The political economy of modern money theory, from Brecht to Gaitskell

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Just over a century ago, in a lecture at the London School of Economics, Dennis Robertson, the friend, critic and rival in monetary economics of John Maynard Keynes, bemoaned his lot as an expert on money, beset by monetary schemes of social improvement:

> "… one cannot set up, even in the most modest way, as a writer on monetary affairs, without becoming the target for a continuous stream of documents – manuscript, typed and printed – designed to show that the ills of the human race are all due to monetary mismanagement, and all curable by monetary manipulation. In the back streets of London suburbs and northern industrial towns, on the plains of India and the prairies of the Middle West, those who have Found the Light about Money take up their pens and write, with a conviction, a persistence and a devotion otherwise only found among the disciples of a new religion. It is easy to scoff at these productions: it is not so easy to see exactly where they go wrong. It is natural that practical bankers, vaguely conscious that the projects of monetary cranks are dangerous to society, should cling in self-defence to the solid rock, or what they believe to be so, of tradition and accepted practice. But it is not open to the detached student of economics to take refuge from dangerous innovation in blind conservatism. He must assess with an equal eye the projects of reformers and the claims of the established order; and to this end he must build up for himself a theory of money – a critical analysis of nature and results of the processes by which, under a modern system of banking, money is manufactured."[1]

Robertson could have been writing about modern money theory. The reference in his final sentence to the way in which "money is manufactured… under a modern system of banking" anticipates the insistence in modern money theory that money is always and everywhere credit money designed to repay debts. Even his location of the source of monetary reform in "the prairies of the Middle West" could be a reference to the members of the Economics faculty at the University of Missouri at Kansas City, who have devoted books and briefings to the promotion of Modern Money Theory. Practical bankers have by and large ignored their promotion – the practice of modern banking leaves little time for serious reading about monetary theory. But the policy doctrines associated with modern money theory have resonated with political movements opposed to the fiscal austerity of recent times. And the claims of Modern Money Theorists to being a legitimate strand in Post-Keynesian ideas have caused outrage among Post-Keynesians who believe themselves to have a more legitimate line in monetary theory.

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[1] D.H. Robertson "Theories of Banking Policy" in *Essays in Monetary Theory* London: P.S. King and Son, 1940.

Modern Money Theory is not so much a systematic exposition of what money is and how it works in a capitalist economy,[2] as a set of doctrines with policy implications that promise to resolve the (monetary) ills of our economies. The principal doctrine is the notion that all money is state money, issued by governments when it spends money. Taxes are not necessary to finance that expenditure, but merely need to be large enough to make people hold that money, and hence "value" it. In the Theory, these doctrines are linked to a concept of "functional finance" originally put forward by Abba P. Lerner, an early feature of which (he was to drop it later on) was the observation that, in contrast to borrowing money, the monetisation of government expenditure (its financing by the central bank's creation of money) is costless, in that the government does not have to pay interest on cash.

Proponents of Modern Money Theory have been active in promoting active intervention in the labour market through a policy of having the government acting as an "employer of last resort" for the involuntarily unemployed. But this is not an essential part of the Theory and there is nothing particularly monetary about such a policy. The most essential revelation is its policy doctrine that fiscal deficits (the excess of government expenditure over revenues) that have been monetised are in effect "free money" that does not have to be repaid. Most recently, Modern Money Theory has been called upon to support fiscal initiatives that are not necessarily intended to provide last resort employment, such as the Green New Deal advanced in more radical sections of the Democratic Party in the US, or the protests of their comrades in Europe, railing against the fiscal rules preventing government expenditure to overcome Europe's economic depression.

So what is wrong with modern monetary theory?

