MANDATORY READING MATERIAL
for the 19th March 2014 Seminar of Warren Mosler, visiting professor at
University of Bergamo, DAEMQ Department, Lectures of International Monetary Economics
(part of the course taught by Stefano Lucarelli)

ME/MMT: The Currency as a Public Monopoly

Statement of Purpose

The purpose of this paper is to introduce Mosler Economics/Modern Monetary Theory (ME/MMT) to the Italian academic community. It begins with a brief history of MMT, followed by a description of the distinguishing aspects of ME/MMT and their application.

Introduction

Warren Mosler, after obtaining his BA in Economics in 1971, entered the financial sector in 1973 as a loan collector in a small savings bank. In 1976 he was an AVP at Banker's Trust NYC on their 'bond desk' before moving Chicago in 1978, where he established the government bond department for William Blair and Co. In 1982 he cofounded Illinois Income Investors, an international investment company that specializes in fixed income relative value investment strategies, and AVM, institutional broker/dealer. In 1993 he authored 'Soft Currency Economics' with editorial assistance from economics Professors Mark McNary and Arthur Laffer, which was the beginning of 'Mosler Economics (ME)'. In 1996, Professor Pavlina Tcherneva, then an under graduate student, published a paper that showed how 'Soft Currency Economics' was in fact an extension of the existing Post Keynesian (PK) school of thought:

"In his essay Soft Currency Economics, he draws from his experience as a practitioner in financial markets in analyzing the underlying forces at work in a modern monetary system.
Interestingly, this analysis incorporates several postulates that can be considered logical extensions of Post Keynesian monetary thought. Considering the fact that he had no exposure to the Post Keynesian school of thought before writing his paper, it is fascinating to see the striking similarities between important aspects of his analysis and Post Keynesian monetary theory. Furthermore, Mosler's work deserves serious consideration for the valuable insights into the monetary system that are not currently focused on by the academic world, policymakers, or the general public."[1]

However, rather than being incorporated by the Post Keynesians, both Mosler and SCE were, in general, not well received by Post Keynesians, and most often rejected when not ignored. Those few who did initially recognize the merits of 'Soft Currency Economics' included Professors Bill Mitchell, Mat Forstater, L. Randall Wray, Stephanie Kelton and Pavlina Tcherneva who. a few years ago, when ME became popularized as Modern Monetary Theory (MMT), became recognized as MMT professors.

[1] Pavlina R. Tcherneva, *A Critical Review Of Soft Currency Economics*, posted 12/8/96
http://www.epicoalition.org/docs/pavlina.htm

In 1998, Professor Alain Parguez, an originator of the theory of the monetary circuit, incorporated the ME/MMT concepts into that theory, likewise causing a division in that school of thought, where many adherents also consider themselves Post Keynesians. And Professor Bill Mitchell, who had independently developed the concept of an employed labor buffer stock in 1978, was likewise all but rejected by the Australian Post Keynesian community when he began incorporating the monetary operations aspects of MEMMT.

Several years ago the Italian Journalist Paolo Barnard discovered ME/MMT on the internet. With further study he recognized ME/MMT's application to the Italian economy, and set out to popularize ME/MMT for the further purpose of restoring full employment and a commitment to public purpose in general.

In February 2012 the world's first large scale ME/MMT conference was held in Rimini, with some 2,180 people attending the two day event. Barnard subsequently discovered Warren Mosler, and his 2010 book, 'The 7 Deadly Frauds of Economic Policy'. When Mosler was in Italy for a presentation in Rimini as a guest of a Mr. Giovanni Zibordi, he met Barnard who arranged a subsequent presentation in Venice attended by over 400 people. This was followed by further events in Rimini and Cagliari, attended by more than 2000 people. At the same time, what are now called "ME/MMT Activist Cells", began to form independently throughout Italy, working to reverse the course of an Italian economy suffering severely from the austerity policy that continues to be demanded by the EU. In June 2013, a tour was arranged in Italy with Warren Mosler and Paolo Barnard making 14 visits in 14 days, from Sicily to Northern Italy, with presentations to the activists and members of the general community. The venues at each location were filled to capacity with up to 700 people attending the 3 hour events to learn about what was happening to the Italian economy and how to fix it. Most recently Mr. Barnard further popularized ME/MMT as a host on national prime time Italian TV. Currently, there are four associations promoting ME/MMT in Italy- Rete MMT, Euro Truffa, EPIC, and memmt.

