10

MMT, THE PANDEMIC, AND THE FISCAL DEFICIT FRIGHT[1]

Tim Di Muzio

As Covid-19 and its variants spread around the world, interrupting the "normal" operations of global capitalism, governments on the centre, left and right have been issuing large spending packages to fight recessionary conditions as businesses recalibrated their operations or shut down altogether and unemployment soared in a locked downed world (OECD 2020a, 2020b, 2020c). The crisis was made worse by the mountains of corporate and consumer debt thathad accumulated to keep businesses turning over and households afloat well before the pandemic (Di Muzio and Robbins 2016; Soederberg 2014).

Surprising for some, against all prior devotion to "fiscal discipline" and so-called balanced budgets, public officials the world over shelved the first commandment of neoliberalism and collectively announced spending in the trillions. As *Bloomberg* noted, "in the battle against Covid-19, governments around the globe are on the cusp of becoming more indebted than at any point in modern history, surpassing even World War II" (Capo McCormick et al. 2021). This spending suggests that when it comes to preserving the class relations that structure our society—worker and employer, renter and landlord, debtor and creditor—it seems that money truly is no object during a crisis. At the time of this writing, no one knows the sum tally of the new spending, though it is certain to far exceed the bailouts witnessed during the Global Financial Crisis of 2007–2008. Indeed, echoing *Bloomberg*, the *Financial Times* dubbed this extravagance "the biggest borrowing spree in history"—and in early 2020, when the article was published, the pandemic was just getting started (Stubbington and Fletcher 2020).

As the pandemic deepened well into 2021, the economic turmoil unravelled while discretionary fiscal spending for relief programs mounted.[2] The ghost of Keynes seemed to be back in the fiscal saddle. To recall, Keynes argued that governments should spend by going into deficit in an economic downturn—particularly in a depression—and increase taxes and build surpluses to service debt

DOI: 10.4324/9781003250432-14

PROOF

when the economy heated back up. Going into debt seemed the only solution to Keynes and his later acolytes (Keynes 2016). This thinking was based on the notion that businesses do not hire more workers nor increase or expand production during a depression due to less market demand for goods and services and greater uncertainty regarding future economic prospects (Skidelsky 2010). The only entity that can spend during a depression to get the economy going again and alleviate the misery of workers and businesses is the state itself. So, while the pandemic may be a once in a century bio-capitalist crisis with its peculiarities, it too has shined a bright light on the importance of government fiscal policy and borrowing to prop up the economy and support livelihoods and business.

Within this context and the scramble to find a new economic paradigm surpassing the orthodoxy of neoliberalism, a seemingly new set of ideas came to be debated beyond the ivory tower—Modern Monetary Theory (MMT) (Boxall et al. 2020; Mitchell 2020). As the *Economist* reasoned after surveying policy options during the pandemic: "What is clear is that the old economic paradigm is looking tired. One way or another, change is coming" (Anonymous 2020: 16). While proponents of MMT do not always agree on the way forward, at its very basic, MMT can be encapsulated in five main claims. First, national governments who are currency issuers always can service their debts, provided they are denominated in the national currency. This means that federal deficits, provided they do not contribute to runaway inflation, can be incredibly useful for achieving public policy goals. This suggests that MMT upholds a strong role in inflation monitoring. Second, the government does not have to wait around for tax receipts or bond sales to spend money on the economy. The treasury simply instructs the central or national bank to deposit payments in a recipient's account. In this sense, governments do not wait around for tax money to accumulate in a piggy bank before spending money on the economy, even in normal times. Third, deficit spending is an injection of money into the economy while taxes, fines and fees drain money out of the economy. In this sense, the government's deficit spending or debt issuance as securities is used by businesses when governments buy goods and services from them, by individuals who receive transfer payments or as a financial asset by citizens or foreigners who purchase government bonds. Fourth, the idea of chasing balanced budgets as an end goal in itself is an artificial constraint rooted in conceptualising the currency issuer as a currency user (for instance, comparing a government's finances to that of a household). Fifth, the government should strive for low inflation and full employment and towards this end, provide a job guarantee for those seeking paid work but unable to find it in the private sphere (Kelton 2020). In sum, MMT does not quarrel with the current way government finances are set up but rather seeks to show politicians and the public that running deficits can benefit human well-being and the economy if the government is monetarily sovereign (i.e. issues its currency). Of course, MMT is not without its detractors, mainstream and otherwise, but they too are largely caught within the legacy of the fiscal-monetary paradigm of which they appear to know little about the origins. The current fiscal-monetary paradigm that developed with the rise of capitalism has, over time, been depoliticised and

9781032168210_pi-286.indd 170 01-Jul-22 22:07:58

naturalised as though things have to be the way they are and there is no accounting, financial or monetary alternative.

This chapter seeks to intervene in these debates and re-politicise the nature of the fiscal-monetary paradigm currently in operation. I argue that to understand contemporary debates on MMT and the COVID crisis, it is important to understand the historical context from which they are derived. It may seem strange to return to the origins of capitalism and the birth of the fiscal and monetary system in England, but if we fail to do so, our current debates will be intellectually impoverished and our policy options needlessly constrained. I contend that current discussions on what the pandemic has taught us about monetary and fiscal policy are myopic. It is the purpose of this chapter to broaden the political economy horizon so that we might think anew about pathways through the crisis and perhaps a new fiscal and monetary order. Part of doing so is understanding that capitalism was not born in a void but in unequal power relations and a massive social transformation that benefitted and, arguably continues to benefit, the few. Moreover, this chapter argues that while MMT has its virtues, it too misses two very important aspects of capitalism (1) *why* there is a constant aggregate demand problem in a capitalist economy and; (2) that the majority of new money creation is not issued by governments, but by commercial banks when they make loans to willing borrowers. To explore these arguments, this chapter is divided into three main sections and a brief conclusion. First, I return to the debates on the dearth of money in England and the vast pauperisation of the countryside as peasants were expropriated from their customary access to land and, thus, their self-provisioning. I show how these debates have long since been forgotten by economic orthodoxy but bear urgently and importantly on current fiscal and monetary debates, given that one of the main critiques of MMT is that it promises a "free lunch" (Epstein 2020; Scaliger 2021: 12). As we shall uncover, the early political economists argued that the able-bodied poor should in no way be relieved at public expense. In the second section, I discuss the virtues of MMT and empirically examine its main criticisms. In the third section, I outline MMT's oversights on aggregate demand and commercial banking and why this is not only important for our knowledge of the macro-economy but could also potentially broaden policy options. This is of particular importance given the centrality of money in capitalist society and the interconnected challenges our global community faces from climate change to an impending energy transition (Di Muzio 2015; Newell 2021). The chapter closes with a brief conclusion.

