Initial Reflections on 'Debt Jubilee', Modern Money Theory (MMT) and the Limits of Monetary Policy

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One of the readers of this blog recently asked me my views on topics such as the call by some left economists for a general debt forgiveness (Debt Jubilee), on Modern Money Theory (MMT or sometimes referred to as 'Magical Money Tree'), and the Federal Reserve bank (central bank) pre-emptive bail outs of banks and non-banks underway and whether the latter will succeed in generating an economic recovery from the current deep Coronaviral impacted US economy. What follows are some of my quick reflections and commentary on these topics.

My views on monetary policy are somewhat summarized by the argument that in the current era of finance capitalism dominance, monetary policy has been the first and foremost choice of capitalist governments and policymakers. Push the bail out (and normal times economic stimulus as well) through the central banks and into the private banking system. The latter then distribute the money injection to the non-banks and financial investors of their preference.

What trickles down to the wage earners, consumers and households is a residual in terms of income. Fiscal policy in terms of taxation is focused on business-investor tax cutting and on expanding government fiscal spending on corporate subsidies. Deficits that remain are financed by global purchases of US Treasuries as the money capital is recycled back to the US from offshore where it accumulates due to US trade deficits with the rest of the world. Industrial policy is to compress real wages, weaken or destroy unions, incrementally shift the cost of benefits to workers, and deregulate and privatize what remains of public works and public goods. Monetary policy is designed to keep interest rates low and ensure a low dollar exchange rate to maximize US multinational corporations offshore repatriation of foreign profits into the maximum amount of US dollars.

In the 21st century both monetary and fiscal policy are about subsidizing capital, especially finance capital, and less and less about stabilizing or stimulating the economy. (See my recent book, *The Scourge of Neoliberalism: US Economic Policy from Reagan to Trump'*, Clarity Press, January 2020, for more of this argument in detail)

As a result of this view, needless to say I am not a big fan of capitalist central bank monetary policy. Nor of monetary policy in general, since it has always been about subsidizing and/or bailing out finance capital. Debt is a means by which financial assets are subsidized as well. Money and Debt are thus central to maintaining the current 21st century capitalist system which requires excessive money injections (liquidity) and corresponding Debt accumulation as means to further expand capitalist wealth. Since it is central, I argue that capitalists and their governments will not entertain either a 'debt jubilee', and MMT is a theory that attempts to invert capitalist monetary policy and employ it for fiscal income redistribution to workers, consumers and households; thus that too is a contradiction to the system and would not be allowed. In short, both a Debt Jubilee or MMT require a virtual political revolution first before they could ever be introduced. The advocates of both Jubilee and MMT are politically naive to advocate solutions that cannot be introduced in the era of 21st century global finance capital hegemony. They are impossible 'reforms' of the system without a fundamental political change that drives capitalist interests from the sources of institutional government and state power.

Reader's questions

My questions for you (Jack) are about the 'Magical Money Tree' (i.e. MMT, my italics). Does it exist? Can the Fed create money to pay for whatever it decided was necessary for the economy? If the decision was to pay off all student debt, could the Fed do so? If so, who gets stuck with the bill. Could there be a complete debt repayment for personal debts and corporate debts? If there is not a Magical Money Tree could one be created? If so, how? What if the government took back the constitutional power to create money and a new Greenback-era developed?

My comments in reply

This is the old Modern Money Theory hypothesis, renamed 'Magical Money Tree'. It assumes that monetary policy, as money creation, can stimulate economic growth. MMT is just QE flipped on its head. Instead of the Fed bailing out corporations and capitalists only (per its mandate) it can be used to bail out the rest of us. But there are limits to monetary solutions to a crisis, whether QE or a public interest QE that would transform the Fed into a kind of public bank. The problem with MMT is it is politically naïve. To create a Fed as Public Bank it will take a political revolution. The banks and investors behind the Fed (they've controlled it ever since 1913) won't allow that without a political fight that changes the nature of the capitalist system itself.

Beyond that, the problem with monetary solutions is that it holds that the redirecting the money supply is sufficient. It ignores the role of money demand and money velocity. You can provide all the money supply you want by creating money electronically, as the Fed does, but that doesn't mean there'll be the demand for money or that money demanded will eventually be used for investment, employment, and real growth. In times of deep crisis like this, much of the money supply might be 'borrowed' but will be hoarded, redirected offshore, distributed to shareholders, or invested in financial assets that are more profitable but produce no real growth.

Can debt be 'expunged'? Yes, but all the talk of debt jubilee is again political naivete. Why? Because it means the finance capitalists that ultimately 'own' the debt will not just take a haircut but will have their heads shaved at the neck. They will resort to any undemocratic violent response necessary with the help of their politicians to stop it. All private debt forms, including credit card debt, auto debt, mortgage debt, revolving debt, and private bank provided student debt are owned by big capitalist investors. Debt forgiveness means their assets would collapse to zero. What about public held debt? US government, government held student debt, fannie mae-freddie mac government held mortgage debt, state-local government debt? While that could technically be expunged since the government (taxpayers & citizens) own it, to do so would cause a collapse of private debt markets' price values and, in turn, mean a major loss of asset values for capitalist investors. So the latter resist that as well. A progressive government might be able to introduce a staged reduction in student debt. Or as I have argued, stretch out the 10 yr. normal term of student debt to 30 yrs and reduce the rate of interest to no more than that for the 30 yr. Treasury bond, or forgive one tenth of the principal per yr. over ten years for all student debt holders. That might pass but not with the Neoliberal governments we've had. Again the concern of capitalists is that even student debt expunging will have a negative impact on the values of other assets held by the capitalists.

