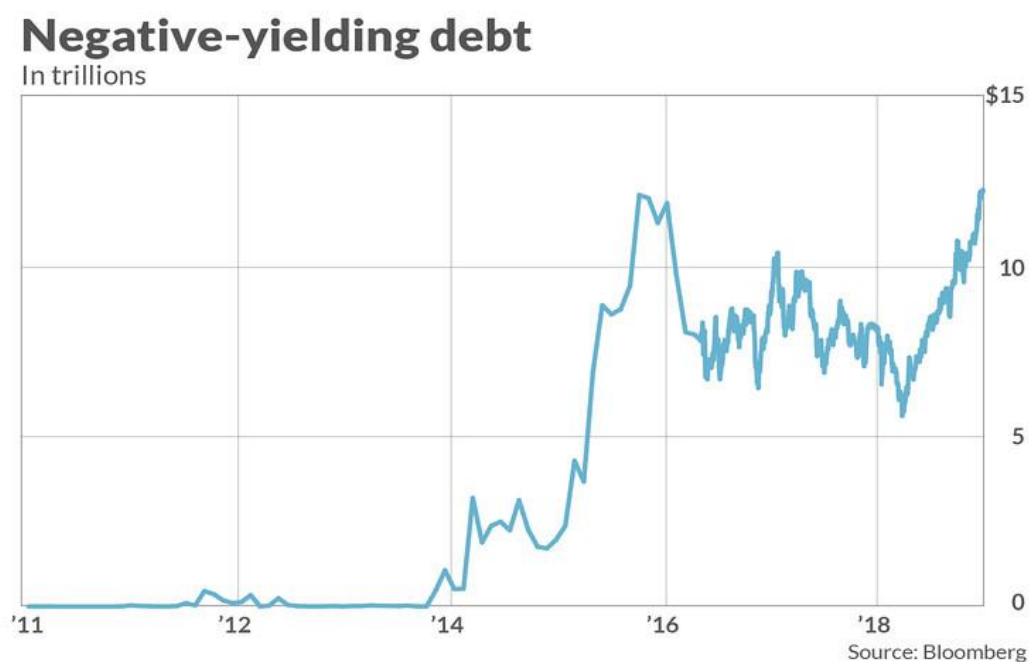


MODERN MONETARY THEORY or MAINSTREAM MONETARY THEORY?

The discussion on how to respond to the deepening Crash of 2019 is focusing minds. It is recognised that interest rate manipulation and regular quantitative easing will not suffice to bring the global economy back into growth, especially now that international trade is so fractured. Increasingly main-stream economists are dabbling with the direct injection of cash into the economy up to and including by-passing the traditional banking sector.

A spectre is haunting the world economy. A lost decade of growth comparable to Japan in the 1990s. It is often forgotten, but economic depressions cause more material destruction than actual wars. As Mark Harrison revealed in his epic investigation: "*The economics of World War 11: an overview* (<https://warwick.ac.uk/fac/soc/economics/staff/mharrison/public/ww2overview1998.pdf>) aerial bombing physically destroyed 39% of fixed assets at the time, whereas the more recent Japanese depression led to a loss of 45% of fixed assets, both actual and potential. For the whole of the 1990s, measured in 2010 Dollars per capita, Japanese growth averaged three quarters of a percent p.a., much of that driven by growing government deficits. (<https://fred.stlouisfed.org/series/NYGDPPCAPKDJPN>)

Japan has been the emperor of quantitative easing and negative interest rates. Total government debt is over 250% of GDP as the Bank of Japan has hoovered up its own government bonds and corporate shares. Today it owns 45% of its own bonds and 15% of the Tokyo Stock Market. Current 10-year yields are -0.141% and the bank rate is -0.1% (<http://www.worldgovernmentbonds.com/country/japan/>) Japan has been a big contributor to the global glut of negative yielding debt now approaching \$14 trillion. To put this into perspective, it is almost the size of the total amount of US government debt held privately.



(Source: MarketWatch 21 June 2019 <https://www.marketwatch.com/story/value-of-debt-with-negative-yields-nears-12-trillion-2019-06-18>)

An interesting observation flowing from the above graph is 2014. Only at the end of 2014 does negative-yield bond issuance gain traction. This is no coincidence. Those who read my articles are

aware that I place great emphasis on 2014, because it was in 2014 that the global rate of profit peaked, symbolising the exhaustion of the first phase of globalisation. The collapse in interest rates at this time is a response to the collapse in the rate of profit towards the end of 2014. The 2016 peak coincides once again with the pseudo recession at the end of 2015. The subsequent valley in negative issuance coincides with the phase of rising animation, and when this ends in 2018, there is a sharp resumption in issuance to a new peak.