The Currency as a Public Monopoly

ME/MMT is distinguished by its explicit recognition that the currency itself is a public monopoly, which is the micro foundation of fiat currency. MEMMT then builds the ramifications of that fundamental understanding. These include, as points of logic, that the object of monopolization- in this case the currency- is, necessarily, not 'neutral'; that a monopolist is 'price setter' and not 'price taker'; that the monopolist has the choice of setting price or quantity; and, critical to public purpose, unemployment is necessarily the evidence that a currency monopolist is restricting the supply of the financial assets need to pay taxes and satisfy savings desires.

Keynes vs the Classics

The Classical economists said that without monopoly markets would clear and there would be no mass unemployment. That is, it's only a monopolist, such as a labor union, that causes unemployment and excess capacity in general. Keynes, on the other hand, said that even in the absence of monopoly there could be persistent mass unemployment, and then discussed characteristics of the monetary system that caused this to be the case. This ongoing impasse alone, which has continued unabated in academia for over 80 years, is sufficient evidence that neither side has yet to recognize that the currency itself is the monopoly in question.

It is ME/MMT that recognizes both sides are correct. The classics were correct in stating it was a monopoly that was the cause of unemployment. And Keynes was correct in stating that it was the characteristics of the monetary system as he described them that caused unemployment. And the reason for the continuing disagreement is simply that neither side has yet to specifically recognize that the currency itself is a monopoly causing the unemployment in question.

MEMMT is thus distinguished by its explicit recognition that the currency itself is a monopoly, and that unemployment is the evidence that the currency monopolist is restricting supply. More precisely, unemployment (as defined) is the evidence the currency monopolist is restricting the supply of net financial assets denominated in that currency. It is only government spending (or lending) that adds the financial assets required for the payment of taxes to the economy, and it is payments to that government that removes those financial assets from the economy.

The Currency as a Tax Credit

ME/MMT recognizes that with fiat currency, the funds the government spends are best thought of as tax credits. Likewise, the funds the government spends that are not immediately used to pay taxes remain in the economy as 'monetary savings' until used to pay taxes in the future. Furthermore, these tax credits outstanding constitute what is called the 'national debt'.

Unemployment

Unemployment is defined as people not working who are seeking paid work. And it is taxation that functions to cause people to seek paid work, presumably to facilitate the government's desire to provision itself, which it does by spending its otherwise worthless currency to hire those its currency caused to be unemployed. Furthermore, as previously discussed, income is not used to pay taxes remains as monetary savings. Therefore it can be said that unemployment is necessarily the evidence that the government's spending is insufficient to satisfy the need to pay taxes and the desire to save. And, consequently, a fiscal adjustment is always an immediate remedy for unemployment. That is, the government can always do some combination of hiring the people looking for paid work or lowering the tax that caused the unemployment.

The Government of Issue is not Operationally Revenue Constrained

MEMMT further recognizes that a government that imposes taxes and then spends its own tax credits is not operationally revenue constrained. In fact, as central bank operations reveal, that government necessarily, from inception, spends (or lends) first, and only then collects taxes or borrows. Outstanding tax credits (credited but not yet debited for payment of taxes) in most nations exist, functionally, as central bank liabilities in the form of cash and credit balances at the central bank. These balances are commonly called reserve accounts and securities accounts. Therefore, the expression 'paying it back' refers to nothing more than the debiting of securities accounts and the crediting of reserve accounts, all on the books of the central bank. Therefore, any constraints on spending are necessarily self-imposed and subject to immediate revocation of the government responsible for the payments. Typically these constraints include budgeting limits, debt ceilings, and restrictions on treasury transactions with the central bank.

With the support of this fundamental understanding of monetary operations, MEMMT dismisses common financial concerns that include the government 'running out of money': the government being dependent on borrowing its own currency in order to be able to spend; the government facing solvency issues and not being able to make future payments; and that the national debt (the outstanding tax credits) is a financial burden for future generations.

