MODERN MONETARY THEORY (MMT) or MUDDLED MONETARY THEORY?

One of this planet's most precious moments occurs when the spring rains fall in Namaqualand, South Africa. A desert is transformed into vibrant and colourful life for a few weeks. Those who do not understand the functioning of a capitalist economy treat money as though it was rain. Sprinkle it over a moribund economy and it will spring to life.

But ask any competent gardener about water and they will answer that water is not always the problem. Indeed, too much water creates its own problems like rot. A good garden needs water but it needs other elements as well such as nutrients, sunlight and so on. So too with money. Leave a bag of money in an abandoned factory, and if you return in six months the factory will still be abandoned and all that will be found is a dusty bag of money (unless stolen). Money is not a thing like water, it is a time specific social construct which emerges only when society is divided by production, because production is carried out by millions of independent and detached producers or groups of producers.

In turn, a society divided by production is only united by the act of exchanging the results of this production. And for exchange to occur, money is needed. Those consumers who enter the market with money leave with commodities, and those who enter with no money leave without commodities. Hence money has come not only come to dominate popular consciousness, but to plague society.

If money, originally the golden bridge, now the paper bridge, is the bridge commodities must cross in order to be consumed, then as in all matter's capitalist, those bridges were and are privately owned or monopolised. To cross over a toll must be paid; interest. To borrow money, costs money.

Hence to minimise the amount of money capital, credit money came into being. The biggest generator of "credit money" was not the banks, and definitely not the government. It was industry and commerce with their bills of exchange which allowed buyers to pay at a later fixed date. Such was the volume of these promissory notes that it shaped modern-day banking. Today the value of outstanding commercial paper traded by the banking system is equal to half the value of commercial and industrial loans outstanding. (FED Table H8 Line 10 for commercial and industrial loans and Table: Commercial Paper.) Given the shorter duration of commercial paper, it is clear that the volume of commercial paper far exceeds the volume of longer dated loans. And, further, considering that only a fraction of the promissory notes issued enters the banking system for the purposes of being discounted, this form of credit money is much larger than any other form of banking credit.

It is of course true that the cost of money acts as a barrier to the development of capitalist production. This cost is minimised by the introduction of credit. The more credit develops the more money is relegated from being the primary means of exchange to a means of settling debts. Money is generally confined to circulating commodities in the retail sphere, while in the productive, wholesale and foreign trade, spheres, commodities circulate against credit.

Capitalism from its inception seeks to step over the limits of private property and credit is its primary ladder. The seller or producer seeks through credit, to provide the moneyless buyer with the means of purchasing of their product. This sets up a chain of obligations comprising credit given and credit taken with money settling these alternating obligations with or without set off. Of course, as the chain gets longer and thicker weighing down the bearers, there comes a point when the limits of private property become unscalable and the whole thing comes crashing down.

What is this cut-off point? Is it simply that credit is overstretched? To be overstretched requires a reference point. A thousand miles in Australia is different to a thousand miles in Hawaii. In the case of

Hawaii, one would always end up underwater most of the time. The reference point for credit is profit. If producing and selling commodities yields a profit greater than any potential borrowing cost, credit is redeemable. As soon as profits no longer generate sufficient liquidity, making credit or a large part of it, unredeemable, then the whole chain of credit is stressed. This observation is important when we deal with fiat currency or token money.

Anything which disrupts the orderly retirement of credit leads to a financial emergency. This tends to occur at the end of the industrial (business) cycle. Indeed, just before the financial emergency, the amount of credit surges because new credit is being used to roll over existing credit or to extend it, thus adding to it. More precisely, it is the time when the ratio of credit being retired is falling in relation to credit creation, for reasons other than changes to the value of commodities in circulation. It is the time when traders and producers are depositing bills of exchange with their banks rather than cash.

In greater detail.

The rate of turnover of working, fluid, or circulating capital is critical in this regard. Anything that slows down the rate of turnover requires more credit for its completion. When viewed from the perspective of turnover, credit assumes the form of capital. If the rate of turnover slows down thereby extending the period of circulation, say from 50 days to 60 days, then everything else being equal, 20% more capital is needed to complete the circuit. <u>Thus, the velocity of circulation of money is itself a product of the rate of turnover and its reduced velocity reflects the slowdown in the rate of turnover</u>.

Should the output formed of that circulation not suffer a price fall, then the amount of value realised after 60 days is no higher than the value realised after 50 days but the working capital advanced has risen by 20%. Thus, each unit of working capital now realises a profit that is 20% smaller. This could of course be the difference between solvency and insolvency because the amount of profit returned may now have fallen below the amount of capital advanced.

Furthermore, the extension of the period of circulation due to deteriorating market conditions, is usually completed only at a discount. Now it is the case that not only is it taking longer to sell something, but in order to sell it a price reduction must be offered. Under these circumstances less profit is realised, and, the question of solvency becomes more critical.

What causes this fall in demand? The primary reason (there are subsidiary reasons as well) is the fall in aggregate investment. Before examining this proposition, we first need to abolish a confusing myth. Most commentators say that in a modern economy consumption is the key driver of economic growth, not investment, because consumption counts for 70% of GDP and investment only 30%. This observation is wrong on all counts.

Firstly, employing the language of Marx we can divide the economy into its two great departments, Department A and Department B. The former produces means of production and the latter produces articles of consumption. Over time there is a tendency for Department B to grow faster than Department A. This differential growth is a function of the rising productivity of labour. Over the course of a century, the typical national rate of productivity rises between 900% and 1300%. This rising productivity makes possible the rise in the living standards of the working class as well as the rise in the profits of the capitalist class. Together they accelerate the development of Department B.

To therefore say that consumption now accounts for 70% of the economy is to say that measured by the value of final sales, Department B accounts for 70% of production while Department A accounts for only 30%. They may produce two different sets of use values, but these two departments have one thing in common. To function productively they need investment. Both need means of production which includes fixed investment (equipment, machinery, structures etc which last longer than a cycle of production) and fluid investment (power, materials, components which are consumed within a cycle of production).

But even here the comparisons need correcting. Only the value of final sales is used to determine GDP, National Income and its division into wages and undivided profits. But the total number of sales in the economy exceeds the number of final sales and so does its value. If we dip into the Gross Output data to obtain total sales across the economy, we find they amount to $34.4 trillion compared to $19.5 trillion for final sales (Final sales unfortunately are overstated by about 20% but we will ignore this discrepancy for the time being). Thus, total sales amounting to $34.4 billion comprise $14.9 intermediate sales (inputs) plus $19.5 final sales.

