EUROPE 16.07.2019 | Dirk Ehnts & Skender Fani

Modern Monetary Theory's promise

The state can never run out of money. Therefore, the argument that we can't 'afford' the green transition doesn't hold

Read this article in German.

Politicians seem ill-equipped to put scientific findings into practice. Climate change and authorities' hesitant responses to it have cemented this view in people's minds in recent years, causing frustration. At the same time, digitalisation and international competition are fuelling fears of job losses. Centrists have been aware of this fear of decline for some time. To overcome these challenges, politicians must rethink the theoretical foundations of their decision-making.

Tight finances are usually cited as a reason for the phased retreat by the welfare state in recent decades. Tax income, they say, would no longer be enough to fund all government spending in full. There is supposedly no more money for future investment in research, education, infrastructure, social justice or any kind of environmental change. The state simply can't afford such things.

Given the state's tendency towards inefficient spending, the financial markets should monitor national governments in the eurozone, for instance. Interest rates would then be raised to punish bad governments and lowered to reward good ones. That would enable good governments to spend more on their citizens as they have less interest to pay – and allow bad ones to spend less. Effectively, this thinking has created a regime that Angela Merkel, in a moment of notable clarity, called 'market-compliant democracy'.

Alternative blueprint

In a market-compliant democracy, governments act at the markets' command. The rise of lobbying, the bail-out of the banks ('too big to fail') along with spending cuts by the euro states and resultant social tensions, the sale of public housing to investors, low wage growth due to the advent of the low-wage sector – these political decisions were made in many Western democracies. New Democrats in the US and New Labour in the United Kingdom, the Third Way in Germany: similar reforms were carried out everywhere.

Social democratic and conservative parties became increasingly indistinguishable. The state was weakened and so, in turn, was democracy. Unelected central banks were expected to boost the economy through the trickle-down effect and their interest-rate policy. Income and wealth inequality grew to record levels, while large sections of the population were left behind by economic development. In the current age of negative interest rates, we must recognise that the interest-rate policy approach doesn't work, or at least not as we thought it did.

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If the model of the market-compliant democracy has outlived its usefulness, it is time to look for an alternative political vision. It must convince people that politicians can solve the problems of the 21st century. This kind of alternative blueprint for society needs a theoretical basis. Modern Monetary Theory (MMT) can make an important contribution. Understanding MMT enables us to envisage progressive politics without getting tangled up in misguided debates about whether we can 'afford' things or not: a new political realism. The first major thing to note here is that 'modern money' is always government money. The state is the originator of currency as it puts money into circulation through its spending. If we have to pay our taxes in euros, the state has to spend a sufficient amount beforehand. That is the only chance we have of getting the right amount of money.

A creature of law

It is also crucial to understand here that modern money can be regarded as tax credit. Specifically, this means our money – the euro – is purely and simply a promise by the state to accept it in future for payments to the state. As taxes account for most of these payments, modern money can essentially be described as tax credit. Money is therefore a creature of law as the state defines the currency in which it accepts payments via its monetary system. In return, we accept the money because we need it for tax payments. Or because we know other people who need it for tax payments and would hand over goods and services or assets such as property or shares to us in exchange. So modern money is not a scarce resource. Under the gold standard, things were rather different. The fact that many of our economic-policy assumptions are still based on this old model of the gold standard is a self-imposed restriction that keeps us as a society from using all the economic-policy options at our disposal.

This means that the state, as the creator of money, puts the money into circulation in its own currency first in the form of tax credits before we use it to pay our taxes later. Although this understanding is fundamental, it supersedes the widespread view that tax payments fund state spending. In a modern monetary system, taxes are not needed to fund state spending. The state first spends money that it practically forces acceptance of through taxes. State spending is not technically limited here. In other words, the state can print as much money as it deems sensible. As it creates the money, it doesn’t rely on an income before it spends anything.

