Modern Money Theory revisited – still the same false promise

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To begin with

The title 'Modern Money Theory' – MMT for short – signals wide-ranging aspirations, announcing some kind of general theory. However, MMT is more like a kit with a handful of hypotheses from different origins. Most of them are taken from Keynesianism and Postkeynesianism, with a particular emphasis on chartalism. The latter term stands for the state theory of money after Knapp, Keynes and Lerner, meaning that money is a creature of state law, and that the official means of payment are created by state bodies or in a mixed private-public arrangement under state control.

One advantage of eclecticism is its ability to readapt. For example, in the beginning of MMT, the writings of Mosler and Wray did not include a systematic element of monetary and financial crisis theory and they did not, and still do not, see any need for monetary and banking reform. They portrayed the present bankmoney regime as a marvelous credit-and-debt machine run as a sovereign currency system. A credit-and-debt machine it certainly is, although it is neither marvelous nor a sovereign currency system. In spite of MMT's self-image to represent new chartalism, MMT is in fact apologetic about fractional reserve banking, belittling the system-dominating role of the banking sector, and thereby defending – as a matter fact – the banks' neo-feudal privilege of money creation by way of extending credit.

As the 2008 crisis did not swiftly fade away and MMT also faced some criticism, they then re-adapted, in that they remembered the financial instability hypothesis of Minsky. Equally, they were confronted with the question why – if what we have is supposed to be a sovereign currency system – there is that strange ban on the government to create money, leaving the sovereign monetary prerogative mainly to the banks. MMT reacted by profiling their thesis that government incurring debt allegedly equals money creation, whereby the central bank is in the role of a partnering government body, while the banks appear to be little more than helpful executors of the government's monetary and will. To most economists, even heterodox ones, this sounds rather strange but is typical of MMT's habit to re-interpret theories and facts.

MMT as an offspring of Postkeynesianism

It may generally be maintained that what is valid in MMT stems from Postkeynesianism, while what is specifically MMT tends to be highly questionable. One core tenet of Postkeynesianism, for example, is

- endogenous money creation. Rather than coming from an exogenous source, money creation is endogenous in that demand for credit from within the economy triggers bankmoney creation, combined with
- accomodationism (be this in a horizontalist or structuralist variety[1]) meaning that central banks re-act to and re-finance the monetary facts the banks have created on market demand beforehand.

However, even these basically valid Postkeynesian elements would need critical clarification:

• The distinction between endogenous bankmoney and exogenous central-bank money (in American usage, inside and outside money) is arbitrary and overstated. Historically, exogenous money only existed in the form of traditional silver and gold currency. With modern fiat money, however, all money is endogenous, because also allegedly 'exogenous' central banks do not issue new money 'just like this' but always on demand, even if on conditionality; like the banks do in this regard. The banks, furthermore, accommodate the market demand for money very selectively, and also create bankmoney for proprietary business on their own initiative. If bankmoney is seen as 'endogenous' than central-bank money is 'endogenous', too, and if central-bank money is seen as 'exogenous' than bankmoney is 'exogenous' to the economy too.

• Most Postkeynesians, like mainstream economists, still have an over-aggregate understanding of the demand for money and thus fail to be clear about its composition. (Over-aggregation is an MMT specialty). There is not the slightest distinction between GDP-contributing finance and non-GDP finance, as if all money creation would serve the real economy. Today, in fact, most of new money and credit creation goes into non-GDP finance – a fact absent in MMT and most of Postkeynesianism; instead, they have been discussing financialisation at great length without asking where all the money feeding financialisation comes from.

• Present-day means of payment – notes as much as reserves, second-level bankmoney and third-level MMF shares – are created by way of credit. Put more precisely, a loaned or invested amount is paid in the form of these means of payment. The close link between credit (financial contracts) and money (the means of payment) has led over time to another over-generalization, which is the false identity of money and credit, prevalent in neoclassical and Postkeynesian thinking alike, and very pronounced in MMT. In fact, most economists today falsely identify money with credit, and thus confuse these two very different things and functions. This again involves an over-generalization blinding out 2,500 years of debt-free creation and issuance of money when precious-metal coins were spent rather than loaned into circulation. (Even today, in most countries treasury coins are still sold, not loaned, to the central bank).

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[1] Palley 2013.

As a result of the false identity doctrine of money and credit, many Postkeynesians and most MMTers deny the possibility of debt-free issuance of sovereign money. In some of them, this even involves a fierce defense of the banks' quasi-sovereign privilege of creating bankmoney. In view of the defenders' claim to be chartalist economists, this is grotesque as it is tantamount to a defense of what they claim to be critical about, namely, Banking School doctrine, efficient financial-markets hypothesis and present-day financial-market capitalism.