Monopoly Pricing

Monopolists set two prices. They set the price of how their item exchanges for itself, which is called the 'own rate', and they set the price for how their item exchanges for other goods and services. The terms of exchange they set for other goods and services is known as the price level.

For a currency monopolist, the own rate is the interest rate it sets for its currency. This interest rate is generally set by the government's central bank, most often by committee vote. It is then implemented through the banking system, with the central bank determining the cost of funds for its member banks. As the monopoly supplier of net clearing balances for the banking system, the central bank can either pay interest on excess clearing balances (also known as reserves) or, alternatively, take action to cause a shortage of clearing balances and then, directly or indirectly, enforce their policy rate by the interest they charge the banking system for the needed funds.

The price level (whether the government knows it or not) is necessarily a function of prices paid by government when it spends and/or collateral demanded when it lends. Again, the funds required for payment of taxes come only from government spending or lending. That means the economy needs the government's funds to avoid the penalties for non-payment of taxes, and it is this requirement that puts the government in the position of dictating the terms of exchange.

In a market economy, as a point of logic the government need only set one price, commonly known as the 'price anchor' or 'buffer stock', with all other prices then becoming expressions of relative value. At one time, for example, most governments set the price of gold as their price anchor, and let all other prices adjust. However this policy was universally abandoned when it failed to promote public purpose. Currently for most nations the price anchor is the unemployed. What MEMMT concludes is that an employed buffer stock is a far superior price anchor than an unemployed buffer stock, along far superior externalities, all with regard to public purpose.

Trade Fundamentals

MEMMT recognizes that labor is a real cost and an input of production, and not an economic benefit as commonly assumed. Likewise, exports are real economic costs and imports real economic benefits. Therefore, public purpose is best served by optimizing the real terms of trade with policy that promotes as many imports as possible for a given level of exports.

Conclusion

MEMMT presumes the role of government is to establish and sustain public infrastructure for public purpose, and that the currency is a tool of government for the promotion of public purpose. Accordingly, what MEMMT offers are fiscal and monetary proposals that sustain employment opportunities for anyone willing and able to work, and that optimize real terms of trade, all in support of real standards of living.

Warren Mosler
February 24, 2014
Christiansted, USVI

Rites of Passage

The Child of Consensus

Conceived in post WWII politics, and baptized in the political waters of the 90's, a new common currency- the euro- assumed its position on January 1, 1999. Representatives of the prospective member nations masterfully achieved political consensus by both the absence of objectionable clauses and the inclusion of national constraints, as manifested in the Treaty of Maastricht. During that tumultuous process, with deep pride, the elders grasped and shielded the credit sensitive heel of the infant euro. The 'no bailout' directive for the new ECB (European Central Bank) emerged as a pillar of the political imperative to address the 'moral hazard' issue that so deeply concerned the political leadership, and, two years later, that same rhetoric of fiscal responsibility continues to ring at least as loudly when the merits of the EMU (European Monetary Union) are proclaimed. Unfortunately, however well intended as protection from a genetic proclivity toward fiscal irresponsibility, the naked heel is but a magnet for the financial market's arrows of our hero's mortal demise.

As Apollo's chariot adeptly carries its conflagration from east to west, the European Monetary Union carries its members on the path of economic growth. Unlike the path of the sun, however, the path of an economy continuously vacillates, including occasional dips into negative territory. And, like the sign most rental car agencies post by the entrance for returning cars about to drive over a one way bump strip, the new EMU, with its lurking unidirectional bias, could do a service to it members with a similar posting - WARNING- DO NOT BACK UP!

The Dynamics of the Instability

The euro-12 nations once had independent monetary systems, very much like the US, Canada, and Japan today. Under EMU, however, the national governments are now best thought of financially as states, provinces, or cities of the new currency union, much like California, Ontario, and New York City. The old national central banks are no longer the issuers of their local currency. In their place, the EMU has added a new central bank, the ECB, to manage the payments system, set the overnight lending rate, and intervene in the currency markets when appropriate. The EP (European Parliament) has a relatively small budget and limited fiscal responsibilities. Most of the governmental functions and responsibilities remain at the national level, having not been transferred to the new federal level. Two of those responsibilities that will prove most problematic at the national level are unemployment compensation and bank deposit insurance. Furthermore, all previous national financial liabilities remain at the national level and have been converted to the new euro, with debt to GDP ratios of member nations as high as 105%, not including substantial and growing unfunded liabilities. These burdens are all very much higher than what the credit markets ordinarily allow states, provinces, or cities to finance.