Moreover, this does not apply, or applies only to a limited extent, to the eurozone countries. Their governments have been relegated to the status of German federal states. They too have to fund themselves through tax income and loans. However, the same applied to the German federal government in the days of the deutschmark. It is the same today in the modern nations outside the eurozone such as the US, the UK, Sweden, Switzerland, Canada, Japan and China. So, the modern state with its own currency is not a thrifty 'Swabian housewife' who can spend only what she has already received. It cannot become technically insolvent, as it creates the money.

A Green New Deal

What is the logical corollary of this understanding as far as the challenges of climate change, digitalisation, growing global competition and social justice are concerned? The state cannot just sit there and say there’s no money left. This also applies to the eurozone. Modern government money can no longer be perceived as a scarce economic resource. Instead, it should be regarded as an instrument for achieving social goals. Economic-policy measures can be truly effective only if they are based on a realistic understanding of how the modern monetary system works.

The main focal point here should not be financial key ratios such as budget deficits and government debt. The basis should be real economic costs and benefits of social progress. At present, politicians assess legislative proposals on the basis of 'affordability' with regard to tax income and spending cuts. Yet spending programmes should be assessed in terms of their real economic impacts and take the real economic costs into account. Likewise, tax income should be seen in terms of its impact on the real economy rather than the deficit.

As a theoretical basis, Modern Monetary Theory provides a stable scientific foundation to underpin new political instruments and policy measures.

We have devised a Green New Deal for Julia Herr of the Social Democratic Party of Austria (SPÖ) in which the European Investment Bank funds additional spending by issuing green bonds. If all EU states were to take part, the programme would amount to over a billion euros a year. This volume is essential to countering climate change politically and to bringing about socio-ecological transformation. It is also technically possible. In an economy, resources are scarce, but money isn't.

In Germany, the German state and the EU could also fund a job guarantee and invest heavily in social and environmental transformation in the form of a Green New Deal. This would not require savings or the blessing of the markets. Such a deal would strengthen Germany as a business location and effect a change towards an economy with greater social justice and sustainable growth in which full employment and price stability prevail and the common good of society comes first.

Jobs for all

As far as digitalisation and global competition are concerned, fear of job losses is at the forefront of people's minds. Many fear digitalisation will sharply reduce demand for labour, as robots will supplant workers. However, this automation of production has been going on for decades: previously, food and plants were cultivated by 99 per cent of the population. Now, people have different jobs and work in the service sector. Unemployment is caused by inadequate spending in the economy, not digitalisation or a lack of meaningful activity.

The task of the modern progressive state is to ensure there is enough macroeconomic spending or lower taxes to enable full employment. To date, we have responded to this only with reduced working hours in order to redistribute work in such a way that everyone has a job. In addition, through a job guarantee, i.e. a right to work, the state could offer unemployed people jobs that are paid with the minimum wage. This would put pressure on the wage structure, which would rise as a result.

Higher wage agreements are a great idea in times of low inflation rates.

Companies will pass on some of the costs in the form of higher prices if their competition situation allows this. Rising prices in Germany mean that we will consume more of our own production and also more from abroad. At the same time, German exports would stagnate, as they would become more expensive more quickly than competitors' exports. This too is an entirely positive effect. There is no reason why a country shouldn't align its consumption with the value of its own production. Consequently, some production will be exported, but the same amount will be imported. The cake will then be fully consumed. With an equal balance of trade, we wouldn't have to tighten our belt too much or loosen it. However, if a country exports more than it imports, it relinquishes some of its production in favour of money, which is generated from imports. But this money goes to the exporters and their employees, not to all of us.

As a theoretical basis, Modern Monetary Theory provides a stable scientific foundation to underpin new political instruments and policy measures. Rather than being the solution to the problems, it is a guide that can be used to identify solutions and convince the electorate that a shift in economic policy is beneficial to the many. The myth of the moneyless and powerless state – this includes 'breaking even' – must be busted in order to open the door to another society. The profit motive should play less of a role here, with democracy being strengthened instead. The state can play a stronger role again and bring about the justice that is beyond the market's power.

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