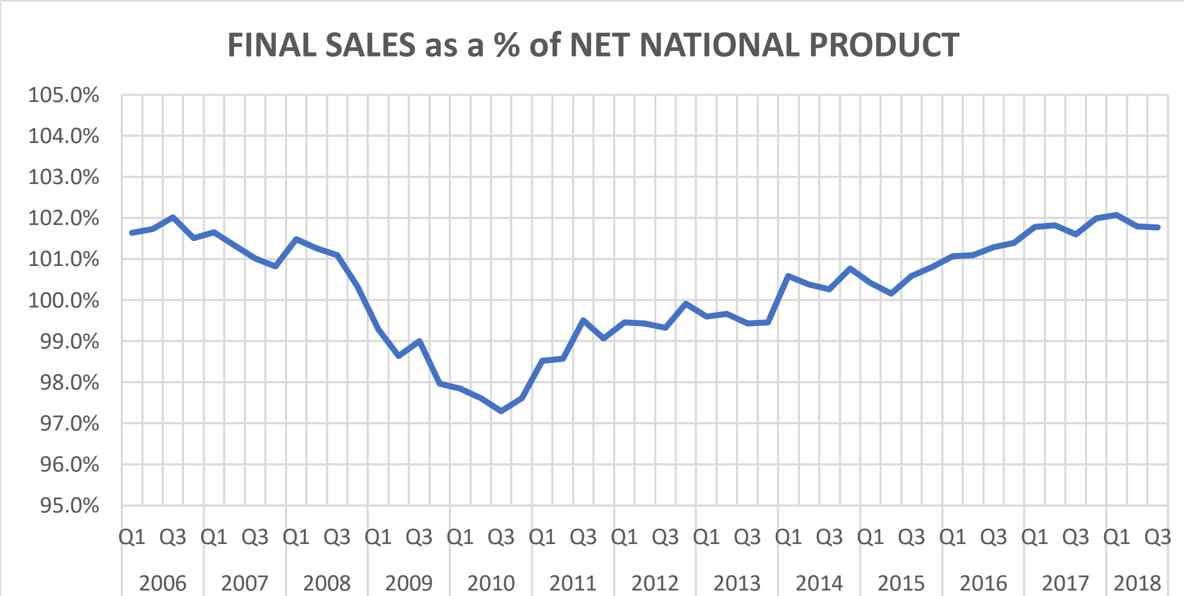
Now if we assume that 70% of this $19.5 trillion represents final sales to consumers then this adds up to $13.7 trillion. If we assume 30% is invested this adds up to $5.9 billion. But this excludes fluid or working capital. Using a number of formulae (Note 1) it is possible to reduce total sales to fluid capital, and when we do, we find it amounts to $9.99 trillion. When this is added to the $5.9 billion fixed investment, it makes up $15.9 trillion which is nearly 20% bigger than the figure for final consumption. (Note 2.) A number of Marxist theoreticians like Michael Roberts have looked at this but because they foolishly reject the turnover formula they are unable to reduce gross output to fluid or working capital thus they are unable to determine the ratio of total investment to final consumption.

Thus far from being the biggest part of the economy, private consumption is actually smaller than total investment. From this we can deduce the following: it is investment, not "consumption" that is the biggest determinant in the economy. This has long been the position of most Marxists. But we are not alone, even sections of bourgeois economists hold this to be true because the empirical evidence is solid. *The historical record on economic growth conflicts with this consumption doctrine. Economic growth (booms) and declines (bust) have always been led by changes in business and durable goods investment, while final consumer goods spending has been relatively stable through the business cycle. For example, during our* past two decades of booms and busts, *investment collapsed first, bringing employment down with it.* (Forbes *Think Consumption Is The 'Engine' Of Our Economy? Think Again* published 30 January 2013).

This perceptive observation by the doyen of bourgeois publications, *Fortune*, is correct though it needs to be qualified. When measured against the Net National Product (similar to National Income) rather than Gross Domestic Product there is a change in the ratio of final sales. This is shown in graph 1 below. I have chosen Net Domestic Product rather than Gross Domestic Product because it avoids depreciation. The reader's attention is drawn to a previous posting on this website: *Towards a Unified Theory of the Causes and Limits to the Industrial Cycle.* The link is - *https://theplanningmotivedotcom.files.wordpress.com/2019/01/the-limits-to-the-industrial-cycle-pdf.pdf* This article shows the significant movement of depreciation shortly after the onset of recession which is in the same order as the movement in final sales. This has the effect of smoothing final sales around the recession. However, because the movement in investment is more than double that of final sales in and around the recession, its movement is apparent.

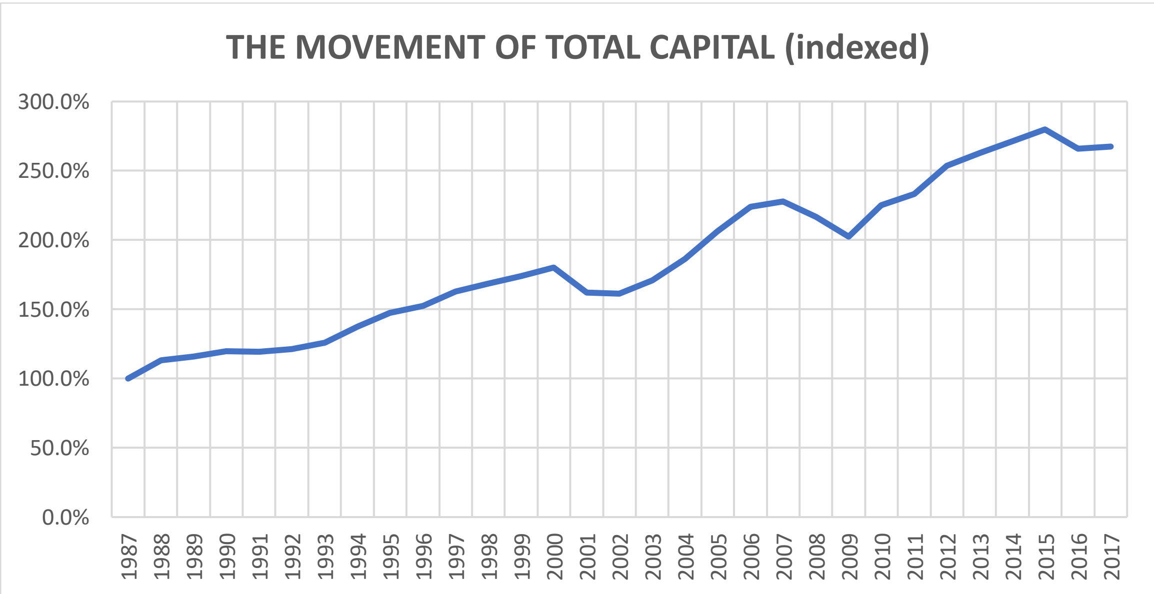
The movement of final sales between the first quarter of 2008 and the trough in 2010 was 4.2%. In Graph 2 over the same period total investment which includes fluid capital fell from 227.9% to 202.5%. This represented a relative fall of 11.1% versus a relative fall of 4.1% for final sales, a difference of 7%, or in relative terms a difference of 270%.