Despite minor oscillations, the rate of profit is well below its 2014 level. One of the factors depressing the rate of profit has been the significant deceleration in the rate of turnover globally (and hence the elongation in each period of turnover). Normally, a deceleration of turnover is synonymous with stresses in the chain of credit as we shall see, but this event has been buffered by low interest rates. This has taken the sting out of the increase in working capital necessitated by the elongation of the circuit (period) of capital.

Money, so many fake explanations.

There are as many explanations of money as there are different currencies. And yet the answer is staring us in the face. How often do we hear the expression: "time is money!" Indeed, it is. But not all time is money. Only productive time is money, time devoted to work, and then only if the results of that work can be sold and converted into money.

Let us turn the expression around. Now it reads, money expresses time. Indeed, it does. It is the universal expression of productive time or what is the same thing labour time. It not only expresses productive time, but it measures productive time. The pennies or cents are its minute hand, and the Pounds or Dollars its hour hand.

The great mistake when viewing money historically, is to rob money of time. Most economic textbooks and authors of Modern Monetary Theory all make the same mistake. They treat money mechanically. Money is the mechanism needed to exchange goods we are told. Actually, the reason money came into being is because of time, in this case the increasing time wasted by bartering as the numbers of exchangeable products grew.

So, society set aside an object to act as money. But not any object. It too was selected on the basis of time. Either it was scarce enough so its collection consumed much time, making it an object of value, or it had to be produced which took time too. The variety of durable objects acting as money historically is not worthy of consideration here and belongs to a different sphere of study. Suffice to say is that none of these products grew on trees, meaning barely any time had to be spent on their acquisition.

To function as money, any object must be universally accepted as the form of money. Ultimately the ideal object became gold. Difficult to mine, therefore full of labour time, durable and dense, it was the perfect monetary object. An ounce could circulate a hundred weight of iron.

The real problem with the discussion on money is when time has not been consumed producing it. This occurs when money is reduced to a symbol, legal tender, a piece of paper. To print eight \$100 bills costs just \$1. A dollar bill has no intrinsic value and can no longer be redeemed for gold. Theoretically a \$100 bill could fall to just 12.5 cents which is its cost of production.

So, what is to prevent it from depreciating like a stone? The backing of the state. And how does the state establish this backing. Through sound finances. That means keeping its assets and liabilities in good order. This reduces to: managing its spending in relation to its income.

The state may have the prerogative of printing money. Unlike the MMTeers, this is not a freedom but a discipline. To understand this, we need to recall that labour imparts value to production and its contribution is measured by time. Taxation does not create value. What it does is to divert of part of this value produced in the private sector from the private sector to the public sector. In turn when the government spends its taxation it returns this value to private sector in the form of purchases and salaries.

Provided the value withdrawn from the private sector approximates the value returned to the private sector, the balance in the flow of value is not disturbed. Under these conditions, and in the absence of a balance of payment crisis, the currency is not under pressure. All it is doing is lubricating the flows. Karl Marx was quite right to state, as against the charlatan Keynes, that it is the flow of commodities that determines the flow of money. More precisely, the quantity of money sucked into circulation is determined by the quantity of commodities being bought and sold times their price adjusted for the speed of their circulation. To this he added, an additional sum to be used as means of payment, that is the settling of credit obligations.

Now let us see what happens when this balance and relationship is disturbed. Here the MMTeers have a point. Only the state as the issuer of paper money can disturb the balance. Keynes used to quote the following statement repeatedly which was first voiced in the US Congress, "that pushing money into the economy was like pushing on a piece of string". But what he was referring to was pushing money at the capitalist class. Now it should be noted, the capitalist class is not short of money. Instead the problem is they are not spending it, so offering them more money was absurd, like Keynes himself. The real problem facing the capitalist class in a recession is that they have too much capital, that is in relation to the profits this capital can earn.