If it is all so simple, and "free" government money can pay for everything, what is wrong with it? After all, the loan from the central bank to the government (the way in which a government deficit is "monetised" in a modern economy that uses bank deposits as means of payment) may easily be made effectively non-repayable by being "rolled over" or renewed on maturity, and any interest on the loan from the Bank (minus the Bank's costs) is added to the Bank's profits which of course belong to the owner of the Bank, the government. In this way, monetisation costs the government and the tax-payer virtually nothing. This economical, apparently free, method of financing government expenditure is of course attractive when public services, welfare and infrastructure are deteriorating in the face of austerity. But this low cost is only the case *at the time of the expenditure*. To understand the true efficiency of this kind of financing, it is necessary also to consider the consequences of such financing. In particular, it is necessary to understand how that money would be absorbed by the economy; in other words how money circulates.

Supposing that a new Democratic administration in the White House decided to raise expenditure on a Green New Deal to the value of 5% of GDP in each year of its four-year administration, and "monetised" this extra expenditure, leaving the rest of public expenditure to be covered by taxation or borrowing. After four years, the total money stock of the country would have increased by 20% of GDP. Supposing further that economic activity accelerated (in accordance with the Keynesian government expenditure multiplier principles) up to 3% per year, on average over that four year period. One could make the case that, with GDP 12%

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[2] That is, "debate on the influence of money and monetary policy… how does monetary policy affect the economic system and how effective is it (or would be) in achieving its aims." (V. Chick *The Theory of Monetary Policy* London: Gray-Mills Publishing 1973, pp. 1-2.

higher at the end of this Democratic administration, "normal" economic activity would absorb in the usual exchange and financing 12% out of the 20% of the increase in the money stock. But what would happen to the rest? Where would it go?

To answer this question it is necessary to look at how money circulates in the economy. The essence of a profit-making, capitalist economy, is that firms make profits and, in this way, accumulate monetary savings or reserves. Not all of course make the same rate of profit: many small businesses operate at a loss, or just break even. It is large corporations that have the highest rates of profit, due to their market power and their control over resources through their extraordinary ability to tap the whole range of financial markets. Through this economic activity, the extra money spent by the government will end up being accumulated by corporations, their shareholders, and the banking system that holds their accounts. If those corporations and banks are happy to hold onto this extra liquidity then there is no problem with the monetisation.

However, if the monetisation is done by a government to finance a radical programme, then it is unlikely that big business and its allies in banking and finance will contentedly sit on their accumulations of bank deposits. To paraphrase Kalecki, the cry will go up that the situation is "manifestly unsound" and they will find more than one economist to adjudicate that the increase in the money supply is inflationary. Even if there is no inflation, economists can be relied upon to provide models that will show inflation accelerating in the future. Paul Volcker's recent memoir, written with Christine Harper, and published to glowing reviews in the financial and business press, inevitably makes the case for the moment of glory in the central banker's career, when he crashed the US economy by squeezing the money supply in order to bring down inflation[3]. It also shows just how close is the reaction of Robertson's "practical bankers" who will cling in "self-defence to the solid rock, or what they believe to be so, of tradition and accepted practice" against "monetary cranks" behind radical policies.

This simplistic thinking will add to the political difficulties of any expenditure programme undertaken by a radical government. The alarm will be raised among corporations, banks and the rich, that their bank deposits are about to be devalued by inflation. In any other country in this situation there is only one thing they can do: convert their bank deposits into bank deposits in a currency deemed to be more secure (the US dollar is the traditional haven in inflationary times). The result will be a currency crisis and the eventual devaluation of the country's currency. That devaluation of the currency, by increasing the cost of imports, will then cause the inflation that was the pretext for the alarm.