Graph 1.



(Source: Table 1.17.5. Gross Domestic Product, Gross Domestic Income, and Other Major NIPA Aggregates)

Graph 2.



Hey there big spender, yes you the capitalist, the one with more money than brains.

Thus, we see the movement in investment is 2.7 times more volatile than final sales. However, there is one compelling observation that needs to be addressed. Even if it is assumed that investment is the determinant, won't a possible fall in final private consumption and therefore final demand not create a gridlock for investment. Like vehicles on a highway, if the exits are blocked, will this blockage not cause the freeway or highway to seize up? This question of clearing goods needs to be addressed, because MMT assumes that final demand is deficient, and, can only be corrected by perennial deficit spending. This question is addressed below.

The only way the issue of demand can be answered, is to address the question socially. All capitalist society contains two classes: the capitalist class and the working class. (The insignificant middle class sandwiched between the working and capitalist class, comprising small capitalists, categories of professionals, senior managers and senior civil servants, does not concern us here.) The working class in most cases does not have the choice between spending or saving. In most advanced capitalist countries, workers live from paycheque to paycheque. (And they are forced to borrow during hard times.) This is why *Fortune* assumes final private consumption is fairly stable over the course of the business cycle.

The same pressures do not apply to the capitalist class. They own the surplus of society. They have the luxury of spending or saving because their income is hundreds of times greater than workers. They can do one of three things with this surplus. They can invest some of it, and the data suggests that about 45% of their gross income is consumed this way. (Fixed capital + increase in Fluid capital) Or they can spend it on themselves by gorging on luxury goods and other goods. Or finally they can speculate with it.

<u>As a general rule, they do not consume the surplus of society in all its forms</u>. This fact has given rise to the theory of underconsumption and the search for markets. But this is the chronic underlying condition. What drives the acute phase, the actual rhythm of their spending, is the rate of profit, because it alone determines investment and the movement of fictious capital. For the purpose of this article we will only focus on investment which in any case is the biggest component of this surplus.

If the rate of profit is rising capitalists tend to increase investment. More workers are employed, and, more factories are built or expanded. Consumption rises. Conversely, when the rate of profit falls absolutely, they tend to cut back on investment and other spending as well, because this is the time asset bubbles begin to deflate as well. The capitalists literally go on an investment strike regardless of its cost to society. This occurs at the end of the industrial cycle and it is the phase where the gap between the revenue received and spent by the capitalist class is at its maximum. It is at this point that the outbreak of crisis appears to emanate from the collapse in demand.

This is the Marxist interpretation of demand and supply in the economy. Demand and supply only coincides when the capitalist class consume the surplus of society in one form or another, either productively (through investment) or unproductively (on themselves). When part of this surplus is unconsumed, when it lies idle, then demand falls below supply, forcing a violent correction in supply. This then describes the boom bust nature of the capitalist economy. It really is a cycle where the surplus is largely consumed (the upside) followed by a collapse in consumption (the downside).

Before proceeding to address how the state can intervene under these circumstances, it is necessary to address how the MMT economists and other economists including the monetarists, the Austrians the neo-libs and the star gazers, view what they call the Macro economy. Here follows a representation of GDP

a) Value of final sales net of inventory = GDP
b) GDP = Wages + Profits + Rent + Interest + Tax
c) GDP = **C**onsumption + **I**nvestment + **G**overnment Spending + balance of trade (**X-N**)
d) GDP = Consumption + Saving + Taxes

All the above formulas express the three main representations of GDP, the final sales concept, the income concept and the production concept. GDP is based on (a) and is then extrapolated into its other concepts. Now it is assumed that all sides balance. I do not intent to analyse how this works. For more information go to https://www.bea.gov/sites/default/files/methodologies/nipa-handbook-allchapters.pdf This balancing of the various sides notably c) and d) is less important than the accuracy of the components themselves. Given their lack of accuracy it is quite amusing to see all those learned economies arguing amongst themselves about the importance of the data, without realising they are arguing over meaningless figures. (I never use economy wide figures for this reason.)

The basis of the GDP figures is based on (1) the value of final sales adjusted for inventory balances. These figures are only accurate if four conditions hold good. Firstly, there are no duplicated sales, secondly, there are no intermediate sales taken as final sales, thirdly production for use is not taken as production for value (exchange), fourthly that the mere exchange of money is not taken as adding value. Unfortunately, though the BEA does its best, the National Accounts bar certain industries, is riven with these mistakes.

Let us take a brief tour. The most egregious mistake is the duplication of final sales. Here the most notable example is the assumption that owner occupiers pay themselves a rent. This imputed (fictitious) sale adds 8% to GDP alone. Then there is the transfer of R&D and software from a cost (intermediate sale) to capital through creating an imputed sale thereby raising GDP by a further 3%. Next the household sector and production for use. If capitalists hire gardeners for example, the wages they pay them are not deducted from the profits these capitalists earn. Thus, income is overstated because the gardener's wage is added to the capitalist's profit. This may not affect the consumption side because the reduction in consumption by the capitalist is made good by the consumption of the gardener, but it does affect the income side. Then there is "religious giving" for example which the BEA treats as an industry. Here donations are treated as though god's infinite love is value producing.

All in all, these mistakes in my opinion amount to about 20% of GDP, ensuring that the US economy measured in terms of value, not physical labour, is really 20% smaller. (GDP both overstates value production while underestimating physical production.) The 20% error far exceeds the element of saving that takes place in the economy. In 2017 net saving as a share of net income was only 3.4% and under 3% when compared to GDP.

Theoretically savings are supposed to equal investment. But this only happens because savings are a balancing item. They are not real. The usual items on the income and expenditure side are described below with the personal element of savings amounting to 300 which is then transferred to the Capital Account to be added to corporate saving, government surpluses/deficits and depreciation to obtain gross savings.