Power, Fiscal Lock-in and Pauperism

The literature on MMT and its critiques are largely ahistorical. They take the current fiscal-monetary system as a given as though things could not be otherwise. To paraphrase Marx, they assume as fact what has to be explained (in Morgan 1992: 1159–1160). For this reason, in this section, I provide some historical context of how we arrived at the present order of things and show how the transformation to a capitalist mode of power is intertwined with the monetisation of society and a

9781032168210_pi-286.indd 171 01-Jul-22 22:07:58

fateful decision about how to expand the money supply to stimulate productivity and improvement.

For various reasons stretching back to King Croesus in Lydia in the 7th century BCE, where the first standardised coins were minted in electrum (an alloy of gold and silver), the so-called West came to believe that real money consisted of precious metals (Weatherford 1997: 30ff). The possession of gold and silver could raise and mobilise armies, pay for provisions and luxury goods and ultimately represent power and wealth in a geopolitically competitive Eurasia. The difficulty of tying an economy to the circulation of gold and silver as the only "real" currencies was that there was a limited supply of these metals. Thus, because of this monetary choice by those in power, a socially constructed and intersubjective limitation was put on the *potential* productivity of an economy and the wealth of rulers and subjects. The former is obvious, but the latter has to do with a ruler spending on the economy—generally for war. Once the expenditure is accomplished, a ruler only has limited options to restock treasury coffers: taxation (which is unpopular), finding a new mine through exploration or conquest, or capturing the gold and silver of others. Though some rulers were more successful than others, this dearth of money problem confronted all political communities who adopted gold and silver as their unit of account and official currency. This is one of the chief reasons the rulers of Western political communities tore themselves apart for precious metals, and merchants and conquistadors travelled to far-flung regions of the earth to find it (Vilar 2011; Kwarteng 2014). But by the early 1600s in England, the shortage of circulating money consumed social reformers and political authorities. At first, the problem of insufficient precious metals to stimulate improvement was met with the solution of alchemy. Was it possible to turn base metals into the precious metals of gold and silver to expand the money supply and promote the greater development of material resources? It was not, and so the problem persisted until, as Wennerlind's detailed study reveals, there was an epistemological revolution inspired by the work of the Hartlib circle, a European correspondence network sharing knowledge on scientific developments (Wennerlind 2011). Over time, the Hartlib circle realised that money was not a material substance but fundamentally an idea in the minds of men. Money, they reasoned, could theoretically be represented by any material substance. The belief that gold and silver had an intrinsic value and were thus the only "real" or "true" stores of value persisted, but that these precious metals could be represented *symbolically* by other instruments freed these early thinkers from the shackles of the precious metal fetish. It was now intellectually possible to expand the money supply, but one question loomed large; how to do so practically? Throughout the civil strife of the mid-1600s in England, social reformers introduced several proposals to tackle the dearth of money problem, while goldsmiths continued to expand the money supply through the extension of credit—albeit in a very restrictive way (Davies 2002: 250ff; Horsefield 1960). Ultimately, the solution came from capitalising the state's concentrated power to tax and extending credit notes on a relatively small amount of silver-backed by future taxes (Desan 2014; Dickinson 2016; Nitzan and Bichler 2009: 294–298). Toward this end, the Scottish trader and banker, William

Paterson proposed the creation of the Bank of England to extend loans to the Crown. This proposal was born in the crucible of King William of Orange's war with France, which was already six of nine years underway (1688–1697). In dire need of finance amidst the war, the proposal was accepted, and the Bank of England was established in 1694. As Wennerlind notes:

> A 1694 parliamentary act allowed the Bank to raise a capital stock of £1.2 million, the full value of which was to be lent to the government, paid out in notes or sealed bills, rather than coin, in exchange for tallies. In return, the government committed £140,000 per year to the Bank from a new tax on shipping and liquor, which was enough to pay subscribers an 8 percent dividend (£100,000 payable in cash and Exchequer Orders), provide a management fee to the Bank (£4,000), and allow the Bank to improve the returns on its reserves by acquiring annuities. The Bank's capital was subscribed in ten days by some thirteen hundred people and the Bank swiftly commenced its operations.
>
> *2011: 109*

While this financial revolution did not completely alleviate the shortage of money problem in England, it did lead to "Europe's and England's first widely circulating credit currency" (Wennerlind 2011: 109). It also leads to a unique capitalist fiscal and monetary arrangement that has largely spread worldwide through the power of finance and colonial violence. It should be recalled here that previous to the Glorious Rebellion of 1688, English sovereigns were *personally responsible* for their debts to moneylenders and could default at will because they could not be tried in a court of law. The Rebellion succeeded in subordinating the Crown to Parliament, with the Crown now only receiving a yearly stipend from the revenue raised by Parliamentary taxes. We should note that this was not a natural development but a political choice based on an asymmetry of financial power between English financiers and the monarchy in the age of the precious metal fetish. In sum, the issuance of credit for war came to be the primary way of expanding the money supply. As Brewer rightly argues, after 1688, England was fast becoming a fiscal-military state (Brewer 1989: 22). It was only much later that commercial banks would play a more important role in extending credit to businesses and households. But the lack of money was not the only problem plaguing England's early modern period. England was also beset by a plague of pauperism that was inextricably intertwined with the question of money.