Since inception a little over two years ago the euro-12 national governments have experienced moderate GDP growth, declining unemployment, and moderate tax revenue growth. Fiscal deficits narrowed and all but vanished as tax revenues grew faster than expenditures, and GDP increased at a faster rate than the national debts, so that debt to GDP ratios declined somewhat. Under these circumstances investors have continued to support national funding requirements and there have been no substantive bank failures. Furthermore, it is reasonable to assume that as long as this pattern of growth continues finance will be readily available. However, should the current world economic slowdown move the euro-12 to negative growth, falling tax revenues, and concerns over the banking system's financial health, the euro-12 could be faced with a system wide liquidity crisis. At the same time, market forces can also be expected to exacerbate the downward spiral by forcing the national governments to act procyclically, either by cutting national spending or attempting to increase revenue.

For clues to the nature and magnitude of the potential difficulties, one can review the US Savings and Loan crisis of the 80's, with the difference being that deposit insurance would have been a state obligation, rather than a federal responsibility. For example, one could ask how Texas might have fared when faced with a bill for some $100 billion to cover bank losses and redeem depositors? And, once it was revealed that states could lack the borrowing power for funds to preserve depositors insured accounts, how could any bank have funded itself? More recently, if Bank of America's deposit insurer and lender of last resort were the State of California rather than the Federal Reserve, could it have funded itself under the financial cloud of the state's ongoing power crisis and credit downgrade? And, if not, would that have triggered a general liquidity crisis within the US banking system? Without deposit insurance and lender of last resort responsibilities the legal obligation of a non-credit constrained entity, such as the Federal Reserve, is systemic financial risk not ever present?

The inherent instability can be expressed as a series of questions:

*Will the euro-12 economy slow sufficiently to automatically increase national deficits via the reduction of tax revenues and increased transfer payments?

*Will such a slowdown cause the markets to dictate terms of credit to the credit sensitive national governments, and force procyclical responses?

*Will the slowdown lead to local bank failures?

*Will the markets allow national governments with heavy debt burdens, falling revenues and rising expenses the finance required to support troubled banks?

*Will depositors lose confidence in the banking system and test the new euro-12 support mechanism?

*Can the entire payments system avoid a shutdown when faced with this need to reorganize?

Conclusion

Water freezes at 0 degrees C. But very still water can be cooled well below that and stay liquid until a catalyst, such as a sudden breeze, causes it to instantly solidify. Likewise, the conditions for a national liquidity crisis that will shut down the euro-12's monetary system are firmly in place. All that is required is an economic slowdown that threatens either tax revenues or the capital of the banking system.

A prosperous financial future belongs to those who respect the dynamics and are prepared for the day of reckoning. History and logic dictate that the credit sensitive euro-12 national governments and banking system will be tested. The market's arrows will inflict an initially narrow liquidity crisis, which will immediately infect and rapidly arrest the entire euro payments system. Only the inevitable, currently prohibited, direct intervention of the ECB will be capable of performing the resurrection, and from the ashes of that fallen flaming star an immortal sovereign currency will no doubt emerge.

Warren Mosler, May 1, 2001

Further optional reading:

http://www.moslereconomics.com/mandatory-readings/soft-currency-economics/
http://www.moslereconomics.com/mandatory-readings/full-employment-and-price-stability/
http://www.moslereconomics.com/mandatory-readings/a-general-analytical-framework-for-the-analysis-of-currencies-and-other-commodities/
http://www.moslereconomics.com/mandatory-readings/the-natural-rate-of-interest-is-zero/
http://moslereconomics.com/2010/10/04/exchange-rate-policy-and-full-employment/
http://www.epicoalition.org/docs/Pavlina_2007.pdf
http://www.moslereconomics.com/?p=8968