The exception here is the United States. Its currency is the reserve currency of the world and "safe haven" for the savings of the rich in the rest of the world. This means that the rest of the world stands ready to absorb any amount of excess liquidity in the US financial system, as it has demonstrated during the recent period of near zero interest rates at the Federal Reserve. However, under Trump-nominee, Jay Powell, that period is coming to an end and, with the slow-down in Chinese economic growth (the real engine of global economic growth in recent years), and the continuing economic stagnation in Europe, the American banks are becoming reluctant to direct their liquidity into underwriting meagre returns in the rest of the world. Much like after the First World War, America's excess liquidity will be ladled into American financial markets, there to cause not so much a renewal of inflation in the economy at large, but

[3] Paul Volcker with Christine Harper *Keeping At It: The Quest for Sound Money and Good Government* New York: Public Affairs, 2018.

financial instability, the responsibility for which can be laid at the door of any radical administration and its "unsound" monetary practices, exposed by the infallible insights of those "efficient" financial markets.

Monetisation of government expenditure may therefore be effective on an occasional limited basis. But a systematic policy of monetising public expenditure hands ammunition to the enemies of any radical change, whether it be socialism or the programmes of populist national solidarity espoused by the current administrations in London and Washington, Warsaw and Budapest. The greater is the monetisation, the greater is the mass of credit that can be mobilised by those enemies to bring about the financial crisis that their agents can blame on the "unsound" expenditure, monetary practice and fiscal policies of any genuinely reforming government.

Keeping money stable

That said, it should also be pointed out there are ways in which a government can increase the ability of the financial markets to absorb larger amounts of money. This is through expanding the long-term debt financing of the government and the taxation of wealth. When the government borrows money to pay teachers, pensioners, policemen, doctors, civil servants, and government contractors, and to subsidise the consumption of the less well off, it drains the "idle" liquidity that lies around in bank deposit accounts and transfers it into circulation in the "real" economy. This increases the "government expenditure multiplier" that drives the fiscal stimulus of the economy. Of course there is a cost to this, in the form of the interest that the rich will have to be paid for their loans to the government. But as long as the borrowing is in the domestic currency that the government issues, the government itself can fix the cost of its borrowing, whether through the rate of interest on reserves held at the central banks, or by "trading along the yield curve", that is by issuing short-term bonds and using the money raised in this way to buy in more scarce long-term bonds, pushing up the price of those bonds until the yield or interest rate on them is sufficiently low so that new long-term bonds can be issued to repay the short-term borrowing and "fix" the lower rate of interest in the long-term bond market. This is unusual, but not an unprecedented procedure in monetary control: it was used in the Depression and, most recently in America in November 2011, to bring down the rate of interest on long-term bonds.

Should we worry about the interest cost of the borrowing? Not really, as long as the tax system is adjusted to ensure that the interest cost does not entail undue transfers from tax-payers on modest incomes to wealthy bond-holders or rentiers. In the past the remedy recommended political economists from Ricardo to Schumpeter, Keynes and Kalecki, to overcome this regressive transfer of financial resources was a "capital levy" or a tax on wealth to pay the government's cost of borrowing, so that its financial budget was balanced. In the case of the United States, most government bonds are held by central banks and associated government agencies, and most of the rest is held by pension funds and insurance companies. Given the sorry financial condition of most mass pension funds, there may even be a case for raising the interest rates on government bonds. But there is certainly a case for reducing the tax privileges of the small number of the wealthy who use their privately managed pension schemes as a way of evading tax. The situation in Europe is rather different, because of restrictions on fiscal deficits and the limited bond operations of the European Central Bank.

Ideally, government borrowing should be repayable in the longest possible term, to fix the government's borrowing costs into the future and reduce the government's reliance on refinancing bonds when they come up for repayment. This too has the benefit of tying up those "idle" bank deposits in the secondary markets for long-term bonds: the rich are usually old (which is why they celebrate the young who inherit their wealth) and are unlikely to live to see the repayment of, say, a thirty-year government bond. But the secondary markets, where already issued bonds may be traded, are places where the rich may get their money back early from their thirty-year investment, turning over their "idle" bank deposits in buying and selling those longer term bonds. We may, along with Keynes, disparage this as mere "speculation". But as long as the rich are with us, and can derail progressive policies with their speculations, government borrowing to drain off their liquid assets must be an instrument of monetary control.