Personal Income and Outlays

Personal Taxes	100	Compensation of employees	900
Personal Outlays	1000	Surplus paid out (dividends, interest etc)	500
Transfers out (govt & foreign)	200	Net govt transfers received	200
Personal saving	300		
TOTALS	1600		1600

But immediately a problem is detected. The underlying assumption is that for every borrower there be a lender. While it is true that one of the functions of the banking system is to centralise hoards and savings in order to lend them out, they also generate credit over and above that. If lending rises above savings then net debt increases. But there is no sign of this in the accounts. The income side is unaffected remaining at 1600. If this increase in personal debt is spent on personal outlays, (consumption) then it follows that these personal outlays must increase. But if personal outlays increase not because the income (right side), then how are the two sides able to balance at 1600. The answer is: personal savings must be reduced because it is the balancing item. If outlays have gone up by 100 due to the effect of bank credit, then actual savings of 400 would have been reduced to 300.

The same applies to the proceeds of speculation. The BEA correctly ignores capital gains, but it is impossible to ignore personal consumption. Not only do speculators have to eat, but they need to drive their Porsches, wear their Rolex watches and Armani suits and so on. But as these men and women are adept at hiding their income, it raises the outlay side without raising the income side. Once again personal savings are reduced. That is why the USA, the monopoly exploiter of the world, recipient of its largest surplus and home to the biggest casinos located on Wall Street, appears to be living beyond its means. It appears the US is facing a savings shortfall when the opposite is the case.

Next let us turn to China. Does anyone believe that China was actually saving between 45 and 50% of its output until recently? That wave of savings allowed investment to grow at more than 20% annually until 2014? If this was the case more Chinese would have starved than during the Cultural Revolution. The savings rate is not a true figure once more. In China, until four years ago most credit went to fund investment. When credit is used primarily for investment it has the opposite effect on savings. It appears to increase it. The reason for this is because the following is held to be true;

$C + S = C + I$ (where C is consumption, S is savings and I is investment)

If we cancel out C on both sides because they are equal in value, it means S must equal I. There cannot be investment without savings. Again, not true. The Chinese did not starve because of forced saving, but instead their banks grew to be the biggest in the world because of the inordinate amount of credit they generated for industrial investment. In reality what was in play was not $S = I$, but $S + Cr = I$ where Cr represents credit generation. It is counter-intuitive to assume that it is **I** that generates the **S** figure in accounting terms rather than the other way around. After all, were we not brought up on the Robinson Crusoe story where he had to put aside coconuts (savings) before his was able to invest his labour in something other than collecting coconuts?

But if the savings figure is a thing of magic, then it blows the Austrians, the monetarists and the neo-liberals out of the water. If it is the case, that in the long run there are excess savings in the system, potential capital that is lying idle, they do not have a leg to stand on. What they all share in common, the podium on which they all stand, is the call for a small state with minimal spending and minimal taxes. As we shall see combining a small state with an underspending capitalist class is madness.

The relation between state spending and spending by the capitalist class.

Says Law, which says that supply creates its own demand is horizontal and apolitical nonsense. Supply and demand can only balance if the capitalists consume the surplus of society one way or the other. This is seldom the case. The most serious consequence of this underspending relates to investment which impacts society and the working class.

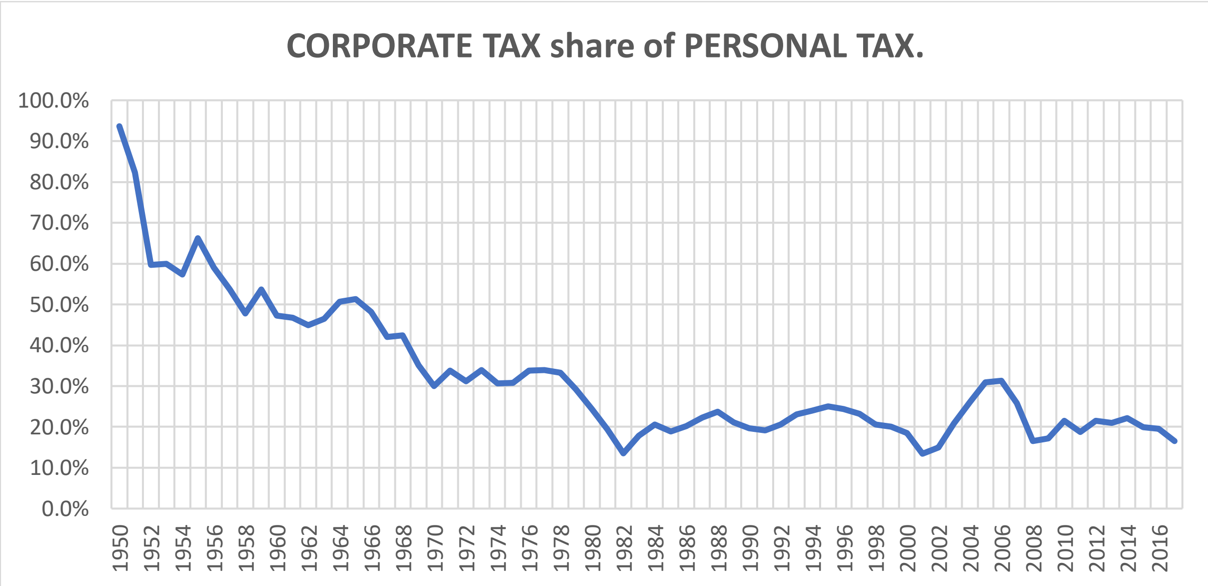
What can the state do in the face of this underspending? The state has three options, which is where MMT comes in. Firstly, they can raise taxes on the rich and their corporations. Secondly, they can mop up this excess by issuing government bonds. Thirdly they can disregard or bypass this surplus by printing additional state money (fiat money).

In the US, the Treasury could issue bonds bought by the FED and in the UK the Treasury could issue bonds bought by the Bank of England. All it needs is a central bank. In both cases the government would end up with more money. In turn this money can be used to invest or improve the welfare state. This third option is the province of MMT, who propose perpetual deficits financed by government bonds bought with government money.

From the point of view of the working class which is the best solution? Unequivocally it is the use of higher taxes on the rich to mop up their unspent money. When the rich are taxed they do not have to be paid back or bribed with interest as would be the case were bonds or gilts to be issued. It is also far better than printing money for the economy as we shall see. It is also interesting that left democrats from Bernie Sanders to Alexandria Ocasio-Cortez are now proposing tax hikes for the rich rather than simply endorsing perpetual deficits. They are pushing at an open door. It is not only the 85% of democrat voters who support this but a majority of Republicans too.