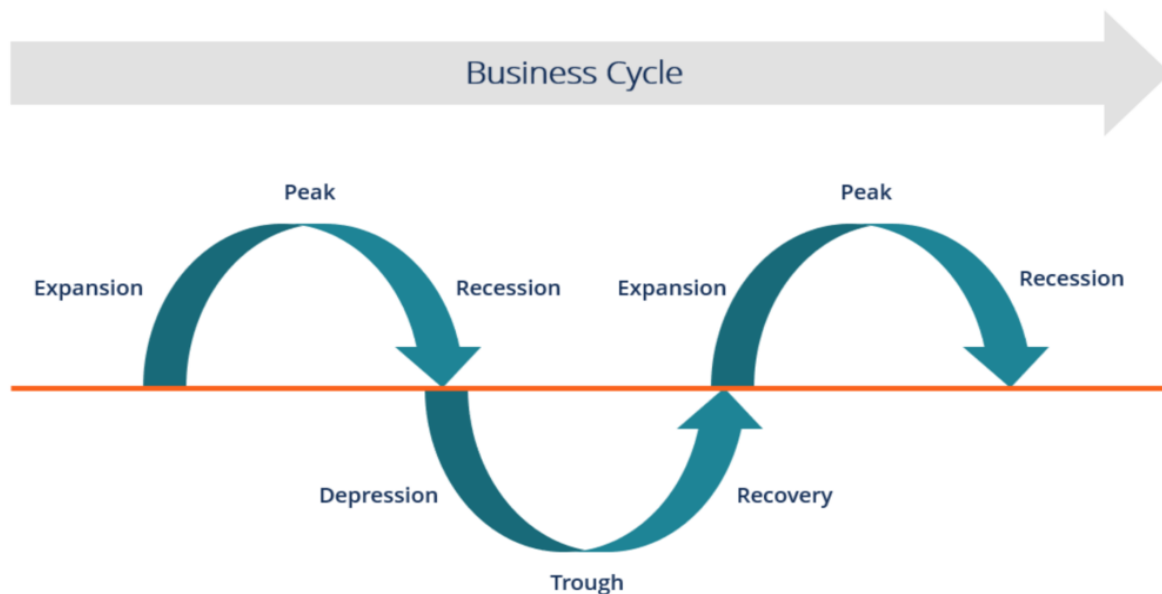
Where the MMTeers differ from Keynes is that in the main, they do not intend to inject money indirectly into the economy, via the capitalist class. They intend to inject it directly, through state investment, the provision of state services and state housing. Under this condition the piece of string is now stiff with political starch. Further they seek to simply print money, not raise taxes. The Federal Reserve or the Bank of England will print extra notes, bag them and truck them over to the Treasury to finance their increased spending. No public debt is involved because there is no transaction with the private sector. The state is not borrowing private idle hoards, but has printed its own temporary hoard ready for reimbursements.

So far so good. However, now there is an inversion. Now it is money leading commodities. Money loses its neutrality. Now it is no longer the case of money being sucked into the economy like an old carburettor but injected into the economy. This money will be spent. It will enter circulation. It will buy goods. Some of the goods will be means of production and some articles of consumption.

Will this be inflationary, and will it produce a balance of payments crisis? To answer this question, we need to return to basics. Why are factories idled, and why are workers fired or not hired? It all has to do with profitability. In a system where production is for profit and profit alone, this question cannot be avoided.

But the MMTeers do avoid this question. For them it is the lack of money is both cause and cure. It is the lack of money in the economy, not profits. The irony is that the unless the injection of money into the economy stirs up inflation it is not working. This flies in the face of the MMTeers assertion that in the presence of excess capacity and unemployed workers, the injection of money will not lead to inflation until all the idle capacity is used up as well as labour.

This kind of thinking is conditioned by the business (industrial) cycle itself. It is only at the peak of the cycle, what Marx termed the phase of overproduction and over-investment, that inflation tends to rise significantly. That is when capacity is stretched. (It is interesting that the graph below expresses six phases, the same number as Marx though he described them somewhat differently as prosperity (expansion), overproduction (peak), crash (recession), stagnation (depression), inactivity (trough) and rising animation (recovery).



(Source: <https://corporatefinanceinstitute.com/resources/knowledge/economics/business-cycle/>)

But why would inflation break out outside the phase of over-production or peak, when capacity is stretched. It has to do with profits. As far as the individual capitalist is concerned profit margins can be increased either by raising selling prices or reducing cost prices. And if profit margins are increased so too will be the mass of profits and with it the rate of profit. Thus, marginal capacity will only be commissioned, if selling prices can be raised.