Elements that are specifically MMT

Let us now focus on additional elements that make the specific MMT profile.
How does MMT come to postulate that we would have a sovereign currency system, while at the same time defending the bankmoney privilege, and failing to be clear about the monetarily all-dominating pro-active bankmoney regime that is re-actively backed by the central banks as lenders and security dealers of last resort, and warranted by government as the bankmoney guarantor of last instance?

Sector balances

An important theoretical building block in MMT is sector balances after Godley/Lavoie.[2] There are two sectors, the public and the private sector, and if need be, the foreign sector as a third one. The sectors are the basic categories of a kind of macroeconomic double-entry stock accounting (enabling aggregate flow analysis by comparing consecutive balances). What is not rebooked within one of the three sectors but leaves that sector, is an inflow into one of the two other sectors.

The sectors can and ought to be subdivided, particularly, for example, into monetary institutions, non-monetary financial institutions, fiscal bodies, and real-economic actor groups.[3] There are such sub-divisions in Godley/Lavoie. MMT claims to do likewise if need be, but in fact they do not. As a result, when they speak of 'the government' it is unclear who is addressed – the governing cabinet or the President's office and the ministries, the executive beyond, parliament, or the central bank as the national or intergovernmental monetary authority (while the judiciary is in fact not much involved here). All state bodies and other institutions under public law are subsumed under the one category of 'government' or 'public sector'. One may then puzzle over what or who more precisely they refer to. What becomes obvious here is MMT's explicit intention to merge creditary and fiscal functions, as if to make that fundamental distinction disappear; a distinction relating to the further development of the separation of powers, which is fundamental to any liberal and democratic rule of law and indispensible in monetary and fiscal analyses.

[2] Godley/Lavoie 2007.
[3] In this sense, Hudson (2006, 2012 55, 297, 333) has suggested to include a FIRE sector in the sector model (Finance, Insurance, Real Estate). Werner (2005 185) and Huber (2017 pp105) have suggested to complete the equation of money circulation by making a distinction between GDP-contributing finance and non-GDP-contributing finance.

In this paper, 'government' refers to the top positions of the executive state power, including a state's treasury, but not including other state bodies and the central bank (if the latter is a state body under constitutional and administrative law at all, rather than a commercial joint-stock company with the majority held by banks and other private owners).

MMT-specific proposition #1
'Government' creates money in the form of sovereign bonds

Having said that, the reader may not feel too baffled when learning that according to MMT it is 'the government' that 'creates' money when it originates sovereign debt in the form of Treasury bills, notes and bonds. Taken literally, this is simply wrong. Treasuries today do not issue money, except maybe for coins. What can be said, however, is that by issuing bonds or similar debentures, a government is likely to add to the demand for money which, if important enough, is in turn likely to *trigger* the creation of additional money in the form of bankmoney and central-bank reserves.[4]

This is in line with the endogenous money hypothesis, *if* government demand for money is introduced as another form of market demand. This too, is not entirely new, as even neoclassical economics has raised the question of whether public demand for money drives out private demand for it. MMT's variant, however, again comes with an idiosyncratic element by insisting on 'the government' to create the money by issuing sovereign bonds. This can be misunderstood in that it implies that government creation of money or government demand for money replaces market demand rather than complementing the demand for money by other market participants.

Of course, and as said, government does not create money, but its demand for money triggers money creation by the monetary institutions in the system, i.e. by the banking sector and the central bank. Depending on whether the bonds are initially taken up by banks or nonbanks and where the money flows to, the issuing treasury is paid in reserves (into a government transaction account with the central bank) or in bankmoney (into a government account with a bank).

At second glance, it turns out that even in MMT it is the central bank that in actual fact creates the money *in tandem* with the Treasury. The central bank is supposed to eventually buy up the government securities – indirectly so, from banks and other institutions, as central banks are not allowed to finance public expenditure by directly taking up sovereign bonds. The banks are strangely absent in this MMT construction. The role of the banks is generally underexposed in MMT.