The other technique of keeping "idle" bank deposits stable is through taxes on wealth. The rich keep an inordinate amount of their wealth in the form of assets that are illiquid, that is they take a long time to sell, and may not sell for a good price. Most notable among these assets is residential real estate, designed to impress other members of the property-owning class, but rarely bringing in sufficient revenue to cover the running costs and maintenance of what Veblen called "conspicuous consumption". Taxes on such wealth oblige rich people to keep bank deposits in their portfolios to service their fiscal obligations. In this respect there is a glimmer of truth in the doctrine of Modern Money Theory according to which taxes are only needed to maintain the value of money. This is nonsense in any country whose tax-payers can dollarize to get better value out of US dollars than that country's currency. But it is true of wealth taxes in the United States, where residents cannot efficiently diversify into another reserve currency, so that wealth taxes oblige them to value their bank deposits above the dollar or nominal value of those deposits.

The rich will of course object mightily on the grounds that the object that is being taxed brings in hardly any income, in much the same way that British landowners, their revenues reduced by Free Trade in agricultural products, objected to Lloyd George's 1909 Land Tax to pay for the first state pensions, and created a constitutional crisis in a country still dominated (to this day) by semi-feudal institutions. But we should shed few tears of sympathy for them. They will of course receive this money back in interest and repayments on the government bonds that they hold; and to the companies that they own will accrue as profits the government's expenditure on that Green New Deal, or the expenditure of government employees and welfare recipients.

Brecht and the economics of everyman

Despite the best efforts of its academic partisans to ennoble Modern Money Theory with antecedents in the work of John Maynard Keynes, Georg Friedrich Knapp, Michał Kalecki, Abba P. Lerner, and Hyman P. Minsky, the theory itself bears little resemblance to the systematic thinking (as opposed to incidental insights) of these luminaries. For those partisans this may be evidence of the originality of Modern Money Theory. But the theory itself is not new. Its elements may be found in one of Bertolt Brecht's less well known plays, *The Days of the Commune*, portraying the rise and tragic fall of the Paris Commune of 1871 and one of the few stage plays to feature a central banker.

One scene of the play recounts a confrontation between a Delegate to the Commune, known only as Beslay, and the Governor of the French central bank, the Banque de France while, outside Paris, in Versailles, the government of Adolphe Thiers is conniving with the Prussian invaders to crush the Commune. In the play, the Governor is unnamed. But at the time of the Commune, it was Goustave Rouland, a French politician rather than banker, remembered today, if at all, for having preserved the Banque's gold reserves through the political crisis, but also for an interest in European monetary union on the basis of coinage minted in different countries but containing a standard amount of gold. Rouland had had a previous appointment as a Minister of Religion, where he sought Papal approval for theological training in state institutions in France. This may explain why he appears in the play entertaining the Ecclesiastical Procurator of the Archbishop of Paris: (The Archbishop was taken hostage by the Communards). When Beslay's arrival is announced, the Procurator is hidden away. On arrival, Beslay comes straight to the point:

> BESLAY: Citizen, the Treasury is refusing to open to the Paymaster of the National Guard. The soldiers' pay is due. If, by tomorrow morning, you do not make available ten million francs, you will be held personally responsible. These men have families to support…
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> GOVERNOR: Monsieur Beslay, please don't think that I doubt for one second the rights of the Commune. The Bank of France does not engage in politics… … you must help to save the Bank. It is the property and wealth of your country. It is the inheritance of your country.
>
> BESLAY: Your lordship, please don't misinterpret us. We work like slaves in 18-hour shifts. We sleep in our clothes on forms and benches. For 15 francs a day each of us carries out the duties of three or four officials at a thirtieth of the cost. There has certainly never been a cheaper government. But we need ten million francs… …We have taxed neither foodstuffs nor tobacco, but we must have funds with which to pay our soldiers. We cannot put this off any longer and continue to govern. If we don't have ten million by tomorrow morning…
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> GOVERNOR: Millions. I haven't even the power to give you one. You talk about corruption at your sittings. You accuse Monsieur Thiers of violating the regulations to obtain money and now you come to me and ask for funds when you haven't even got a Ministry of Finance to control your spending. You must create a Ministry of Finance. I shan't ask how, but show me some authority that I can recognise and accept.
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> BESLAY: That will take at least a fortnight. Don't forget that we have the power.
>
> GOVERNOR: I cannot forget that I have my rights and responsibilitie… Let us consider together how we can satisfy the needs of our great and beloved city without arbitrarily transgressing the host of complicated, but I'm afraid necessary, rules and regulations of this ancient institution. If we can negotiate and co-operate on a peaceful, respectful basis I am completely at your disposal.