One easy example will demonstrate this. Let us assume that the government decides to give their employees a back dated increase in wages of 20% not paid through taxation but the printing of money. Unlike the capitalist class, workers do not have the luxury of spending or saving. So, let us assume that the workers receiving this pay rise decide to replace their worn-out things and add variety to their meals and clothes. Immediately shops, both physical and online, will experience a surge in demand. Some of this demand will translate into price rises. Farmers and other producers will soon clamour for the price squeeze imposed on them by the supermarkets to be lifted.

Clearly if public sector workers are enjoying pay rises this will filter through the labour market to the private sector. Hence a general rise in wages may be forthcoming. But if wages are rising, so too will cost prices. If other inputs rise in price so too will cost prices. One capitalist's rise in selling-price will be another capitalist's rise in cost-price. The whole process is self-defeating. Higher selling prices are negated by higher cost prices. Profit margins in the end do not increase.

What does increase is total prices. This impulse of new money has depreciated money and repriced the value of production. Nothing much has changed in terms of profitability except that profits are repriced upwards. But then so too have costs. They cancel each other. More banknotes change hands but that is all. Marx pointed out in *Das Kapital* that if prices doubled it would not alter the rate of

surplus value (exploitation) and therefore the share of profits would not change, despite the fact that in monetary terms they have doubled.

The point to make is that if the infusion of money into the economy does not lead to real investment, which it is unlikely to do because of its self-defeating nature, then the temptation will be to infuse more money into the economy. Thus, MMT despite its pretensions, does potentiate inflation. (This is a slightly different approach to my first article. The link to this article on MMT is: <https://theplanningmotivatedotcom.files.wordpress.com/2019/02/multiple-monetary-theory-pdf.pdf>)

Of course, if prices do not change then it means the injection of money into the economy is being hoarded or being used for speculative purposes.

All the central banks are already MMTeers.

The FED is quite explicit. It seeks a 2% rate of inflation. No one questions this. They should. Why does the FED want inflation in the first place and why 2%? This is not the natural increase in prices, because there is nothing natural about price increases. Why not aim for zero price increases? Why is the FED so scared of deflation?

The New Zealand Central Bank was the first to set an inflation target in 1990. Other banks followed with the FED turning its unofficial target into an official target only in 2012. It is no accident that inflation targets have become official only in the last 20 years. Cynics say this is because it is the last target left standing. All previous targets, like exchange rates, have proven to be unattainable. Undoubtedly its delay must also be due to the severe resistance within the ranks of the capitalist class itself to this target, because after all, they are mainly creditors. Creditors hate inflation because it favours debtors by devaluing debts. Over 20 years, a 2% inflation rate turns every \$1 of debt into 67 cents, a loss of one third to the creditor.

Two reasons are given for the need for inflation. One is bunkum the other spot on. The bunkum reason given is the fear of deflation. Deflation is associated with depressions. Sometimes it is even given as one of the causes for the depression, and if not the cause then for the enduring nature of that depression. Of course, this is confusing cause and symptom. It is like saying that a patient, having lain exposed to the elements and falling into hypothermia, is hypothermic because the thermometer registers a low body reading. It is the equivalent of blaming the thermometer rather than winter for the condition. Deflation occurs because of the paralysis of investment and investment becomes paralysed because the rate of profit has collapsed.

Even when economists do not attach deflation to depressions they still say, ahah, deflation curbs spending under all conditions. *"The first relates to a shift in "consumer expectations", in that if consumers come to expect prices to decline in the future, they may delay purchases for as long as possible."* <https://vickeryfinancial.com/federal-reserve-want-inflation/> Oh dear. Are they not aware that all the products enjoyed by the masses, the so-called mass market, were the product of deflation? Without the rapid cheapening of products, they remained luxury goods, unaffordable and produced in small volumes. The motor car was invented in Germany in 1886 - the Benz Patent-Motorwagen. However, before the Model T was brought out in 1908 there were fewer than 200,000 cars on the road worldwide. By May 1927, 15 million Model T's had been built and sold. The reason, the assembly line which dramatically reduced the original Model T's sticker price of \$825.