If the MMT view of this were true, government debt would equal the central bank's holdings of government debentures – which is definitely not the case. Neither the central-bank holdings of government securities (assets) nor central-bank reserve

[4] For a detailed description of how the present money system works see Ryan-Collins/Greenham/Werner/Jackson 2012, McLeay/Radia/Thomas 2014, Ravn 2015, Huber 2017 57–100, 2017b, Deutsche Bundesbank 2017.

balances (liabilities) equal government debt. For example, at the beginning of 2019, reserve balances with Federal Reserve banks were roughly 1,600 billion USD, Treasury securities held by the Federal Reserve 2,200 billion, but government debt was 22,500 billion.[5]

Most government-originated securities do not end up on the central-bank balance sheet, not even if including foreign central banks, or even under the recent conditions of Quantitative Easing policies that have absorbed extraordinarily high levels of sovereign bonds so as to flood the banks with reserves. Most sovereign debt papers are still held by banks and other financial institutions, with less than one sixth held also by private persons, depending on the country.

MMT-specific proposition #2
Government expenditure means money creation. Taxes do not fund government expenditure, rather, government expenditure funds tax payments

The next step in MMT's deliberate monetary-fiscal confusion is that taxes are *not* said to fund government expenditure, rather, that government expenditure equates money creation that would provide the funds for tax payments by which the money is retired.

There is a historical example that corresponds to such a mechanism: the medieval money surrogate of wooden tally sticks. Besides merchants, also feudal treasuries issued such sticks that were split up into a stock (for the creditor who thus became a stockholder) and a foil (for the feudal treasury as debtor). The stock circulated for a while as money, within certain milieus, before being used for the settlement of tax obligations – by which act the treasury hard-currency debt and the creditor tax debt were cleared, and the stocks withdrawn from circulation. Tally sticks thus represented a type of tax credit.

In modern monetary systems there was a similar practice that allowed using future tax claims in advance. From the 18th to the beginning of the 20th century, a number of European governments, for lack of revenue in silver coin and gold, have issued treasury notes. These notes were not a security but banknote-analogous paper money, used, for example, for paying state officials or suppliers. Such treasury notes, or say, treasury pay vouchers, represented modern sovereign fiat currency, issued side-by-side with central-bank notes and/or commercial-bank notes; generally accepted in everyday domestic use, but largely useless in foreign and wholesale financial transactions. For the most part the notes were not retired upon tax payment but re-spent into circulation. Of course, whether re-spent or retired and replaced with a new issue just makes a formal, not a real, difference.

Regarding the MMT postulate of 'government bond issue equates government expenditure, which equates money creation providing the funds for tax payments', the

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[5] Figures according to Federal Reserve of St. Louis, FRED Data, https://fred.stlouisfed.org/ as well as Board of Governmenternors of the Federal Reserve System, Quarterly Report on Federal Reserve Balance Sheet Developments, Nov 2018, 5.

important thing is, firstly, that those treasury paper notes represented only a small part of the entire money supply (except maybe for the American greenbacks) and, secondly, that their issuance has long been discontinued. In Europe, treasury pay vouchers no longer exist and governments are no longer allowed to issue paper money, less so digital money. In the U.S., Treasury paper notes, going back to the Lincoln greenbacks of the Civil War, are still valid, but issuance of new ones has been discontinued. Should the U.S. government decide to issue new Treasury money in the form of paper notes or digital currency, it could in fact do so. Simply, it does not, and is not considering such a step, thus leaving the sovereign monetary prerogative to the banking sector.

Tax payments of nonbanks go into bank accounts of the revenue office and normally end up in a treasury account with the central bank. Whether in bankmoney or reserves, the money spent on taxes continues to circulate through ongoing government expenditure. The respective reserve balances are not deleted (as is the case with bank payments in reserves to the central bank itself; or with nonbank payments in bankmoney to a bank). Instead, the treasury reserve balances continue to exist and circulate in government payments to whosoever. This does not depend on a monetary decision of the government or the central bank.

Therefore, it is clear that tax payments do not delete money but serve funding government expenditure together with additional debt taken up. Public expenditure spends the money obtained from taxes and debt, but does not create money, even though extended government demand for credit, as said above, is likely to trigger money creation, much like expanding credit demand from finance, companies and private households.

If it were true, by contrast, that public budgets are funded by government-issued money in the first place rather than being funded by taxes and debt, why originate bonds at all? And, why levy taxes at all? Even in a pure sovereign money system, additions to the stock of money by the monetary state authority must roughly keep within the boundaries set by the potential of factor utilization, including employment, productivity (output) and competitiveness. Responsible money creation can simply not be high enough to replace taxes for funding public expenditure to a large extent. (Sovereign money creation issued as genuine seigniorage to the public purse could possibly substitute for 1–5% of total public expenditure, depending on the rates of growth and government expenditure).