> BESLAY: Your lordship, I haven't come to shed blood but to secure the means by which the National Guard can be paid and the factories and workshops of Paris re-opened. The Commune, legally elected by the people, has got to be financed. In this matter too I am completely at your disposal… I will expect to hear your proposals.

Beslay departs and the Governor releases the Archbishop's Procurator from his hiding place to say "You may tell the Archbishop, the ten million francs will go by way of the usual route to Versailles."[4]

In Brecht's play, therefore, the Governor clearly represents Robertson's practical banker, who is more than just "vaguely conscious that the projects of monetary cranks are dangerous to society". His class instinct tells him that the political project of the Communards is dangerous, and he clings "in self-defence to the solid rock… of tradition and accepted practice" only to cast it aside in the interests of his class. Beslay's conception of money is more practical. He represents the proletarian Everyman, the hero of nearly all of Brecht's plays, interested in survival which, in a capitalist economy, means having the money to buy the necessities of life. The circulation of money outside his pocket is meaningless to him, and that is the weakness that brings him to the door of the Banque de France and allows its Governor to baffle him with his "complicated" but "necessary rules and regulations", hallowed by "tradition and accepted practice", formed in maintaining the stability of the old social order rather than the new.

The impertinent charm of modern money theory

Monetary heretics, or cranks, flourish in times of political crisis when the distortions of inefficiency and inequality, that mar the claimed dynamism of capitalism, become so egregious as to be obvious to the exploited and the socially aware. But awareness of waste and exploitation does not bring understanding of monetary processes.[5] Conditions of mass unemployment place a pressing need for money in the pockets of the poor and become the pretext for innovations in monetary theory. As the world sank into the economic depression of the 1930s, the socialist economist and academic G.D.H. Cole put together a book of essays entitled *What Everybody Wants to Know about Money, A Planned Outline of Monetary Problems*. The essays were by colleagues from Oxford University, of whom one, Hugh Gaitskell, was to become famous as leader of the Labour Party after the resignation of Clement Attlee in 1955. Gaitskell contributed to the volume an essay on "Four Monetary Heretics" that explains in a direct and simple manner the attractions of monetary innovations in crisis. He defined his monetary "heretics" as public figures who disagree in general with economists and have never held academic appointments in economics. His four heretics were Major Douglas, Professor Frederick Soddy, Silvio Gesell, and Robert Eisler. Soddy was the only academic, a Fellow of the Royal Society, and a Nobel Laureate in Chemistry in 1921. Gaitskell's conclusion was that the success of monetary heretics lay precisely in their recognition of what was obvious to Beslay:

[4] Bertolt Brecht *The Days of the Commune* translated by Clive Barker and Arno Reinfrank, London: Eyre Methuen. 1978, pp. 59-61.
[5] Cf. Geoffrey Ingham, Ken Coutts and Sue Konzelmann "Introduction: 'cranks' and 'brave heretics': rethinking money and banking after the Great Financial Crisis" *Cambridge Journal of Economics* Vol. 40, No. 5, September 2016, pp. 1247 – 1257.