The same is true of white goods, jet travel, electronics and so on. The latest example is flat screen televisions which started off costing tens of thousands and sold in their thousands, now they cost hundreds and sell in their millions. History does not support the assertion that price falls leads to less

spending. Rather price falls broaden and deepen markets. Depressions are not driven by the absence of consumer spending but to the absence of investment.

To illustrate the point, I have added a spreadsheet. In this case I have used industry wide figures to simplify the calculations rather than corporate data which requires more refining. The calculations on the spreadsheet showed that total investment in 2017 comprising circulating capital and gross fixed investment is 89% the size of personal consumption expenditures or final consumer spending. Moreover, it is investment not consumer spending that is more volatile. As a previous article shows, the volatility of investment is 2.7 times that of consumer spending. Multiply this volatility with a figure that is only 10% less than consumer spending, and it becomes clear very quickly, that the real driver for the change in market conditions is not personal consumption but investment itself. Investment decisions of course are not made by workers but by capitalists. Workers are merely the victim of these decisions.

While we are on the issue of working capital let us take a swipe at all those fiat money internet professors. It falls to every generation, especially when a novel form arises, to rediscover the wheel. Over a hundred and fifty years ago, those who worked for the bank of England, as remarked upon by Marx, were totally at ease with credit being created with the swipe of a pen instead of the return key on a computer as would be the case today. Marx also wrote at length about trade credit, noting that outside retail, most commodities circulated against credit and not money. Indeed, money was reduced from the means of circulation to the means of payment, that is clearing credit on due date, or in the case of Bill Dealers, settling the balances between bills payable and receivable.

Over these 150 years little has changed in this regard. Trade credit is still the biggest form of credit in the capitalist mode of production. It is not mortgages, it is not corporate bonds, it is not even government gilts or treasuries, but trade credit. In the spreadsheet, the amount of circulating capital less retail is \$11.3 billion. It is impossible to quantify how much of this is circulated by credit. But even if it is half, that is over \$5.5 trillion in 2017. This compares to new issuance of treasuries in 2018 of \$1.34 trillion (<https://www.businessinsider.com/new-us-debt-in-2018-how-much-highest-recession-2018-10?r=US&IR=T>) new corporate debt issuance of the same magnitude in 2017 (Source: Mike Smith, <https://www.sifma.org/resources/research/us-corporate-bond-issuance/> and net residential mortgages of \$0.57 trillion (<https://www.federalreserve.gov/data/mortoutstand/current.htm>)).

Together these two forms of longer-term dated credit total \$3.25 trillion, still well below the \$5.5 trillion of assumed trade credit. Not only is trade credit much larger, but it is more vulnerable to the industrial cycle. A deceleration in the rate of turnover of this capital always strains this form of credit as producers and distributors find it difficult to discharge or refinance their credit when turnover stalls. Once this chain of trade credit shatters, as it does at the peak of the industrial cycle, the recession proper commences. This does not rule out a crisis beginning with, or, exacerbated within the longer dated credit markets such as mortgages in 2008, an event which can be described as being of a purely financial nature.

Returning to deflation. The real reason capitalists are petrified of deflation is hinted at by Vickery Financial quoted above, *"Finally, a lesser-known benefit of positive inflation is the improvement of employer flexibility on labor costs."* The Economist magazine concurs: *"But if inflation is high, then the real cost of labour can fall even if actual wages don't (because workers become cheaper relative to the goods they are producing), so firms face less pressure to sack workers in a downturn."* (<https://www.economist.com/the-economist-explains/2015/09/13/why-the-fed-targets-2-inflation>) Lesser! Really! The primary reason that the capitalist class is desperate to avoid deflation is their fear of the class struggle.