Around the same time that social reformers and public authorities fretted about the dearth of money, they noticed another problem of the ruling class's making: the rampant pauperisation of the rural population. If the scarcity of money problem leads to how to expand the money supply to increase trade, productivity and improvement, then the problem of pauperisation leads to the question of what to do with the growing mass of unemployed paupers? As Polanyi suggested, there was no shortage of pamphlets proposing solutions to the problem, with Bentham's

9781032168210_pi-286.indd 173 01-Jul-22 22:07:58

for-profit Panopticon proposal perhaps the most infamous (Polanyi 1957: 90). These early debates on what to do with the poor continue to inform current discussions on welfare and welfare reform and link up directly, as we shall see below, with MMT's proposal for a jobs guarantee funded by the central government—a program greeted with suspicion by MMT's critics.

The rise in pauperisation was due to the centuries long enclosure movement where peasant proprietors were denied customary access to their patch of arable land and the commons by violence and, over time, Parliamentary decree (Wood 2002: 109). As the countryside gradually monetised, the desire for profit and power grew fiercer among the lords of estates, and evermore peasants were evicted from the land so that pasture could be grown for sheep (Marx 1990: 879). The dissolution of the Catholic monasteries during the Tudor Protestant Reformation in the sixteenth century added more sub-tenants to the class of growing paupers, vagabonds and beggars, as did the dissolution of feudal retainers aimed at centralising the monopoly of violence in London. Those who could not find work had two unenviable choices: break the law or starve. As Marx argued in section eight of *Capital*, the scourges of pauperism and the dearth of employment opportunities were met with two major strategies employed by the ruling class, the increasing criminalisation and corporeal punishment of the poor and outdoor or indoor poor relief. Corporeal punishment came in the form of whipping, branding, torturing and even hanging the perceived beggars, vagabonds and criminals. Indeed, such was the threat to property by a growing mass of paupers that by the early eighteenth century, no less than 225 offences against the propertied could warrant the public hanging of an offender.[3] Poor relief evolved in fits and starts over the Tudor period and was orchestrated at the parish level. The poor could be given indoor relief, which meant entering an institution like a workhouse or poorhouse to be guaranteed sustenance. In contrast, outdoor relief did not require the relieved to enter an institution. The quality, level and coordination of relief varied as it was administered locally, and parishes did not have equal resources. However diverse and perhaps insufficient in many cases, the poor law statutes and acts at least gave the poor the "right to live" (Polanyi 1957: 81). Nevertheless, by the early eighteenth century, the "right to live" was incompatible with the emerging capitalist system and the pressing need for a labour market for capitalists.

The first salvo in the war on the poor and unemployed was launched by the writer of *Robinson Crusoe* fame, Daniel Defoe, in a pamphlet entitled *Giving Alms no Charity* in 1704. In it, Defoe "insisted that if the poor were relieved, they would not work for wages; and that if they were put to manufacturing goods in public institutions, they would merely create more unemployment in private manufactures" (Polanyi 1957: 108).[4] The next shot against relief was fired by the medical doctor and cleric Joseph Townsend in his *Dissertation on the Poor Laws*, published in 1786. Townsend imagined Robinson Crusoe populating his lonely island with goats that multiplied and provided a steady food source for him and his guests. But the goats were also a source of nourishment for pirates who were ruining Spanish trade through waterborne pillage. So Spanish traders dropped off some wild dogs on the island, quickly

9781032168210_pi-286.indd 174 01-Jul-22 22:07:58

reducing the number of goats. Townsend took two lessons from his allegory. Firstly, "it was the quantity of food which regulates the number of the human species" and secondly, granting the poor the "right to live" through relief would keep them idle and out of the workforce (Polanyi 1957: 112–113). Townsend's solution was to strip away all relief and threaten the able-bodied unemployed with hunger and starvation. This would spur them to work better than any legislation. Years later, in his *Principle of Population* (1798), the English cleric Thomas Robert Malthus, perhaps with more finesse, essentially plagiarised Townsend's work, arguing that unchecked population growth naturally outstrips the food supply. In Malthus' view, the public did not have a responsibility to feed those who hungered. Parents should simply abstain from having children if they are unable or unwilling to provide for them.

By 1834, this current of thought, among other ruling class ideas, contributed to the Poor Law Amendment Act, which made the search for relief difficult. If in want of clothing, shelter, food or money, the poor would be forced into workhouses. The policy goal was to make conditions in the workhouses so unpalatable that the able-bodied would seek work in the factories and mines. Thus, abolition of the "old poor law" ushered in a labour market for capital, and as Polanyi argued, 1834 can be considered "the true birthday of the modern working class" (1957: 101).

The point of this return to history is twofold. First, due to the circumstances and the monetary power asymmetries between financiers and the Crown in Parliament, a specific fiscal structure was formed based on the belief in limited precious metals as the only "real" money. The public force, or government, was not permitted a free lunch because the Bank of England (and later commercial banks) had control over the issuance of credit. If Parliament wanted to spend more money than it received in taxes, it was structurally forced to go into debt to the private social forces that owned the Bank of England. This is what I call *fiscal lock-in,* and it gives tremendous power to financiers since mounting debt—principally for war at the time—can then be leveraged to influence government policy in favour of bondholders and financiers less the Bank of England turn off the credit tap in an increasingly capitalist society premised on war and industrial development. Secondly, the discussion on pauperisation highlighted the fact that in a capitalist market economy, the able-bodied poor and/or unemployed require money to survive but are to be given as little relief as possible. Modern welfare policies reflect the legacy of these early debates on what to do with the poor. Poverty is viewed as a moral choice, not a structural feature of capitalism. If they are relieved at all, the poor and unemployed are to be given a minimal level of subsistence below or near the national poverty line. As in the past, such treatment is designed to encourage recipients to enter the workforce as soon as is humanly possible. This is despite the widespread liberal belief in a "natural" rate of unemployment. In this view, a degree of unemployment is considered a net positive to the overall economy since the economic suffering of the unemployed is assumed to hold down inflation, as posited by the infamous Philips Curve. Like the government, there *should* be no free lunches for idle hands at the public expense. With this historical background in mind, in the next section, I discuss the virtues of MMT and survey its main criticisms before outlining MMT's

PROOF

9781032168210_pi-286.indd 175 01-Jul-22 22:07:58

oversights on aggregate demand and commercial banking and why this is not only important for our knowledge of the macro-economy but could also theoretically broaden practical policy options, up to and including non-interest bearing and debt-free sovereign money (Crocker 2020; Huber 2017).