MMT-specific proposition #3
Government debt is not really debt

Following on from the idea that issuing government bonds equals money creation, MMT has it that government debt is no debt. According to MMT, government debt would need to be re-interpreted – which again takes some getting used to, the more so as it contradicts MMT's assertion of the identity of money, credit and debt. That false identity is decomposed here in a somewhat schizophrenic way, in that money is still supposed to be 'credit money' but not 'debt money'.

Admittedly, others have also had such thoughts, including Keynes when he conceived of 'perpetual zero-coupon consols', that is, non-interest-bearing government debt without maturity, eternal credit free of interest so to say. Similarly, in the earlier stages of the contemporary approach to sovereign money, the idea was for the central bank to provide genuine seigniorage to the treasury in the form of non-interest-bearing credit without specified maturity, as a special category of credit adding to the national monetary endowment; formally a credit but in fact no credit in almost any sense of the term. From the beginning, however, that re-interpretation was felt to be dissatisfying for confusingly over-stretching the notion of credit and related accountancy practices.

The next idea then was of booking additions to the stock of sovereign money (issued as genuine seigniorage free of interest and redemption) by an entry into the central-bank equity account, thus adding genuine seigniorage as a new class of 'profit' in the profit and loss statement. In terms of central-bank accountancy, this still remains dissatisfactory, this time for over-stretching the notions of equity and earnings.

The final solution – revisiting an old idea by Ricardo and the Currency School – was to separate sovereign money creation from operational central banking, including a currency register separate from the conventional central-bank balance sheet.[6] This does not involve any confusing re-interpretations, while nevertheless allowing to treat sovereign money like coins were formerly treated, that is, as a monetary asset only, no longer as a standing liability on the central-bank's balance sheet. MMT, by contrast, sticks to re-interpreting debt as not to be debt.

MMT-specific proposition #4
Deficits and debt are no problem but an endless source of funds

Going even one better, MMT asserts that the government of a sovereign state with its own currency cannot be over-indebted, cannot become illiquid, and thus need not default in its own currency, because the treasury and the central bank in tandem can always create as much money as they deem adequate. On the surface of it, this might seem to be so. In actual fact and practice it is a chimera as all over-indebted governments and empires had to experience at some point in time. Being indebted in domestic currency, and to domestic creditors, certainly carries less risk than being indebted in foreign currency and to foreigners; a risk position it remains nonetheless.

Beyond critical thresholds, 'too much finance' – that is, too much credit and debt on the basis of overshooting creation of money and money surrogates – burdens the productive real economy rather than supporting it. Inflation and/or asset inflation go up, real mass income and purchasing power go down. The foreign exchange value of the currency weakens. If the currency has the status of a reserve currency, that status is bound to decline. Imports become more expensive and more difficult to finance in

[6] Cf. https://sovereignmoney.eu/central-bank-currency-register-for-accounting-for-sovereign-money.

domestic currency, the more so in foreign currencies. Foreign investment drains off. Austerity penetrates public and private finances. Many developing and newly industrializing countries made such experiences in recent decades. Hitherto advanced countries, too, have temporarily faced similar problems.

The U.S. has by and large been able to avert the more dramatic phenomena of that contingent causal complex. The reason is America's 'exorbitant privilege' resulting from the U.S. dollar's role as the single dominant world currency.[7] Most international transactions in trade and finance are made in U.S. dollars and carried out through American banks and payment systems. The world thus needs many dollars, which Wall Street and Washington are happy to provide. The U.S. dollar has been devaluing in the long run since 1971 when the *gold dollar* gave way for what Hudson has dubbed the *U.S. Treasury bill standard*.[8] The dollar nevertheless continues to be the benchmark for all other national currencies. In this regard, Mosler's first MMT paper from 1995, titled *Soft Currency Economics*, was programmatic. Today they say, 'money is for creating', indirectly signaling 'as you like', while keeping back from saying 'and make the others pay for it'. It costs Wall Street and Washington very little to provide dollars, while the 'foreign sector', also known as 'rest of world', has to deliver for each dollar equivalents worth 100% of those dollars.

Some Postkeynesians and individual MMTers have suggested periodical debt cancellation, inspired by the antique practice of debt jubilee when a new ruler came to the throne.[9] Today, as long as the existing standards for monetary and financial accounting apply, debt cancellations to a large extent are out of the question, because on the central bank's and banks' balance sheets this would involve writing off credit claims (financial assets) without being able to cancel related liabilities that represent the money-on-account of banks and nonbanks. Consequently, writing off claims on debtors can only be done to a small extent.