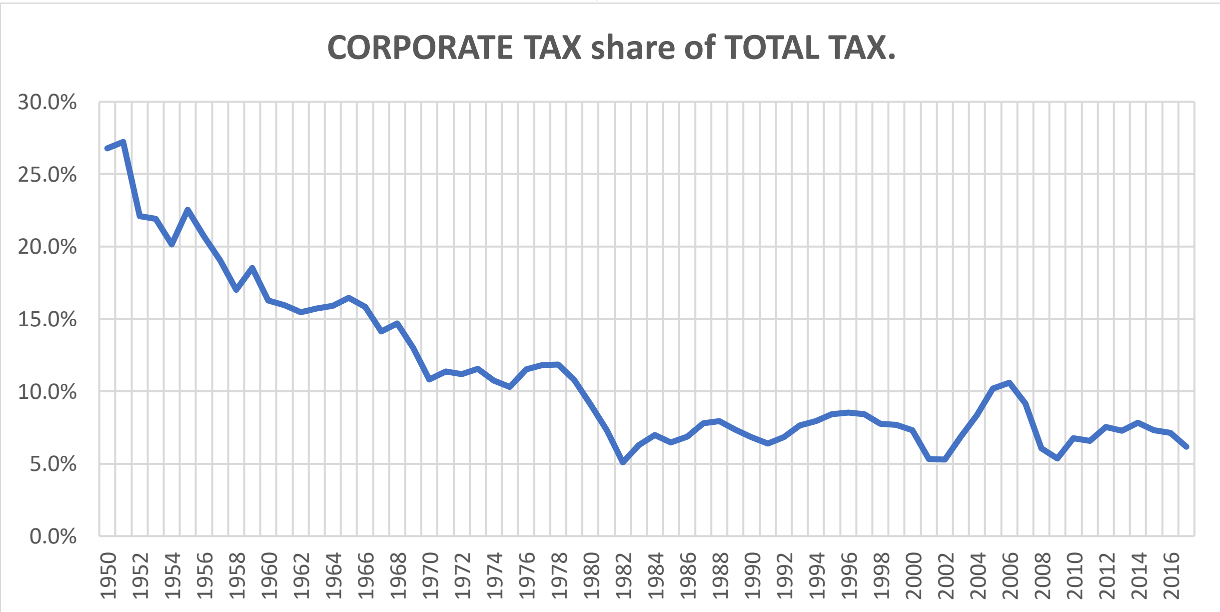
Below are some eye-opening graphs on taxation in the US taken from the selection of graphs the reader can find on the accompanying spreadsheet. They highlight the change to the tax structures.

Graph 3.



(Source: Spreadsheet titled "NB TAX CALCULATIONS, GRAPHS 1950-2017")

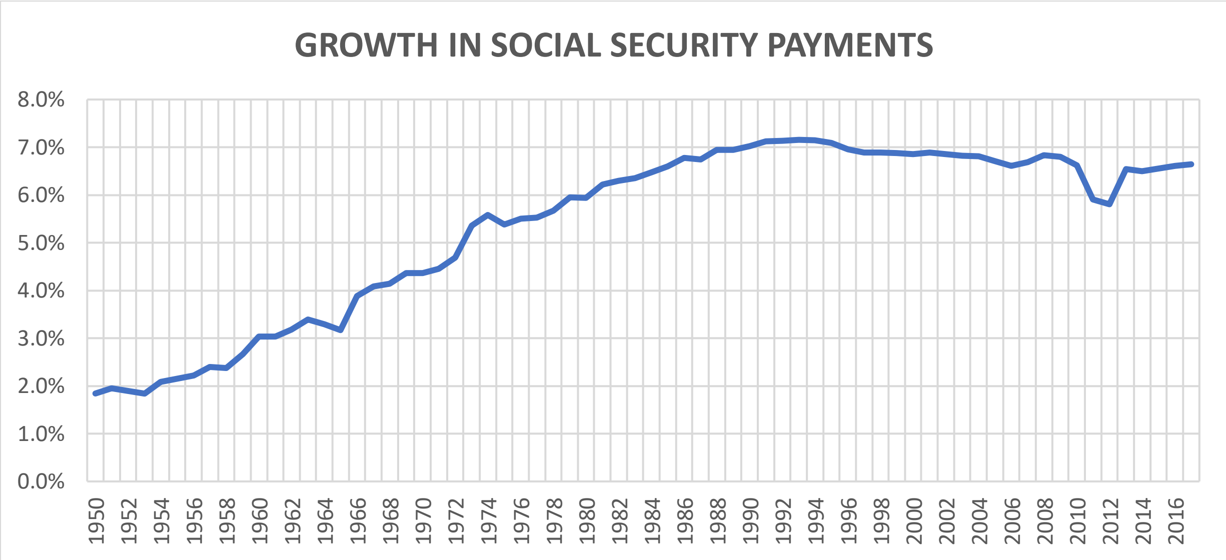
Graph 4.



Graphs 3 and 4 describe the incredible fall in corporate tax compared to personal taxes (Graph 3) and also compared to gross national income (Graph 4). Although the figures are not yet out for the whole of 2018 to reflect the "Trump Cuts", the first three quarters are out. On average, the share of corporate taxes compared to personal taxes fell from 16.5% in 2017 to 10.5% in 2018, and, as a share of total taxes it fell from 6.2% to just 4%. In terms of National Income, it fell from 2% to just 1%. Little wonder the US government is broke.

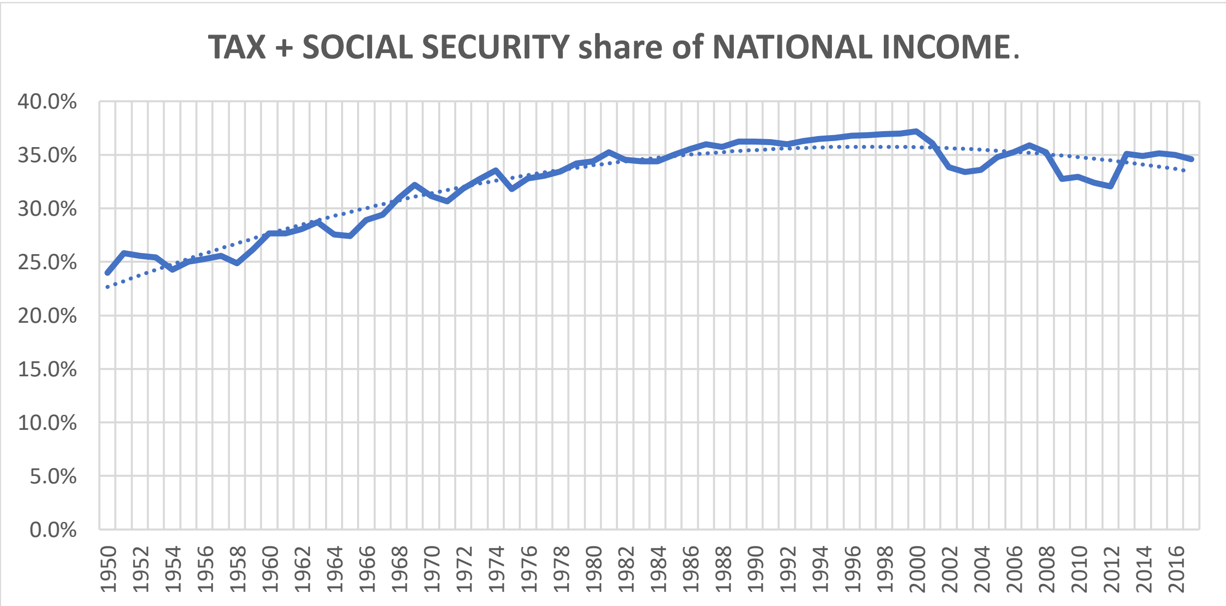
Of course, it must be noted that the fall in corporate tax contributions is associated with a fall in the general rate of profit since the 1960s. However, this can be overstated because the rise in social security contributions, and therefore the price of labour power, is an offsetting factor. From Donald Reagan to Ronald Trump there has been a shift in tax away from corporate tax onto personal tax contributions. This is particularly true of social security payments (the figure that is always omitted when the apologists for the capitalist class trumpet how the rich pay the lion's share of tax). Graph 5 below plots the rise in social security payments as a share of National Income.