MMT, Free Lunches and the Pandemic

As we have discussed, the need to finance fiscal budgets that exceeded tax revenues in the early formation of the English public financial system was largely due to power asymmetries between financiers (who had money) and the state (in need of finance). Originally backed by an unknown quantity of silver, by 1816, England legally adopted a gold standard (Cooper 1982: 3). The development of the British Empire and its financial and industrial power over other colonial and non-colonial powers internationalised the idea that high-powered money consisted of gold. Eventually, foreign powers not under the direct control of the British Empire came to embrace this idea once the United States and Germany—the two other industrial powerhouses—adopted the gold standard from the 1870s. With some exceptions (e.g. China and Persia), "the largest part of the world was on the gold standard" by the end of the century (Eichengreen and Sussman 2000: 20). World War I, the Great Depression and World War II disrupted the international gold standard, but the idea that gold was the only true money remained in the minds of investors, businessmen, economists and politicians. After World War II, this belief was institutionalised in the creation of the International Monetary Fund (IMF). Originally the IMF was designed to facilitate international trade by maintaining relatively fixed exchange rates between currencies and temporarily overcoming balance of payments problems if countries suffered a trade deficit. Under this new regime, the strongest world currency, the U.S. dollar, was pegged to gold at US$35 an ounce. Largely because of the world wars, the United States gained greater industrial might and attracted much of the world's gold because of its investment opportunities and superior technology (Panitch and Gindin 2012: 67–110).

Most of the world struggled with the gold standard until 1971 when the Nixon administration was advised to close the gold window at the Federal Reserve. While the abandonment of the gold standard served American grand strategy in various ways, the move was made because the Nixon administration reasoned that there were too many American dollars outstanding for the stock of gold held by the U.S. Federal Reserve.[5] In other words, countries with surplus dollars could drain away America's gold supply. Relinquishing the gold standard made this option impossible for foreign countries. But it also set the world on a new monetary footing. The world was no longer constrained by the strictures of the gold standard, and currencies now had value, not because they were anchored to a precious metal, but because states enforced their value (Gowan 1999: 19–20). For the first time since the rise of the international gold standard, money was untethered from a precious metal that arbitrarily limited its supply. The move also gave governments more room to deploy deficit spending since outstanding currency could no longer

9781032168210_pi-286.indd 176 01-Jul-22 22:07:58

be redeemed in a limited gold supply. However, the intellectual legacy of the gold standard and the need for austerity and fiscal discipline tied to it lingered on in the minds of economists and politicians (Blyth 2015).

This is perhaps the major reason many are sceptical about MMT's claim that currency-issuing governments should not worry about mounting deficits and (national) debt provided they do not contribute to runaway inflation. As in a household, an unbalanced government budget is treated as a vice, not a virtue. Yet, MMT claims the opposite: government deficits can be a virtue if the excess money injected into the economy stimulates real productivity growth, eases the suffering of the unemployed and keeps inflation at bay. If we take Kelton's *The Deficit Myth* as the most recent formulation of MMT, then deficit spending can be used to tackle several social, economic and environmental ills, from needless unemployment to global climate change (Kelton 2020). In other words, the currency issuer has the power of the purse and should spend to increase the nation's well-being and its local communities. Kelton, among others working in the tradition, also calls for a national jobs guarantee that would put willing people to work in their local communities, providing them with worthwhile jobs that add value to their communities (Tcherneva 2018). It should be noted here that no MMT economist argues for wild untargeted deficit spending, particularly where there is little room for productivity growth in the economy and a high probability of inflationary pressure.

MMT could have been brushed aside as a new intellectual fad (or old Keynesian wine in new bottles), but the global pandemic demonstrated how previously inconceivable deficit spending was very useful in propping up economies around the world vastly avoiding the potential for widespread unemployment and bankruptcy. Despite this practical demonstration, however, MMT has its share of critics—with some even labelling it as an "extreme school of thought" (Makin and Tunny 2021: 2). While I will also critique MMT momentarily, I contend here that MMT's critics are tied to the mast of dismal science orthodoxy and have little to no imagination for getting us beyond the legacy of fiscal lock-in. Current fiscal and monetary arrangements, seemingly cast in stone due to decisions made by politicians and financiers in the distant past, need to be re-politicised and rethought for the challenges of the 21st century. But before getting to that, let us briefly survey the main criticisms of MMT and see if they hold any empirical water.

A key criticism of MMT is that it sees the macroeconomic puzzle to solve as only demand related. As such, MMT may under-theorise supply-side constraints and advocate for greater deficit spending, which may help promote inflation by creating too much demand. This is the familiar "inflation is too much money chasing too few goods" maxim of the reigning economic orthodoxy. A second criticism is that we cannot anticipate how much inflation will be caused by what level of deficit spending. This leads to the question: how do we know how much the government can spend on the economy above its revenue before we start seeing dramatic rises in price levels? Furthermore, should inflation rear its ugly head due to deficit spending, the government will have to act fast to tax money out of the economy, lessening the money supply for the circulation of goods and services and

PROOF

9781032168210_pi-286.indd 177 01-Jul-22 22:07:58

potentially angering voters whose discretionary spending may be diminished. The next argument against MMT is the infamous crowding out problem. This problem is premised on the binary assumption: "private sector good"', "public sector bad". According to MMT critics, crowding out can happen in at least three ways. First, borrowing to finance public deficits could lead to mounting interest rates, making it costly for businesses to borrow and grow. Secondly, greater deficit spending could lead citizens to anticipate future tax hikes and therefore save rather than spend their money, creating a greater glut in the economy. Finally, crowding out can occur when foreigners increase their capital investments in the country due to the attraction of higher interest rates. This can lead to currency appreciation and a lack of export competitiveness (Bird et al. 2021: 38–39).

