MMT AS AN ALTERNATIVE TO AUSTERITY

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Ask yourself: where does the US government get dollars? From taxpayers? From Chinese purchasers of its debt? Well, can taxpayers and the Chinese print dollars? No. All the tax dollars received were previously created through government's own spending or lending. Citizens, businesses and banks can only use already existing dollars to pay taxes or buy Treasuries (government bonds)

Think of it this way: government spends by creating dollars (coins, notes, reserves, and bonds) or through electronic deposits into bank accounts. Can it ever run out of its own currency? Does it need to borrow its own dollars? Does it need taxes to spend? No, of course not.

To recap: government creates US dollars when it spends or lends, never has to borrow them or raise them through taxes, and cannot run out of them. You might recall that last year the US ran up against its Congressionally-imposed "debt limit", and President Obama claimed the government was "running out of money", but as soon as the debt limit was raised, Washington resumed selling its IOUs to private banks. The problem was never with markets, but with the self-imposed, political constraint.

Clever analysts had come up with suggestions to get around the constraint, such as the Trillion Dollar Platinum Coinage proposal. The Fed (America's equivalent to the Bank of England) is prohibited from buying US government debt and crediting the Treasury's checking account so it can spend. But the US Constitution gives the Treasury the unique power to coin and an obscure 1996 law permits coining platinum in any denomination. Treasury can stamp three trillion dollar coins, sell them to the Fed, obtaining a credit to its checking account used to finance spending or to pay down debt.

My point is not to push giant, platinum coins but rather to emphasize that a sovereign issuer only faces self-imposed constraints. These are human-made, not economic, rules.

When government issues more dollars while spending than it receives through taxes, we call that a deficit. It generates net income in the private sector, creating additional private sales and jobs. A budget surplus is the opposite: government removes dollars and income and spending and jobs from the economy.

So what's the downside of dropping debt limits? Government might spend too much—driving the economy beyond full employment and sparking inflation. The solution is to spend less or hike taxes.

Fortunately, budget deficits automatically fall in recovery—because taxes grow and government social spending falls. If the deficit still remained high enough to fuel inflation, fiscal retrenchment should be adopted—but only once the economy recovers and inflation threatens—not now with unemployment near postwar records and the economy appears poised for a double-dip recession.

There is another consideration: sometimes deficits that promote economic growth also produce trade deficits as imports grow faster than exports. Many believe this generates currency depreciation. The evidence is weak, but even if true then the trade-off is: more growth and employment versus a stronger currency. Would you prefer a job or a foreign holiday?

The danger is said to be even worse if foreigners hold the government's debt—they might refuse to lend unless the deficit is reduced. But we already noted that foreigners cannot create dollars—they get them by exporting to the US. Every dollar lent by Chinese came from the US.

And the reason they export is because they want the dollars! If they decide they don't want dollars, they have to stop earning them through exports. And in reality, if foreigners decide not to lend by purchasing Treasuries, they instead hold cash that doesn't pay interest. Why should Americans worry about that?

Governments do need to be constrained by budgets, spending just enough to achieve the public purpose, while leaving sufficient resources for private purposes. Today, with massive unused resources, government ought to be spending more, not less.

The euro nations face entirely different circumstances—they effectively surrendered the power to coin to the European Central Bank. They are users, not issuers of the currency. Their spending is constrained by tax revenue plus the euros borrowed from markets or the ECB.

MMT does not apply to Greece, but it is applicable to all sovereign currency issuers, including the UK, Japan, Brazil, and India—which cannot face the PIIGS's fate.

It is also applicable to Argentina, since its abandonment of the currency board. As a sovereign issuer of its own currency, it can apply MMT principles.

None of this should be interpreted to call for "unlimited" government spending. Too much can cause inflation; and it could cause the external value of the currency to fall against other currencies. But those are not issues of "affordability" or "solvency". A sovereign nation that issues its own currency does not face "affordability" or "solvency" problems in its own currency.

That does not mean that everything is possible. But it does mean that there is more policy space than is commonly believed.