Graph 5.



If it were not for the increase in social security payments the total tax take would not have risen. Furthermore, it would not have held at around the 35% level as shown in Graph 6.

Graph 6.



Graph 6 shows us that tax as a share of gross national income has not changed much from the figure in 1981 when it first popped above 35%. But since then inequality has jumped. This is generally recognised and needs no further elaboration. So, let us provide the riposte to the apologists paid by the capitalist class to claim they pay the lion's share of tax. (The cheek of it, moaning about the state skimming off some of the unpaid labour they appropriate from the working class.) The riposte is this. Under conditions of rising inequality, the volume of tax should rise. As more and more of society's income ends up in the hands of the rich, this income should be taxed at a higher rate. Conversely as the poor enjoy less income, they would be paying less tax because the rate at which they pay is lower. Hence the tax that is lost because of the falling income of the poor, should be more than offset by the tax that is gained by the rising income of the rich.

Except this has not happened. Personal taxes as a share of national income has been falling since 2001 courtesy of Bush junior and now Trump. This means that their marginal tax rate for the rich has been reduced. This fall in taxation amidst rising inequality has exacerbated the unspent surplus and encouraged speculation. Far from tax cuts representing trickle down economics, it is more a case of the rich pissing down on the poor. What is good for the rich always turns out to be bad for society.

Thus, the state can step in and raise taxation on the rich and their corporations. This will put more resources into play. Since the 1980s, the tax take has shifted by 5% of GDP benefitting the capitalist class. Thus, reversing this would generate substantial revenue. On the other hand, an 5% addition to the budget deficit arising from MMT proposals would destabilise the economy.

The capitalist state does not redistribute from the rich to the poor. Rather, when it raises taxes on the rich all it does is to slow down the underlying redistribution from the poor to the rich, from the worker to the capitalist, the upward flow of unpaid labour that forms the profits, rents and interest payments of the capitalist class. It reduces the overall exploitation of the working class, that is all.

When viewed in this way the role of the state is clear. The state is the guarantor of the process whereby labour is turned into unpaid labour for the benefit of the capitalist class. Such a state does not relinquish this role when it raises taxes on the rich. It agrees to this only when the growth of inequality threatens the whole basis of that society. Thus, taxation will never be allowed to expropriate the capitalist class, only to rid it of some of its dangerous excesses.

Next, let us switch from taxing the rich to borrowing from the rich. This mopping up of the surplus grows the deficit of the state because it increases state liabilities (bonds). On the other hand, higher taxes, because they are not paid back, does not grow the budget deficit. Additionally, interest has to be paid annually, which over the lifetime of the bond, depending on duration, can equal the cost of the bond itself. In comparison to higher taxes, there are no advantages to the working class from this form of borrowing. There are of course advantages to the capitalist class, these rentiers do not lose any capital and they receive a guaranteed stream of income (interest payments).

Muddled Monetary Theory.

Finally like the illusory perpetual motion machine we have the perpetual deficits proposed by the MMTs. It was always going to be the case that following Quantitative Easing, the printing of money to reimburse the rich for their losses, truly a case of throwing bad money after bad money, there would be those who said if it could be done for the rich then why not for the rest of us. Thus, MMT whose theoretical origins precedes the crisis of 2008 only gains a popular audience after the crash of 2008 and the onset of Quantitative Easing.

There is very little new about MMT. It holds the following to be true, (1) the state is the monopoly provider of currency (2) it cannot run out of money (3) excess capacity and the underemployment of workers is blamed on a shortage of money because of state underspending, and, (4) that the money tap can and should be turned off if the economy approaches full employment and inflation rises. (However, MMT says very little about a potential balance of payment crisis prior to full employment if consumption is satisfied by increased imports.)

MMTeers don't need a theory of value because they have a quantitative view of money. Prices depend on the supply of money, thus inflation can be regulated by means of controlling the money supply. This would be true if all the money was spent. It is true that higher wages can lead to higher prices for goods consumed by workers because they do not have a choice over whether or not to spend. The same is not true for the capitalists because they do have a choice over investing, which is why Keynes opined that trying to inject money into a depressed economy where animal spirits were subdued was like pushing on a piece of string.

MMTeers remain unconcerned that perpetual deficit spending by the government will provoke a solvency crisis for government finances. It all seems to be too good to be true and one wonders why it not being used regularly. In fact, even a FED governor is now suggesting it is used regularly. Mary Daly president of the San Francisco Federal Reserve https://www.reuters.com/article/us-usa-fed-daly-balancesheet/fed-debating-if-balance-sheet-should-be-regular-tool-daly-says-idUSKCN1PX27N

So, let us consider how it will work and whether it will resolve the fundamental contradictions found in a capitalist society. Here we assume there is no increased taxation on the rich. Secondly, that this printing of money takes a specific form. The additional money will not be channelled through the commercial banking system via central bank deposits with these banks, because the commercial banks will be a choke point, lending the money onwards only on commercial terms.

Rather that this money is funnelled through the treasury. The treasury issues bonds which are sold to the central bank who pay for them with national currency. Though the public debt increases it is held publicly not privately. The treasury can then funnel the money through government agencies to the needy or set up new agencies like an investment bank to oversee lending as well as subsidies.