MMTers avoid discussing the dynamics of 'too much money, credit and debt', except maybe for some incidental remark on, say, inflation. MMT acknowledges that limits to money creation exist due to possible inflationary implications. This, however, is treated as a rather theoretical consideration. Government expenditure is thought to be non-inflationary because for the most part it is spent on real-economic purposes, which is supposed to contribute to higher but non-inflation accelerating economic capacity utilization. But where is government expenditure directly and subsequently ending up? It is ending up in firms as well as in banks and other financial institutions, in both ways contributing to ever more unequally distributed income and wealth of private households, with much of the money being lastingly absorbed by non-GDP finance. If this does currently not cause CPI to rise for temporary historical reasons, it

[7] Eichengreen 2011, Hudson 2003.
[8] Hudson 2003 pp377.
[9] Cf. Hudson/Goodhart 2018, Keen 2011 pp354, pp398.

clearly contributes to asset inflation and 'too much finance' as this has already been the fate of Keynesian-style all-seasons deficit spending.

Contrary to present short-sighted expectations, CPI is bound to rise again to the extent that financial investment opportunities are pushing the limits and financial investment is superseding real assets such as real estate, housing and commodities. More generally speaking, CPI will rise again to the extent that the existing overhang of money is making inroads into real-economic expenditure, also including a lifestyle of conspicuous luxury consumption, increasingly detached from the rest of the people who struggle to maintain their standards or in fact are losing purchasing power.

MMT has so far swept aside such concerns on the grounds of its distorting interpretations of over-aggregate sector balances. The basic line of arguing reads 'The sectoral balances are netting out, no problem here'. Sure, double-entry balance sheets do balance out. Economically, this is next to being non-informative. Balance sheets and sector balances as such do not reveal much about the dynamics and causalities behind. To MMT, however, public-sector debt even appears to be benign as it equals private-sector fortunes; never mind, more closely looked at, who is getting the money and who does not (distributional aspect), and what 'too much finance' over time actually involves for the real economy.

Similarly, also foreign sector imbalances are re-interpreted by MMT not to represent a problem. From an American perspective, this has a point. The U.S. domestic economy benefits from imports of goods, services and brain power, while foreign economies obtain lots of dollars. The foreigners in turn can use the dollars for financing their international trade, or re-invest the money in the American real economy or, more often, put the dollars in American financial assets, including lots of Treasury bonds etc. As one saying goes, 'it works until it doesn't'. For once, Wray brought himself to say that foreign sector deficits might actually be a 'beggar thy neighbor' strategy; which, again, can only be said for the special relationship between the Unites States and its 'neighbors'.

Conclusion

Rather than being a coherent theory, MMT is primarily a U.S.-specific and partially self-contradicting compilation of accommodation teaching, pleasing Washington and Wall Street alike and also many of their European and Asian 'neighbors' who are caught in the trap of never-ending deficits and debt, requiring self-propelling credit expansion and overshooting money creation, which in turn has ever more been feeding non-GDP finance rather than the real economy.[10]

MMT has already been dubbed 'voodoo economics' (by L. Summers) and in the *Economist,* MMT has of late been characterized as 'quackery'.[11] J. Meadway, a policy advisor to the Labour party, is reported to have said: 'MMT is just plain old bad

[10] Also see Hunt 2019.
[11] *The Economist*, Feb 16th 2019, 9, 18.

economics'. That was confirmed in a subsequent issue where the author concluded that 'MMT is not obviously a step forward. … It is macroeconomics as usual'.[12] That is what MMT in fact comes down to, irrespectively of its sailing under false flag.

MMT does not see a need for reform, neither regarding government finances nor the system of money creation and banking. The things MMT would like to see implemented are of a different and lesser nature, for example, money creation for funding a government job guarantee. Active labor market policies in the 1970–80s have proved employment subsidies not to be such a good idea. They provoke deadweight or windfall effects without helping much. On the other hand, MMTers tend to be critical about the idea of an unconditional basic income that would help reduce the traditional lopsided wage-dependency of social security and welfare.

In any case, MMT recommends merging fiscal and monetary responsibilities so as to facilitate the ongoingly over-expansive creation of credit-and-debt money. This caters to almost all political interests – those who want to carry on with Keynesian-style deficit spending, those who pursue clientelistic policies of any kind, those who represent the military-industrial complex, and those who are, or benefit from, big finance. MMT promises all of them to be able to continue with what they are used to without remorse. No wonder that quite a few politicians in America and Europe are now giving an ear to MMT's siren song of 'Don't worry about imbalances, deficits and debt'. In times of fake news and arbitrary truth, who cares when this represents economic surrealism rather than sober science.

[12] *The Economist*, March 16th 2019, 70.

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