure to the risk of a major collapse. And to transform finance, we need a slow, methodical process akin to defusing a bomb — not a further explosion. It will mean 'structural reforms' to our economy — building new institutions to deliver investment, like the regional development banks; changing the ownership and control of productive assets, for example through the Inclusive Ownership Funds — issues on which MMT advocates are usually silent.

Any future Labour government should not just aim to undo the damage of austerity, pressing though this is. Confronted by immense social challenges — climate change and automation chief among them — it will have to look beyond the horizon of a subsequent election and towards delivering a fundamental shift in the economic structures of this country, at least comparable in scale to those made by the Thatcher governments.

If we're thinking in those terms, we cannot allow a mass of unfunded obligations and government debt to be built up over time; the real danger is not the debt itself, or even the market reaction. The danger is what we saw from 2008 onwards: that the grim political economy of an excessively large financial system will reassert itself as demands that government debt must be reduced, and austerity applied. For as long as our major economic institutions continue to place finance first in their considerations, this risk will endure. If Labour wishes to make permanent changes — including permanent increases in public funding for public services — we must establish clear lines of tax funding for day-to-day spending, and set out a path for future deficits to follow.

The problem with MMT for a genuinely transformational government is not that it is too radical. Quite the opposite: it is nowhere near radical enough. It substitutes a belief in the unlimited capacity of a sovereign government to spend money for the hard reality of the political fight needed to rebuild and transform our society. It is the expression of a deeply conservative faith in the benign nature of our economic institutions. In an increasingly class-divided society, with institutions from the Treasury to the Bank of England to the City that have failed systematically to deal with crisis after crisis, we cannot simply flush away our social problems on a tide of government-printed money.

Worse yet, in a country so profoundly and obviously overstretched internationally, with a major financial centre that we know to be a major vulnerability, MMT promotes a blasé indifference to the real relationships of power and patronage that sustain the world economy. To the extent that it disorientates activists, peddling simplistic monetary solutions to complex problems of political power, it is a barrier to a genuinely transformative Labour government. We need to build an organised and educated mass movement that can see the problems such a government might face. MMT cannot help us do this — in fact, it will hinder us in that mission.

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