At this point we need to retrace our steps. The spare capacity in the economy is merely an expression that part of the surplus of society lies idle or is engaged in speculation. We assume that this unspent surplus does not go away unless it is mopped up through state borrowing or through taxation. Thus, the key question is how does the extra money resulting from state issuance of currency interact with these idle hoards.

Does it increase it or decrease it, and, will it mobilise it? Clearly if the printing of money and its disbursement improves the conditions of profitability the idle hoard will diminish as private investment is stimulated. On the other hand, if this disbursement of money impairs profitability, the hoard will increase because investment will be deterred, and, this will negate the extra influx of money.

There are a number of possible outcomes. If we assume that this sprinkling of money does not improve profitability, the capitalists will then respond by raising prices rather than investment in the face of rising consumption. There are two ways to improve profit margins, and therefore the mass of profits at a given level of output. The first is to raise selling prices and the second is to reduce cost prices.

Raising selling prices is no panacea. One capitalist's selling-out price is another capitalist's buying-in price. It is self-defeating especially when workers demand higher wages to keep pace with price rises.

(We assume MMT type government are not hostile to workers.) The result will be stagflation replacing the current stagdeflation.

The only way to improve profitability generally is to reduce cost prices which requires investment to improve productivity and therefore a reduction in unit costs. But as profitability is discouraging investment in the first place, this is unlikely to happen. Of course, the MMTeers can subsidise production, but what they have categorically ruled out is competing with the capitalist class through state led production for the market. Instead they have proposed investing on the margins - investing for use - such as coastal reclamation, reforestation, making cities colourful and so on.

They have also suggested a large investment into converting carbon-based energy production into green energy. The problem with investing in green energy is that it does not reduce cost prices for industry without massive subsidies. This may not always be the case as the substantial fall in the cost of wind power has shown. But it is true for the foreseeable future. Nor will investing on the margins.

Nor can rolling back the wheel of history. In the 1980s industry and manufacturing were hollowed out in the advanced capitalist countries by the export of capital to countries like China. This led to a reduction in the number of domestic investment outlets. Privatisation of state services provided additional outlets. Companies which barely existed at the time became behemoths such as Capita, Interserve, G4S, and Compass. They grew fat on state contracts and their squeezing of workers previously employed under more favourable conditions by central and local government.

If the state decided now to take most of these services in-house, this would prove convulsive. Without these state contracts and the NHS internal market, most of these world-size corporations would go bankrupt. It would add to the crisis of investment. (This does not mean it should not happen, it should, and all moves to reverse privatisation should be supported.)

Or we could take the example of social housing. The housing market in both Britain and the USA (as well as other countries) has been financialised and thus rendered unaffordable to most. But to achieve this the supply of housing has had to be restricted. Britain currently builds one fifth the square footage per head of population compared to the 1930s and the USA one-half compared to the 1970s. If the supply of housing was to suddenly be boosted by the provision of large-scale municipal housing, house prices would collapse. With a significant number of mortgages now under water, the banking system which is reliant on rising house prices, would be imperilled.

The argument here is not concerned with the merits or demerits of social housing and welfare spending. The author is a big supporter of renationalisation and social housing. What is being pointed out is something different, how convulsive it will be to reverse the financialization and leverage resulting from neo-liberalism.

However, we should not be confused with the role of state spending prior to the 1980s. True the state was concerned by the rise of the USSR and the strength of the trade union movement. But the primary purpose of state spending still focused on boosting profits. If municipal housing rents were low, if healthcare became free, if higher education became free, it meant the wages that needed to pay for these elements of labour power, were reduced. By reducing the price of labour power, profits were boosted.

Further the state could provide these elements cheaper and more efficiently than commercial competitors contrary to the neo-liberal propaganda. In providing these services and housing, tax revenue only had to cover their cost price. True, these services had to be financed by a continuous flow of tax revenue (Thatcher's lament) and they could not be self-expansionary. But what Thatcher always failed to comprehend, was that the taxes needed to pay for these services, which is a deduction from potential profits, was always going to be less than the increase in wages and subsidies after privatisation. This is why the housing benefits, tax credits and in-work credits needed to subsidise the price of labour power far exceeds the savings privatisation has yielded. The capitalists may appear to be making more profits because of privatisation and financialization, but they only appear to be.

The lessons of 2008.

Which brings me to the point of departure: what will happen when this new wave of money interacts with the idle hoards (even when they are engaged in speculation)? If it mobilises these hoards so that some of it is thrown back into the real economy it will generate inflation long before full capacity is reached. This will not happen of course if the state mops up this surplus through additional borrowings or taxing it.

The MMTeers pay no attention to a social analysis of the problem. They simply believe the problem lies with the state monopoly of money, which like all monopolies, distorts the market. They forget that state money monopolies only emerged in the mid-19th century and then only in response to systemic financial crises. Prior to that there was no such monopoly because currencies were generally issued by commercial banks themselves – hence the term banknotes – notes made valuable because they were backed by the deposits (stores of value) held in the banking system itself. This however did not prevent monetary crises, because monetary crises are seldom caused by money itself.

Furthermore, the MMTeers are of the opinion that budget deficits are not important because the state is self-financing. It does not depend purely on taxation. They could not be more wrong. If we were to follow their logic, that the “value” or better still, stability of a currency does not depend on the solvency or prudency of the state, then they misunderstand what happened after 2008. They use the example of 2008 but without grasping what really took place.

The capitalists’ response to 2008 must be seen in the round, not one-sidedly. Yes, governments did sprinkle money over the rich, but they siphoned it off from the poor. Quantitative Easing and Austerity are two-sides of the same coin, one cannot exist without the other. Two-dimensional, one-sided coins simply do not exist.

Had governments not responded by cutting public services and subsidies in order to control their soaring budget deficits, had they not acted prudentially, then their backing for their currency would have been compromised. The majority of bonds bought by the FED via QE were investment grade bonds with a marketable value (they remained stores of value through commanding a reliable stream of future Income.) Thus, the state was not impoverished or indebted by the expansion of the money supply.

The dollar was backed not only by taxation but by the additional stream of income these bonds attracted. Between 2008 and 2016 the Federal Reserve trebled its profits to $565 billion because of its increased holding of bonds. Most of this profit was paid over to the Treasury. Had there been a crisis of oversupply of dollars leading to its depreciation, then the state was in a position to sell some of these bonds to compensate for this, thus driving up interest rates. On the other hand, the state reduced the outflow of value by curbing government spending. By degrees it reduced the deficit even while handing out tax cuts to the rich, a double insult to workers.

An idealist engages in pseudo-science by asking the wrong question, why can’t an entity act differently? A Marxist on the other hand asks the penetrating question, why does an entity have to act in the way it did? QE and austerity, the means of saving the financial system were not optional.