What about relief from rents and mortgages.? Same story here. Who puts up the money capital for multi-family apartments, and for both residential and commercial property mortgages? It's the rich private investors and their financial institutions (hedge funds, private equity, etc.). They take major losses if there's a rent or mortgage forgiveness. A moratorium for rent and mortgages is different. It just means they move the payments to the back of the term of the debt payment schedule. On paper it doesn't change the value of their assets significantly. But forgive it, or expunge it, and it destroys their values.

The current crisis has only just begun, both in health terms and economic. The virus is a precipitating causal force, not the fundamental driver of the current crisis–which is still unfolding both in health effect terms and independent dynamics of economic contraction. There will be a second virus wave, likely worse than the first which always happens in these severe pandemics. The present reopening of the economy by Trump and business interests behind him demanding it will exacerbate the contraction in a second wave, moreover. It's certainly not a V shape recovery; it will be more like a 'W' shape, with successive contractions after short shallow recoveries. And if defaults lead to general bankruptcies it will mean a financial crisis at some point that will exacerbate the contraction still deeper.

And there'll be no re-shutdown once a second viral wave happens, later this year most likely. Trump and broad sections of the capitalist class have already decided that they'll accept the death toll and stay open throughout the second wave. (and the third, which also historically follows about 6-12 months later).

That's been the pattern with the 1918 and 1958 pandemics. The second wave is always the worst.

Ditto for the economy. In other words, there are forces economic released that are now independent of the health effect, although the latter will also continue to wreck havoc economically. The massive $9T Fed-Treasury liquidity injection (so far, more coming) should be understood as a pre-emptive bank and non-bank bailout. Massive defaults are coming, already spreading from oil,energy and retail sectors, eventually to other service sectors and state and local governments. The bailouts are designed to flood the banks with liquidity and the contain the defaults in the non bank sectors. But once again, massive liquidity as money supply injection may slow down or even prevent some insolvency crises (i.e. defaults and bankruptcies) but that doesn't mean stimulate economic investment and recovery. Once again, money solutions don't necessary result in boosting the real economy, and that means jobs, and wage incomes that will collapse. Most of the liquidity will be hoarded on balance sheets or to make minimal payments on debt. It won't go into real investment that generates real jobs, wages, consumption, and recovery.

Can the government, using MMT, engage in direct spending to restore the economy? Technically yes. But that kind of Treasury provided funding will add to the government debt at a time when business and capitalists are demanding more funds (and debt) for them (i.e. raise the government debt to bailout them out). So there's a competition for who gets bailed out. Who do you think in the current Neoliberal era is going to get funded then: capitalists or consumers/households/workers? Corporations will come first, as we've seen in the bailouts of the last couple months: Trillions in loans and grants (mostly grants in the end since loans will be converted and forgiven eventually for businesses) for them vs. just $500b for workers. And there'll be no more for extended unemployment benefits after July or supplemental income checks of $1200 forthcoming. That's it. Go back to work and die. And if you're on unemployment benefits now, if you don't return to work you lose them.

The Fed 'money tree' is backed by US Treasury bonds sales. And those bonds add to the federal government debt. The Fed doesn't simply create an electronic entry in its accounts from which banks and capitalists can withdraw funds. US Treasuries are created to allow the Fed to make those entries. And that adds to the government debt. You could have the US Treasury to perform the function of the Fed, as was the case before 1913. But the function remains the same, whether carried out by the Fed or by the US Treasury-Government. The Treasury was the Fed before 1913. So the problems of excess debt to bail out capitalism will continue even if the US Treasury took back the money supply creation function. Nothing really changes. The choice will always remain: create Treasury bonds for spending (or lending to banks, non-banks) for whom? Finance capitalists (bankers)? Non-bank capitalists? (airlines, oil frackers, etc.). Or consumers and workers? It again comes down to a political issue and whether the capitalist State will bail out capitalists or us. And who pays their politicians? So guess who they'll bail first and foremost?

The Fed was created so that the politicians would not have to bail out the bankers and capitalists directly, by raising taxes. The bailouts funnel through the Fed, funded still however by T-bonds, which add to the national debt. How high can the US debt rise? It's now well above 100% of annual GDP. But Japan's is over 200%.

The US government is creating the money supply, but indirectly: by using T bonds to fund the Fed who injects liquidity into the banks (and now non-banks too). To say let's get rid of the Fed as intermediary and use the Treasury itself only changes the structure but not the actual process. The Fed now in effect transfers the private capitalist debt on to its own balance sheet each time it bails out the banks and corps now. The Treasury would do the same without the Fed. But that would pose a political problem for the politicians with the electorate, so they prefer an intermediary like the Fed, central bank, to do it so folks don't understand what's really going on. Simply put, the government ultimately bails out the banks and capitalists. So ending the Fed and giving money creation back to the Treasury changes nothing but the appearances!

MMT simply creates the fiction that somehow, if the Fed or Treasury could directly fund social spending, that the liquidity injection to households could stimulate the economic recovery.

To sum up my view: it doesn't matter if it's the Fed or Treasury. Pure monetary solutions don't work well in a deep contraction and crisis. Liquidity injections get hoarded not invested. And they don't stop, only maybe slow, insolvency crises (defaults, bankruptcies). And what we have today is a Fed massive liquidity injection trying to hold off a general insolvency crisis. I predict it will fail. What we'll need is another even larger 'New Deal' direct government spending, including government hiring (per WPA). But you don't need an MMT program for that. You don't need a Fed. The Fed is there to provide cover for the politicians and capitalist State so they don't appear directly responsible for bailing out bankers and capitalists to the electorate. (Check out my 2017 book, *'Central Bankers at the End of Their Ropes: Monetary Policy and the Coming Depression*' for more on the limits of monetary policy in general).

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