THE MODERN MONETARY SYSTEM

a visual model

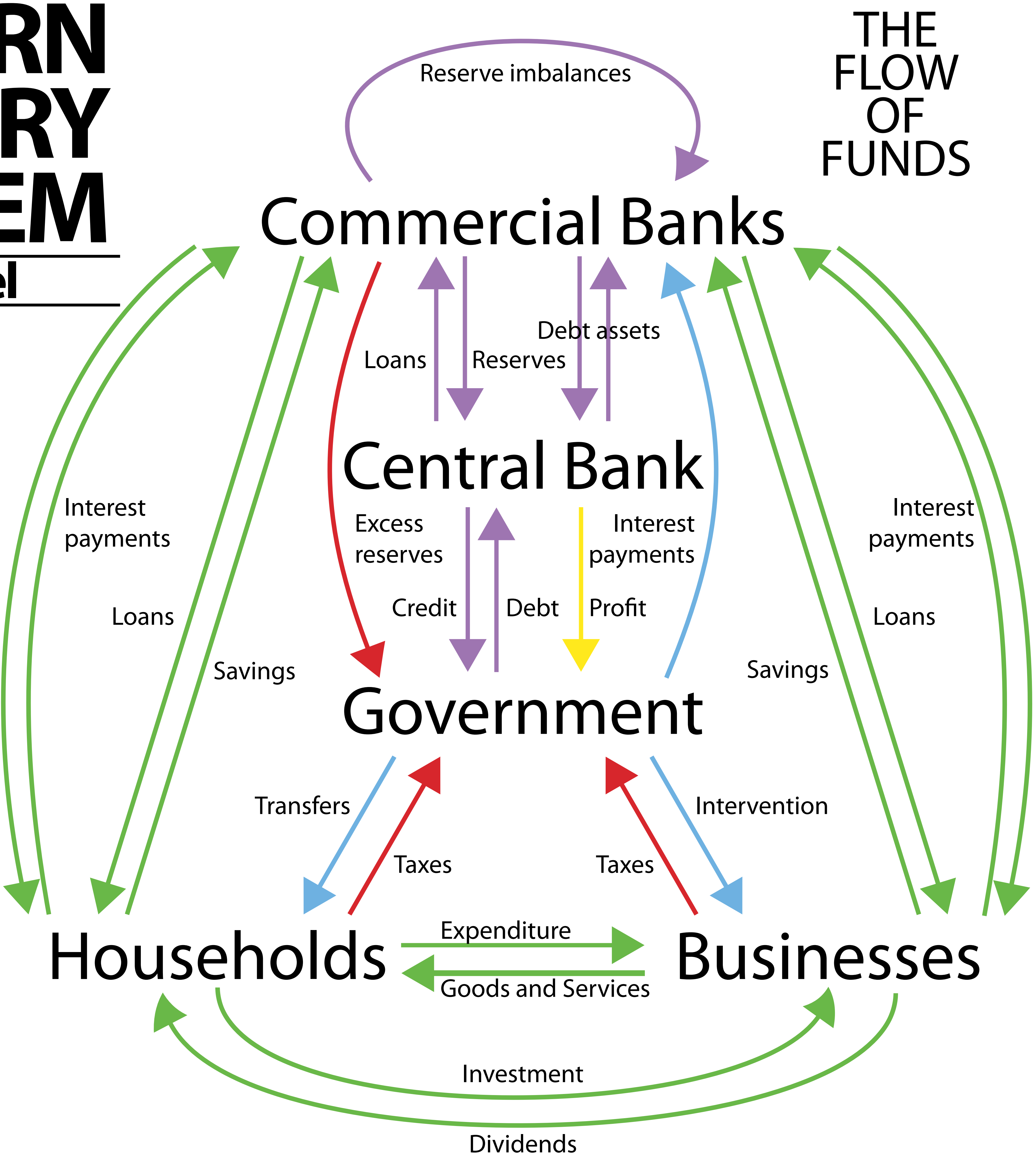
WHAT IS MMT?

Modern monetary theory is not so much a theory as it is an accurate description of how savings and debt are created and destroyed in a modern fiat money economy. The old neoclassical models in mainstream use today rely on specious assumptions about human behaviour - the Efficient Markets Hypothesis even requires us to be able to look into the future! MMT only makes readily falsifiable claims about how the financial and government sectors interact in the strange dance that we call the fiat money system.

MMT is the modern revival of chartalism (not charlatanism!), from the Greek 'charta' which means 'token'. It is the study of token currencies, which are devoid of intrinsic value and may be issued in unlimited amounts by a currency issuer. This has far-reaching consequences for the way we think about money - not since 1971 has any monetarily sovereign government had any constraint on spending or impetus for taxation except for the risk of inflation.

Before the 2008 financial crisis hit (and, ironically, afterwards) MMT was frequently criticised for being more accounting than economics. A meta-study of the academic literature to find economists who predicted the crisis found just thirteen people worldwide. The common element to their work was an emphasis on accounting.

Most of the economics that influences policy today has more or less ignored the realities of the modern monetary system. Outdated notions like "financing the deficit" and "fiscal austerity" are still seen as important issues by policymakers and academic economists alike. In the wake of the worst economic crises since the Great Depression, it is time to wake up.



Colour Key

Horizontal transactions
move funds within the private sector
Private trade
Financial market

Vertical transactions
create and destroy net private savings
Net savings created
Net savings destroyed

Other transactions
do not involve the private sector
Legal requirement

HOW DOES IT WORK?

When the Government wants to spend, it issues bonds - basically IOU notes with interest, paid to the holder of the note - and lists them for sale to commercial banks on the open market. It then spends the money in the private sector by mass electronic bank transfers at the central bank (which is the special bank used by the government, where commercial banks must keep their reserves) to the reserve accounts of the banks of the recipients of that spending. These banks find themselves with excess reserves, and they don't want to just sit on them because the central bank pays them little to no interest on reserves. They can't lend them to other banks, because they find the other banks have excess reserves too. They can't lend them to customers, because they've already serviced all the customers - no bank manager ever leave a customer waiting for a loan because of a lack of reserves. So the banks buy the only safe, interest-bearing asset left to them: the bonds that the government listed for sale to borrow the money to spend in the first place. It doesn't matter which order it happens in - the end result is the same: goverment debt generates its own demand simply by being the only thing left to spend excess bank reserves on.

WHAT DOES IT MEAN?

It means that only the government can create and remove savings, net of debt, from the private sector.

It means that the government never needs to worry about "financing the deficit" - deficits finance themselves. Unlike governments who have yielded control of the currency to an external body - eg: in the eurozone - governments with control of their own currency can and should make spending decisions based only on the needs of its citizens - never on any outdated ideas about "fiscal responsibility".

It means that the proper response to an economic slump - when low aggregate demand is killing jobs as everyone perpetuates the cycle by trying to save more money - is for the government to spend until the people's demand for net savings is satisfied, and life resumes as normal.

It means that our policymakers have it completely backwards.

MOSLER'S LAW: There is no financial crisis so deep that a sufficiently large tax cut or spending increase cannot deal with it.

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