They were the only responses the capitalist system could engage in which allowed for the increase in the money supply (liquidity) while protecting the integrity of that money supply.

As lender of the last resort the purpose of the central banks was to pump liquidity into the system. The government bail out on the other hand was designed to deal with solvency issues for the largest banks and industrial firms by recapitalising them. The Austrian's response would have been to allow capitalism to unleash creative destruction by returning economies to the years before 1857, before the era of central bank intervention. Perhaps some central bankers, especially in Germany entertained such an idea, but even they balked at provoking an economic catastrophe when workers now outnumber capitalists 1000 to 1. On the opposite side were the idealists who maintained that austerity was optional, that instead of cutting, the state could have increased its spending by printing more money, and, dispersing it not on the speculators but on the welfare state.

It is difficult to see which option would have been more catastrophic. In the case of the pre-1857 Austrians, the credit crunch would have been catastrophic, but the currency would have been supreme. In the case of the of the idealists, the crunch would have been reduced but the currency would have been lost. The deficit could have quickly grown to over 20% robbing the state of its ability to back its currency because it no longer commanded an adequate store and flow of value.

Conclusion.

Reforming capitalism is a hot topic currently. As the global economy decelerates sharply the debate is moving from the fringes to the main stream as we saw with the President of the San Francisco FED. The question is not whether quantitative easing will be deployed again, but how it should be deployed.

The vast majority of society are fed up with neo-liberalism. It now includes Trump supporters. 30 million North Americans are waking up to the fact that Trump's tax cuts have led to their tax rate going up instead of coming down. In politics you can fool the electorate only once, never twice. Trump supporters hit with higher taxes are furious at his betrayal and rebelling. Expect this to be the first of many rebellions before his term is up. (https://www.cnbc.com/2019/02/07/failed-to-withhold-enough-tax-in-2018-the-irs-has-a-nasty-surprise-for-you.html)

In searching for alternatives, workers are always tempted to reach for the soft options first, and, nothing is softer than printing money. This is as true for the left in the Democratic Party as it is for the Corbynistas in the British Labour Party. What could be more tempting than money for the needy, for services, for the setting up of a state investment bank, municipal socialism, a basic income. Capitalism can be reformed in the interest of workers, why overthrow it for an unproven alternative.

Except that it cannot be reformed in the manner described. The more capitalism develops the more irreformable it becomes. This is not a question of politics but of economics. Neo-liberalism, the reversion by capitalism to its ugly naked self, was not a plan, it was a reflex, it was a response to the crisis of profitability that broke out globally in the late 1960s and 1970s. This crisis could only have been resolved in one of two ways, victory for capital or victory for labour. History shows that the stratagem of the capitalist class triumphed over the illusions of the working class.

Conditions are different today. The capitalist class despite the benefit of social media, is ideologically weaker than it was then. The legitimacy of capitalism is already threadbare, and what is left will be shredded by the Crash of 2019. Secondly, its room to manoeuvre is reduced. Capitalism, because the technical composition of capital is so advanced, is palpably weaker. This has been noted indirectly by the more astute bourgeoise observers of capitalism. They have been terrified by how quickly the global economy succumbed to the briefest elevation of interest rates in 2018, to levels still considered "far below normal".

Thus, the Crash of 2019 is in play. True the markets had a month long, rather than week long fling after the FED capitulated, Trump beamed on the trade talks and the shut-down silenced hard data. For a few weeks, momentum trumped valuations. But of the two forces, valuations are the stronger especially in the longer term. And valuations are coming to the fore and they are downbeat. Bank after bank is telling their clients to batten down the hatches because earnings are going to be lower for the foreseeable future (which is why more expensive vehicles fell by 8% in January).

Every week the economic news turns more negative. The data coming out of Europe, Britain, China and Japan points to an expanding deceleration as the second half of 2018 unfolded. In the US data releases were delayed by the government shut down but private data is available. Orders for Class 8 trucks fell 86% in January (fracking hell). The December CASS Freight index has now fallen below its December 2017 level despite the rise in e-sales.

The problem for the reformists is that with a global recession gaining traction, the economic conditions will not be conducive for their programme. Remodelling a house which is on fire is a very difficult task. Abandoning it would be the safer option. (Asking workers to form a self-sacrificing water chain is the most likely option.) Nevertheless, we cannot ignore these proposals. Many workers will be tempted by them. That is not the problem. The real problem appears afterwards when the politicians promoting these proposals abandon them because they harm the system they are loyal to, or, because they have suddenly become unaffordable.

It is this betrayal of the soft-option programme or manifesto that prepares the ground for the darker options - nationalism, xenophobia, racism. Developing and fighting for a socialist programme adequate for the 21st century is therefore not an option it is a necessity. The first step is to abandon complacency, to recognise we do not have all the answers, and to recognise the emergence of such a programme is a joint effort. In the mean-time we need a united front with the soft-left to prove we are not sectarians and to gain the attention of workers, but we also need a programme to win them over when the soft-left abandons or sabotages the united front.

Thenextrecession.wordpress.com website.

Michael Robert's website is still the best Marxist window to what is being discussed topically in the world of economics and politics. The comments on his postings are also a window to the small group of Marxists who exist outside Academia. I will no longer be commenting on his website because those who ignore developments in theory and continue in the old way are providing a disservice to the working class. For those who want a deeper insight into Modern Monetary Theory read the recent three well referenced postings on Michael's website above. It is to be noted however, that the three articles do not examine the role of taxation, a serious omission when discussing MMT.

Note 1. To distil working capital, we need to deduct the surplus from gross output and then divide by the rate of turnover. (All figures for 2017 in billions of dollars.)

Obtaining the rate of turnover: $\frac{34445.6}{19485.4} + \frac{(34445.6 - 19485.4)}{19485.4} = 1.77 + 0.77 = 2.54$

Obtaining annual cost of gross output: 34445.6 – 9064.8 = 25380.8

Obtaining working capital: 25380.8/2.54 = 9992.4

Note 2. Based on the research I have done into duplications etc in the US economy I would suggest that the adjusted figures below are more proximate to the actual value producing element of the US economy. Final sales are reduced by 20% or $3897 billion, intermediate sales are increased by 8% or $1197 billion which means that total sales are reduced to $31746 billion. Thus,

$$\frac{31746}{15588} + \frac{(31746 - 15588)}{15588} = 2.05 + 1.05 = 3.1 \text{ (versus 2.54)}$$

In this case the rate of turnover has gone up by 0.6 (over half a period) or by 22%.

Brian Green, January 2019.