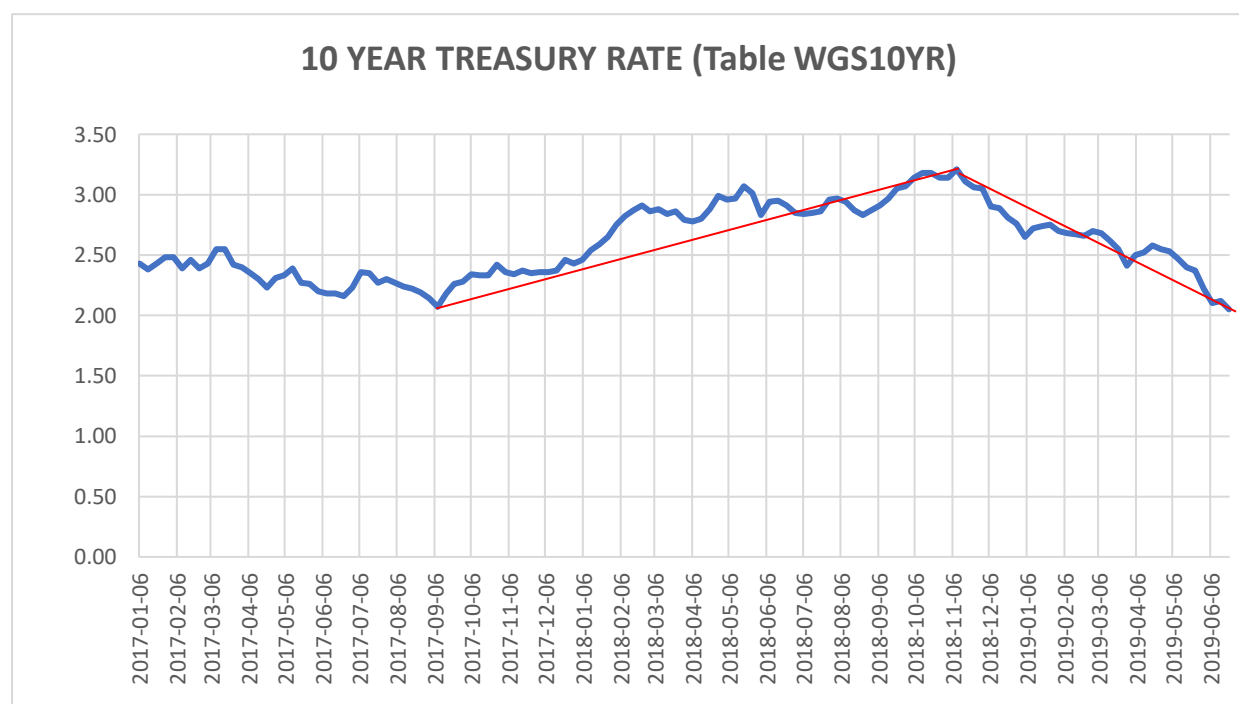
The 2% figure is not arbitrary. It is the average (until recently) annual productivity gain for the non-farm sector. This data can be found on the Bureau of Labour Statistics website. Between 1990 and 2012 annual average increases in non-farm all-business productivity averaged 2.2% which is proximate to 2%. (Table PRS85006092 <https://beta.bls.gov/dataViewer/view/timeseries/PRS85006092>) It follows that if workers do not get a wage rise or get a rise less than 2%, then some or all of their productivity gains would go to their employers. If prices did not rise, it would mean that any rise in wages would soak up these productivity gains.

Finally, if prices were falling but wages were not, then most of the productivity gains would be diverted to workers. Imagine how wage negotiations would be conducted against a background of deflation. The opening gambit by the employers would have to be, *"this year we are going to cut your wages by 2%."* In effect, this would not represent a pay cut because prices are also falling by 2%, but it would mean all of the productivity gains would belong to the employers.

Thus, deflation would force the bosses to cut monetary wages, whereas inflation allows them to raise monetary wages thus defusing the class struggle. Losing part of their capital (debt) to inflation is a small price to pay for the employing class, when it enables the fraud (inflation) which diverts productivity gains back into their pockets. This is the reason I have insisted that inflation is good for capital while deflation is good for labour.

Returning to the real world and the FED. The mandate of the FED is a 2% inflation target (as well as restoring full employment whatever that means). Currently everything is going wrong. The budget deficit is soaring to 5% of GDP while inflation is plummeting. Price rises are trending towards 1% and beyond, away from the promised land of 2%. At this rate the USA will shortly be joining the EU and Japan teetering on the precipice of deflation.

And this is happening at a time when interest rates are falling as well. The fall in the important 10-year Treasury bond rate is found in the graph below.



We note that it took nearly 18 months for the rate to rise from around 2% to 3.2% but only 6 months to fall back to around 2%. It now looks likely to fall below and stay below the 2% mark, which by some inflation measures puts the real rate of interest below 0.5%. Thus, the ammunition locker of the FED is looking a bit bare. In terms of inversions. Currently the 10-year bond interest rate remains below that of the 3-month rate and it is only 0.2% higher than the 2-year rate. This is happening despite the collapse in the 10-year rate which is unusual, and what else is unusual, is the duration of this inversion and compression of rates.