I argue that as long as we remain within the intellectual and structural confines of economic orthodoxy, these critiques appear to have some weight. This is despite the fact that during the pandemic unprecedented deficit, spending neither contributed to runaway inflation nor higher interest rates (Anonymous 2020: 14). In fact, in some quarters, there were calls for even more generous deficit spending and the maintenance of low-interest rates to stimulate economic activity even before the pandemic (Putnam 2021: 16). But critics may rightly charge that the pandemic was an exceptional circumstance, leaving considerable room for loose fiscal and monetary policy. However, when things return to "normal", it is presumed that fiscal discipline will be reinstated and that central bankers will raise base interest rates to arrest the flow of cheaper credit. Yet this return to normal only holds if we collectively believe in these strictures in the first place. But if we re-politicise current fiscal-monetary arrangements and imagine how fiscal-monetary relations can be reinvented to better suit public and democratic goals, then we can clearly see that these strictures are not natural laws but the stuff of historical human construction. Let us take the two major critiques—inflation and crowding out—before we move on to our own critique of MMT.

As noted, MMT critics fear that too much deficit spending could lead to increasing prices for goods and services. The assumption here is that deficit spending can be a *primary driver* of inflation. In the economic literature, inflation is said to be ignited by two main forces: cost-push inflation and demand-pull inflation. The first understands rising prices resulting from increasing costs to the business that get pushed on to consumers in the prices they pay for goods and services. A leading example is the oil price shocks of 1973 and 1979, when the price of a barrel of oil increased by 400 per cent. Another tired example of cost-push inflation is increasing wages, primarily attributed to collective bargaining and the power of unions to get their pay indexed to the inflation rate.[6] In this case, since wages are a cost to business, prices have to increase by the logic of cost-plus capitalist accounting (Di Muzio and Robbins 2020). Demand-pull inflation results if demand backed by the ability to pay outstrips the economy's productive capacity. In other words, there is too much demand for fewer goods and services, pushing prices up. These claims are sensible enough, but critics of MMT worry about government deficits driving inflation—a particular claim that, to date, has been asserted without empirical

PROOF

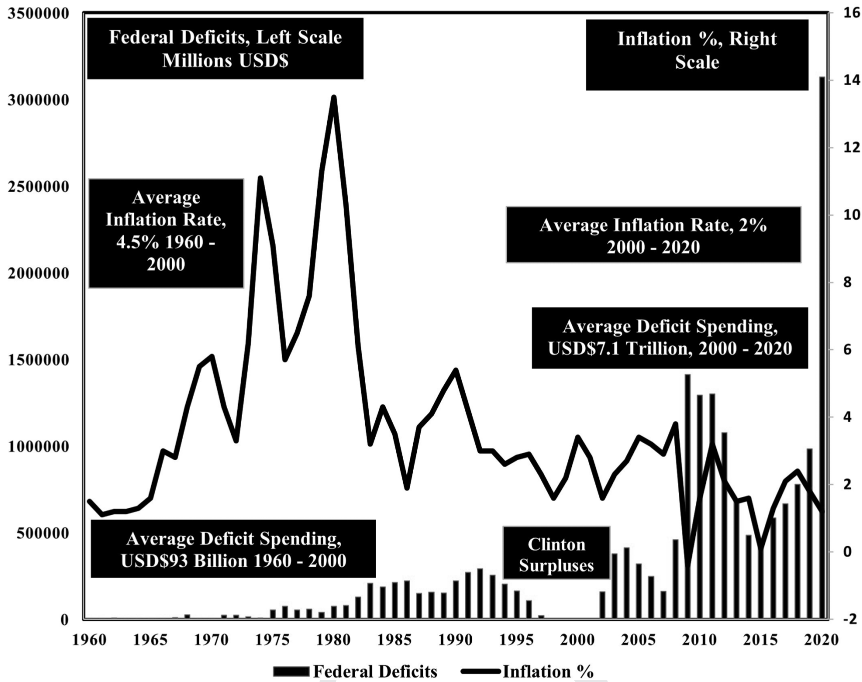

FIGURE 10.1 U.S. federal deficits and inflation rate, 1960–2020

Source: St. Louis Federal Reserve: https://fred.stlouisfed.org/series/FYFSD and https://fred.stlouisfed.org/series/FPCPITOTLZGUSA.

evidence. Figure 10.1 charts the relationship between federal deficits in the United States of America and inflation in consumer prices. The chart is rather revealing and suggests that federal budget deficits are hardly a primary driver of inflation. If fact, the chart suggests that during the era of higher federal deficit spending (2001–2020) the inflation rate was two percentage points lower on average than in the period from 1960 to 2000. Thus, the notion that high deficit spending can lead to runaway inflation appears to be a chimaera.[7]

Now that we have debunked the deficit-inflation bug-bear, we can discuss the so-called crowding-out phenomenon.

The crowding out hypothesis claims that deficits will lead to higher interest rates, making it more costly for firms to borrow money to grow their businesses. This view assumes that there is a limited pool of capital that can be lent out. If a government's demand for loans is high, interest rates will be pushed up and crowd out private industry. This is completely incorrect and premised on a false understanding of how new money is created in an economy. In actual fact, loans create deposits, not the other way around. There is no limited pool of capital. When commercial banks purchase government securities, they do not use the savings of their depositors (the assumed but incorrect, limited pool). If banks decide to hold

government securities, they merely create the digital money to exchange for the securities and therefore expand their balance sheet. What is more, this is also done through central banking when the central bank purchases government securities. The process is a digital balance sheet operation, pure and simple. This helps explain how suddenly central banks came to the rescue of the banks after the Global Financial Crisis and how they funded stimulus spending throughout the pandemic (Kelton 2020: 34). Where there was a dearth, there is now plenty! But is there any empirical evidence demonstrating that government borrowing will lead to higher interest rates? Figure 10.2 takes a closer look at this claim.

As Figure 10.2 suggests, there is no empirical evidence that federal budget deficits in the United States trigger higher base interest rates and thus crowd out capitalist access to finance.