> "… the heretic can claim that he is a practical man in touch with the realities of economic life and vitally interested in its reform, not content to toy with abstractions behind the shelter of a professorial salary. From his position he sees the depression as the general public sees it, as a paradox, as something not to be tolerated, as a problem for which there cannot conceivably be *no* solution, as a problem which *can* be solved at once. To plain man and heretic alike, the natural limitation to material welfare is essentially technical. That, quite apart from this, there should be almost as inevitable and difficult a problem of organisation, of social relations, is a vision confined as a rule to the expert who has to handle it…
>
> … A unique master stroke is required. There is to be no painful waiting, no lowering of standards, no difficult compromises, no social upheaval, but simply the adoption of the one perfectly simple, perfectly feasible PLAN…"

The attraction lies not just in the simplicity of the PLAN:

> "… the heretic is able to enlist support just because he is not an expert, just because he represents and expresses the common dislike against the expert. He is a plain practical man, proving to other plain practical men that the mysteries which these exalted intellects are alone suffered to understand are matters which can be made perfectly intelligible to the rest of the community. Thus he restores the public's self-respect."

Gaitskell denied any intention to suppress such heresies:

> "… it is of the utmost importance that every individual should be free to express himself on economic affairs. The plain man's instinct is in this case right. Economic experts can never be wholly trusted, and only with the utmost possible freedom criticism and construction can rapid scientific progress be made."[6]

Modern Money Theory presents an inversion of Gaitskell's definition of monetary heretics. The originators of the Theory are not amateurs, but a hedge fund manager and men and women with PhD's in Economics who offer to the "plain man" the ideas of Beslay. The political ambition for a better world, and revulsion against Robertson's "blind conservatism" of "practical bankers", are obvious. But is this enough?

The purpose of a radical economic policy is social and economic change, and not experiments in economic theory. Truly radical monetary theorists test their ideas against the possibilities of achieving that change, rather than using social and economic change to add radicalism to the thought experiments of academics and hedge-fund managers. Policies of environmental protection and improving the material conditions of working people through full employment and subsidy of workers' consumption (such as health, education and welfare)

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[6] G.D.H. Cole (ed.) *What Everybody Wants to Know about Money, A Planned Outline of Monetary Problems* London: Victor Gollancz 1933, pp. 412-413. It was this phrase that Keynes echoed, perhaps unconsciously, in his *General Theory*, where he remarked that "the brave army of heretics", including Douglas, Bernard Mandeville, Thomas Malthus, Gesell and John A. Hobson "… following their intuitions, have preferred to see the truth obscurely and imperfectly rather than to maintain error, reached indeed with clearness and consistency and by easy logic, but on hypotheses inappropriate to the facts." (London: Macmillan, 1936, p. 371).

challenge the social and political interests that govern society. Brecht knew this, which is why he put his "modern money theory" into the mouths of Communards who had the naïve idea that the central bank has money, but no notion of the true place of central banks in the modern capitalist society. Modern Money Theory therefore represents a certain retrogression of monetary theory: a set of doctrines to reassure Gaitskell's "plain man" that the money is always there, rather than a theory explaining how money circulates in a capitalist economy. The doctrines are naïve and the radicalism lies in the purposes for which the money will be spent, rather than in any new thinking about money.

The Green New Deal and similar projects are worth having because they improve our lives and those of future generations. They are worth having and financing for the sake of those improvements and do not need the burden of crankish monetary ideas as an additional obstacle to the acceptance of social change, and a gift to those whose interests lead them to oppose social change. If we wish to be radical in our politics, we should look at how successful radicals in the past have succeeded in financing their programmes: Roosevelt's New Deal, the financing of the Second World War, and the reforms of Atlee's post-war Labour administration were all achieved without monetizing fiscal deficits. The flaws, discussed above, in Modern Money Theory indicate that more conventional monetary and fiscal policies may be more effective in financing radical reforms.

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