Therefore, in terms of interest rates the FED does not have much room to manoeuvre. This applies to both the short and long end. Here the long end is more important. If the FED restarts quantitative easing (QE), this will apply to longer term bonds whose rate of interest is already below 2%. As the effect of QE is to force down interest rates, it could push them to below 1%. For the US Treasury, which is custodian of the world's reserve currency, this is highly problematic.

The combination of a rising budget deficit and falling prices is a bad omen, a harbinger of things to come. Over May and June, the US economy hit the wall. It is now not only in a profit recession, but an investment and industrial recession. This is what FactSet had to say about its perspectives for 2nd quarter S&P 500 profits (April – June) *"2nd Highest Number of S&P 500 Companies Issuing Negative EPS Guidance for Q2 Since 2006."* (June 28 release).

Which leaves only the injection of money into the economy to combat deflation. But this is money not aimed at purchasing back debt. It will be money injected directly into the economy. Already the governor of the FED in California says she is amenable to this proposal. Undoubtedly others will follow her lead. The MMTers may find they are pushing at an open door.

But this proposal is not borne of a new idea, but of desperation. How to avoid a depression at any cost. The fact remains: the theorists of MMT do not understand money, do not understand value and where it arises, and they do not understand the role of profits in the economy. They are the equivalent of pilots trying to fly the 737 MAX who are oblivious to the feature called *Angle of Attack (AOA) Disagree alert*. They may claim to be qualified to steer the economy, or fly the plane, but are they, and would you like to board the plane?

When Xi met Trump in Osaka.

This meeting was the equivalent of two punch drunk fighters with cracked glass jaws. It was a negotiation conducted while both men were on their knees. The Chinese and US economies are hurting. Thus, it was predictable they would press the pause button in the trade war. If anything, it was Trump who stepped back, now that he belatedly understands the interconnectedness of the global economy. The US administration will no doubt explore new choke points to hurt the Chinese economy, ones that potentiate less collateral damage to the US economy, as the US pursues its strategic imperative, which is to prevent China overtaking the US economically and in defence of the Dollar.

One clue to how much the US economy is hurting is highlighted by the numerous tweets Trump is aiming at the chairman of the FED. Already Trump is looking for a scapegoat, someone to blame for what is going wrong in the economy. Interest rates, not an unaffordable tax cut, is being primed to take the fall. Trump is right to worry about his election prospects, industrial production is falling, investment is falling, profits are falling, and the farm belt is under water.

And yet despite, "the in your face hard and soft data" and a trade war, shares on Wall Street have had their best June in 81 years. Surely a case of heavily sedated algorithms. This has gone beyond

grandstanding. It is starting to make the latter half of 2007 and the first half of 2008 look like a B-movie. Then the price of bundled mortgages barely changed despite mortgage defaults going through the roof. Now it is the case that barely a ripple breaks the surface of the sub-prime pond filled with high yield and junk bonds.

China on the other hand, with its more numerous policy tools, has once again embarked on a programme of infrastructural spending. This is a miscalculation. The logic of this kind of spending is to fertilise downstream private investment, precisely the kind of investment that is no longer taking place because of over-capacity. The latest release on investment shows that the purchases of equipment and instruments (means of production) fell by 2.2% during the first five months of the year while overall investment in production (secondary industry) at 3.2% barely covered inflation. (www.stats.gov.cn/enGLiSH/PressRelease/201906/t20190618_1671112.html) Profits continue to fall, they fell by 2.3% for the first five months, but the overall fall is reversing slightly. This is mainly due to the infrastructural surge and profit growth in the oil industry. The rate of profit remains in decline, because, while total assets went up by 6.3% in May, profits only rose by 1.1%. www.stats.gov.cn/enGLiSH/PressRelease/201906/t20190627_1672893.html

Thus, the world economy remains in a precarious state with the trend continuing to deteriorate. The trade truce will not make much difference. The slowdown began before the trade war, and, whatever deal is struck between China and the USA, trade barriers and a fractured global market will remain. This makes the situation distinct from 2008 when globalisation was intact and international co-operation possible.

Under these conditions we can expect a move in the near future from monetary easing to monetary injection. Desperate measures for desperate times.

Brian Green, June 2019.