The next major tenet of the crowding-out hypothesis is that big deficit spending will lead to greater savings because the public anticipates higher taxes in the future. Excess savings can slow demand for goods and services in the economy, thus creating a glut. As Figure 10.3 suggests, savings did increase substantially during the recessionary conditions tied to pandemic lockdowns. But the crowding out claim overlooks the fact that savings are differential. This means that not everyone is saving the same amount, with the better off able to save at a faster rate. According to the Federal Reserve of Kansas, people do not save in anticipation of higher taxes in the future. Saving is normal in recessions because there is less opportunity for consumption, and people tend to save for fear that they will be unemployed or underemployed in future (Smith 2020). Government assistance during the pandemic may have given a boost to household income, but this does not offer strong

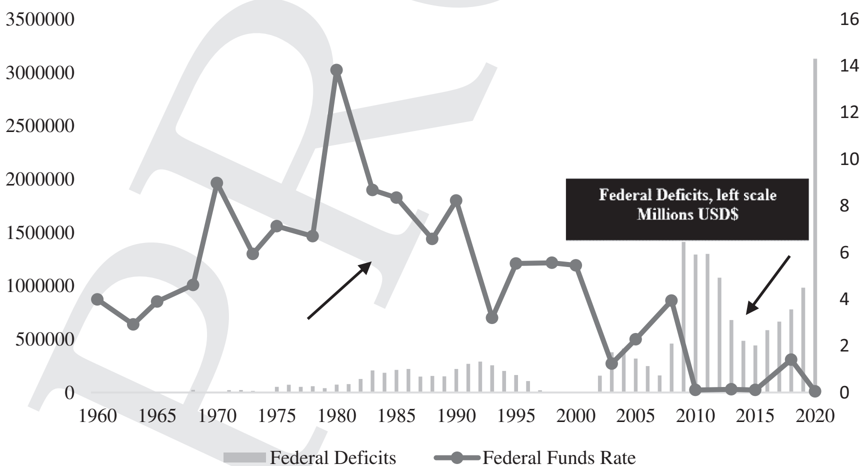

FIGURE 10.2 Federal deficits and federal funds rate 1960–2020

Source: https://fred.stlouisfed.org/series/FYFSD and https://fred.stlouisfed.org/series/FEDFUNDS.

PROOF

9781032168210_pi-286.indd 180 01-Jul-22 22:07:58

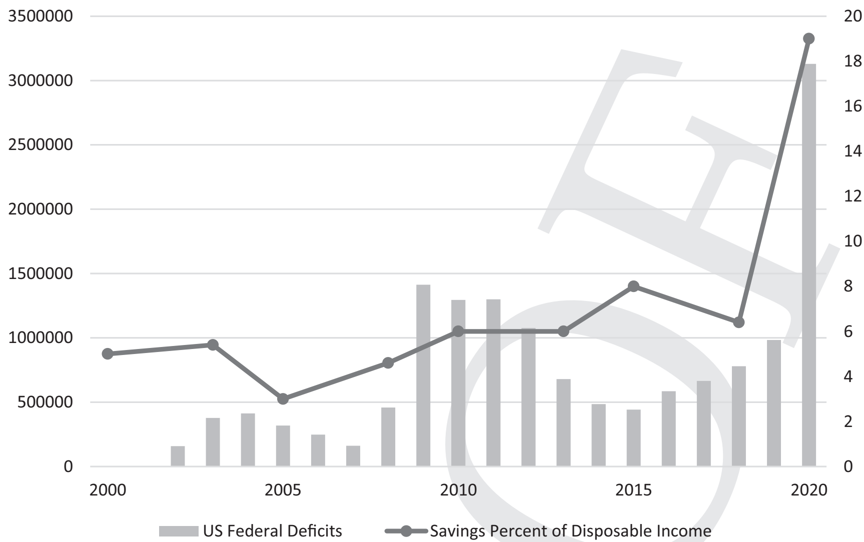

FIGURE 10.3 U.S. Federal deficits and savings per cent of disposable income, 2000–2020

Source: https://fred.stlouisfed.org/series/FYFSD and https://fred.stlouisfed.org/series/PMSAVE.

PROOF

evidence for the claim that government spending over and above what it takes in in tax, fines, fees and privatisations, contributes to excessive saving by the public, save during a major crisis or the memory of one, such as the GFC.

The final crowding out claim—that higher interest rates will lead to currency appreciation and less export competitiveness can be dismissed as we know that interest rates are at record lows in major capitalist economies (see Figure 10.2 for the USA). Moreover, base interest rates are expected to remain low as economies recover. It is true that analysts continue to debate the possibility of greater inflation, but its primary cause should not be sought in fiscal deficits.[8] In sum, we can largely dispense with the orthodox critiques of MMT. It is now time to offer a new critique of MMT that goes beyond conventional concerns.

The Dearth of Money Revisited and Commercial Banks

As I have already argued, capitalism is born into a world with an artificial shortage of money. This was primarily because power-holders were convinced that gold and silver were the only true money form by history and convention. But there is another major reason why there is a constant shortage of money in modern capitalist economies, and Modern Monetary Theorists seem to be unaware of this: capitalist cost-plus accounting. As originally discovered by C.H. Douglas, the founder of the social credit movement at the start of the twentieth century, it is due to this

TABLE 10.1 Uncle Pepe's super happy fun margarita mix costs

Sugar	$50
Lemon and lime juice	$93
Gas for the stove	$25
Bottles and caps	$44
Labour	$100
Total production cost of one bottle	$3.12
Mark-up	$6.88
Total cost of one bottle with mark-up	$10
Total market value of margarita mix	$1000

accounting that there is a dearth of purchasing power or aggregate demand in the economy. This causes a drastic need for commercial bank credit and increases the power and leverage of commercial banks over individuals and businesses. To provide a simple example here, we can imagine going into business making a margarita mix at home for sale in the local community. All we need is water, sugar, some lime and lemon juice, a stove, some bottles and caps and two labourers paid at minimum wage. Suppose we do one run of 100 bottles at the following costs as show in Table 10.1 below:

While simplified, we can clearly see from this example that there is only US$100 of purchasing power created during the production process of 100 bottles, yet there is a total of US$1,000 worth of margarita mix on the market, for a gap of US$900. But since the labourers cannot purchase all the bottles of the margarita mix, the owner of Uncle Pepe's has to rely on the wider market for sales and the purchasing power created by other capitalists when they pay wages and salaries. But since all capitalist accounting works this way, if we extrapolate across the economy, there is always a shortage of purchasing power for goods and services outstanding. This is shown empirically in Figure 10.4.

Figure 10.4 plots yearly GDP, or the total monetary value of all goods and services produced in the U.S. economy alongside total wage and salary disbursements. The gap between purchasing power and goods outstanding on the market is clear and should not surprise given capitalist cost-plus accounting (Di Muzio and Robbins 2020). Even without the gold standard, *the dearth of money problem is structural* in capitalist economies.[9] If there were no gap, there would be little need for credit, and there would be no talk of an aggregate demand problem and the need for fiscal stimulus. Currently, the only thing that can come remotely close to filling the gap between available purchasing power and the economic goods outstanding on the market is the interest-bearing credit issued by commercial banks as debt to individuals, corporations and governments. This "solution" largely enriches the owners of commercial banks while everyone else sinks deeper into debt. Debt can then be leveraged as a power technology by creditors, especially over governments that want to appear fiscally responsible to their electorates and the international credit rating agencies (Di Muzio and Robbins 1916; Sinclair

PROOF

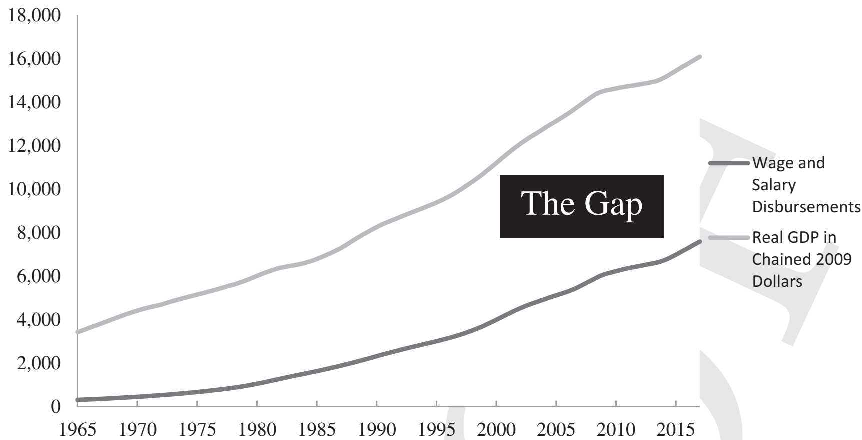

FIGURE 10.4 GDP & wage and salary disbursements in the USA, 1965–2017 (billion US$)

Source: https://fred.stlouisfed.org/series/GDP and https://fred.stlouisfed.org/series/A576RC1.

2005). This structural gap between incomes and outstanding prices for goods and services on the market is why C.H. Douglas argued for all citizens to be issued a social credit by the government. Rather than go into debt to commercial banks to expand purchasing power, Douglas argued that a monetary reward based on a given level of economic productivity be granted to all citizens. This yearly credit does not have to be issued by borrowing from the capital market and going into debt but simply instructing the central bank to credit the treasury. Treasury can then electronically credit the bank accounts of individuals.[10] We can debate the accounting identities for such a transaction and its amount, but that it can be practically done is hardly in doubt. However, there are at least three main obstacles that stand in the way of such a political action (1) the general public and most economists are unaware of the structural gap identified in Figure 10.4; (2) even if knowledge were widespread and the political will was there, the idea of "getting something for nothing" from the government may ignite moral outrage in some quarters—remember the poor are not to be relieved—lest they fall into universal idleness; (3) the owners of commercial banks would be vociferously against such an initiative given that this would radically reduce the need for borrowing at interest. It should be noted here that those against governments issuing a yearly or quarterly social credit to their citizens are implicitly in favour of the current lending regimes of the commercial banks. And this brings me to my final critique of MMT: there is little critical discussion in the literature on how the vast majority of new money enters the economy. It is not by government deficits or borrowing to finance them, albeit important, but by commercial banks issuing loans to willing borrowers.

9781032168210_pi-286.indd 183 01-Jul-22 22:07:58

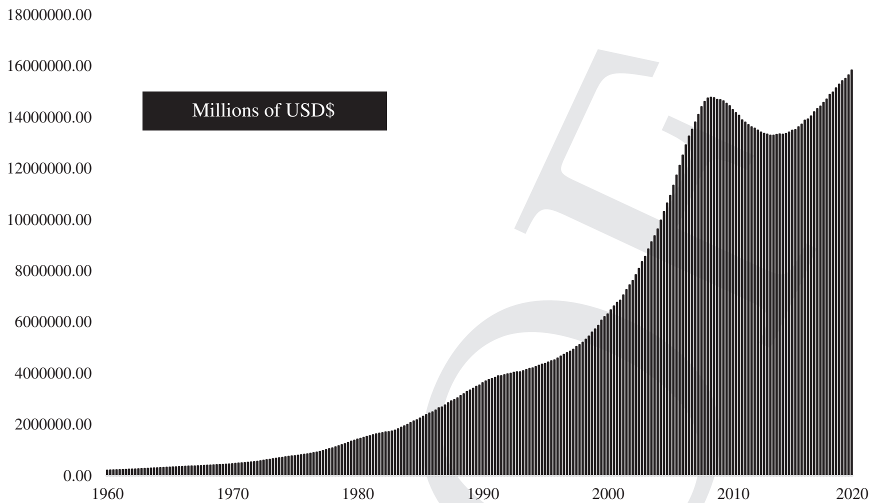

FIGURE 10.5 Mortgage debt outstanding, USA, 1960–2020

Source: www.federalreserve.gov/paymentsystems/coin_data.htm.

To be sure, governments and their agencies create new money as notes and coins and benefit from the difference between the nominal value of the notes and coins and their low cost of production. But notes and coins make up a tiny proportion of the total money supply. For instance, in the United States, notes and coins only make up 8 per cent of the total money supply; the rest of the money supply is digital and created by commercial banks when they issue loans to customers—mostly for home mortgages—see Figure 10.5. This means that *most new money enters the U.S. economy as mortgage debt*, with a total of just under USD$16 tn recorded by the third quarter of 2019.

The following closest categories for commercial bank lending are credit card and other revolving debt, consumer loans, and commercial and industrial loans with a grand total of USD$4.8 tn at the start of 2020—see Figure 10.6.

So while federal deficits can certainly impact the U.S. economy and benefit certain sectors of the economy, commercial bank lending is the primary way new money enters the economy. This means that most new money is allocated by banks, not central governments. And this should be the focus of any so-called "modern monetary theory" because of its perverse implications such as the generation of inequality.[11]

Conclusion

This chapter has argued that the pandemic has opened up intellectual space for rethinking and re-politicising current fiscal and monetary arrangements. To do so, I returned to the transformation of capitalist social relations and to the debates on

9781032168210_pi-286.indd 184 01-Jul-22 22:07:58

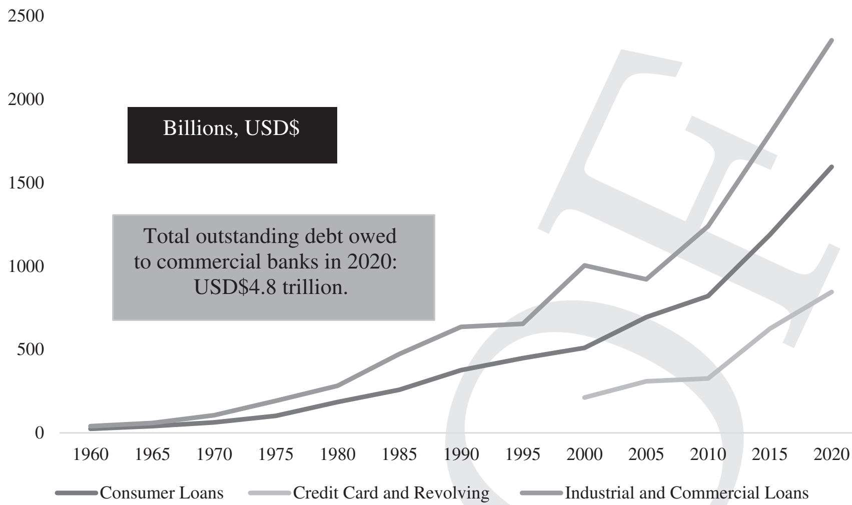

FIGURE 10.6 Commercial Bank Lending, USA, 1960–2020

Source: https://fred.stlouisfed.org/series/CONSUMER, https://fred.stlouisfed.org/series/CCLACBW027SBOG and https://fred.stlouisfed.org/series/BUSLOANS.

the dearth of money and the rise of pauperism. Firstly, to show how the current fiscal-monetary order originated and secondly to demonstrate how economic liberals have always been sceptical about public handouts to the oppressed. The legacy of both events looms like a spectre over current fiscal and welfare policy debates—even though many scholars are unaware of their historical origins. A further point was that the fiscal-monetary regime that advanced capitalist economies are embedded in was a historical creation and gave commercial banks tremendous power over the creation of new money while setting debt traps for governments. I then moved to highlight the virtues of MMT and empirically dismissed some of the major arguments advanced by their critics before proceeding with my critiques, of which there were two. First, MMT has not considered the root cause of a lack of aggregate demand, which we can find in capitalist cost-plus accounting. The dearth of purchasing power is endemic to capitalism because of this accounting logic. Secondly, the gap between purchasing power and outstanding market prices only gets partially solved by individuals, businesses and governments accessing credit at interest from commercial banks. If no one took on debt, capitalism would collapse tomorrow. There is no natural reason why the vast majority of money creation has to be issued by commercial banks and plenty of reasons why it should not—unexplored here due to space constraints.

As in previous crises, the pandemic has revealed that sovereign currency issuers do not have to be chained to a limited pool of capital, balanced budgets, and severe fiscal discipline. However, the question is whether we continue with the current fiscal-monetary arrangement that creates the national debt fright and austerity

politics, or whether we push for an alternative way of injecting purchasing power into the economy and change fiscal accounting identities to reflect public investment rather than debt. In the end, we would do well to recall the words of Douglas himself:

> A phrase such as "There is no money in the country with which to do such and so" means simply nothing, unless we are also saying "The goods and services required to do this thing do not exist and cannot be produced, therefore it is useless to create the money equivalent of them." For instance, it is simply childish to say that a country has no money for social betterment, or for any other purpose, when it has the skill, the men and the material and plant to create that betterment. The banks or the Treasury can create the money in five minutes, and are doing it every day, and have been doing it for centuries.
> *1923: 9–10*

Notes

1 I wish to thank Matt Dow and Frances Cowell for comments on this chapter.
2 For a breakdown of fiscal spending and initiatives not discussed in this chapter see: www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19 (October 9, 2021).
3 www.nationaljusticemuseum.org.uk/museum/news/what-was-the-bloody-code (accessed August 9, 2021).
4 This is likely the earliest formulation of the "crowding out" model cherished by neoclassical economists—though they are unlikely to know from which situation it was derived given the ahistorical nature of their craft.
5 The primary reason for this excess was extravagant U.S. military spending abroad to combat the social forces of communism combined with Johnson's Great Society programs (Gowan 1999: 17).
6 This is also called built-in inflation since collective bargaining agreements can trigger wages to increase relative to inflation so as to maintain living standards.
7 It is beyond the scope of this chapter to discuss the history of U.S. consumer price inflation.
8 For an interesting theory on the source of inflation see, https://strangematters.coop/supply-chain-theory-of-inflation/ (23/05/2022)
9 This helps to explain recurrent Marxist debates on overproduction and underconsumption. The problem is that Marxists have never got to the root of the problem in capitalist accounting and problematically regard the labour theory of value as the primary determinant of prices and profit.
10 Some may note that this is similar to a universal basic income (UBI), but the literature on a UBI is not aware of the structural gap between purchasing power and outstanding market prices for goods and services. The major impetus for a UBI seems to be increasing automation and the threat of mass unemployment—a worthwhile debate but one we cannot address here.
11 www.monetaryalliance.org/the-major-problems-with-bank-money-creation/ (accessed January 10, 2021).

PROOF