Positive Money Meets Modern Monetary Theory

As an organizer working to set up a Positive Money affiliate in the US, for the past year I have taken it upon myself to try to sort out the differences between Positive Money and MMT, in order to hopefully reach a resolution to the conflict and a basis for cooperation, or at least a better orientation to the situation. I believe resolution through synthesis is now within sight, but brokering reconciliation between the two groups remains a challenge, perhaps more for reasons of factionalism now than actual substantive differences. This is of course lamentable if accurate, though it may not be, and surely many will dispute that it is. I was first exposed to both PM and MMT in 2013 when I first started learning about monetary reform through a reading group I was participating in at the time. While we recognized MMT as a heterodox, progressive school of thought that was shining a light on how money really worked, (much as PM did) and welcomed the idea of a job guarantee, we were puzzled at their apparent blind spot with regard to the big PM idea: the transformative potential of stripping the banks of their power to create money. Both within my reading group and on my own over the following years I sought out critiques of the PM concept, from MMT as well as others. Each treatment left me feeling the critic strangely didn't get it, or perhaps even didn't want to.

It was not until I established a dialogue with MMTer, Rohan Grey of the Modern Money Network that I ever felt genuinely challenged by any of the critiques of the PM concept. What ensued was probably a 100+ hour dialogue, to my knowledge the longest sustained dialogue to date between members of the respective camps. The following is my account of what I learned and where my current thinking on the subject stands. In short, while MMT is more advanced than PM in terms of academic ground covered and refinement of its understanding of monetary and fiscal policy as well as the functioning of financial markets and the contemporary monetary production economy in general, I do nonetheless still think there is a key, valid insight that PM offers which MMT has resisted integrating into its thinking and using as a basis to strengthen its platform. Whether my assessment is correct or not, hopefully this write up will bring greater clarity to the issue and help facilitate its resolution.

What I see as the core of the PM proposal:

Perhaps the essence of the challenge of trying to make sense of and reconcile the differences between these two schools of thought is the task of distillation. What is really key and what can be discarded? What are the fundamental dynamics underneath the distinct terminologies? While I have discarded or revised much of my understanding that I entered this dialogue with in favor of what appear to me somewhat more sophisticated MMT-informed understandings, the process has distilled for me what are the key aspects of the core PM concept. While others may disagree, I would argue that the aspects of the PM proposal that I have discarded were never essential and in fact reflected a somewhat less sophisticated understanding of the dynamics in question. In my judgement, the core of the PM concept is as follows:

Limit private allocation of public funds to publicly approved uses.

This is meant to be a more refined formulation of the standard "strip the banks of their power to create money". I have come to the belief that this standard formulation sounds more radical than what PM actually means by it. I also think it is largely because it sounds so radical that the MMT crowd is so dismissive of it as a proposition. To an MMTer, this proposition sounds roughly like "abolish the entire financial sector", or "abolish banking while continuing to allow the shadow banking sector, which was at the heart of the 08 crisis, to run amok". The reason I think my above version better reflects the aspect in question of the PM concept is because PM actually allows for the central bank to allocate funds to banks for the banks to lend out for publicly approved uses (which, so does Kotlikoff's Limited Purpose Banking proposal, which is similar in key ways to the PM proposal). The PM concept recognizes that without any public funds allocated to banks to lend out for publicly approved uses there would be the danger of a shortage of credit for important public interest uses. So, the PM concept really only stipulates that rather than banks being able to create as much money on their books as they want, they should have to obtain funds for these loans from the central bank and that there should be credit controls which limit the lending of these funds to public interest uses. What exactly qualifies as a "public interest use" and whether there should be quantitative as well as qualitative credit controls are questions that I don't believe have been adequately hashed out yet.

Key to this formulation is the idea that when banks create money they are essentially allocating public funds in that they are distributing the public's monetized full faith and credit. This is an idea put forward by Grey's MMT-friendly PhD advisor, Robert Hockett. The idea also applies to shadow money creation as shadow monies similarly manage to appropriate the public's full faith and credit in order to bolster their "moniness". For PM's concept to be coherent, it must also target private allocation of public funds via shadow money creation.

This general concept speaks to Jan Kreigel's critique of 100% Money (a variant of the PM proposal) based on his understanding of Minsky (though as far as I can tell Minsky never explicitly dismissed 100% Money in any of his writings and in fact said the idea deserved consideration). According to Kreigel, (who was a colleague of Minsky's and may have derived his understanding from conversations with Minsky) Minsky gave up his interest in 100% Money when he arrived at the understanding that the essential function of banks was acceptance. This is to say that what banks do is accept the debts of economic actors (lower in the hierarchy of money than the banks), as their own. This is valid as an insight as far as I can tell. However, I would add that crucially the banks do not merely accept on behalf of themselves, but on behalf of the government, thereby modifying the description of their function to: acceptance on behalf of the government, by which process the banks allocate the monetized full faith and credit of the government. This brings us full circle to Hockett's formulation, which appears to be perfectly compatible with the core PM concept.

Use additional fiscal space to increase money creation via public spending.

The second key aspect of the core of the PM concept is the idea of using the "fiscal space" gained through the above restrictions to enable increased money creation through public spending, or what MMTers would characterize simply as deficit spending. What I mean by "fiscal space" is space for increased deficit spending within the bounds of acceptable levels of inflation. I would even go so far as to

say that the most essential core of the PM concept is to restrict the private allocation of public funds to publicly approved uses in order to create additional space for increased public spending. Of course, this is without getting into any of the various expected benefits of doing so.

Maintain a place for private allocation of private funds, while fighting creation of shadow monies.

While the PM concept aims to restrict the private allocation of public funds to public interest uses, it does not aim to restrict what private investors do with their own money. The PM concept aims to permit private allocation of private funds according to private preferences, though it must aim to do so without allowing private investment to become shadow money creation. This is trickier than we on the PM side typically seem to appreciate, as I'll get into later.

Caps on interest rates when necessary.

In order for the PM concept to retain its coherence and have a chance of achieving its aims, there will have to be interest rate caps at least in certain cases. Otherwise scarce loanable funds would lead to interest rate spikes so pronounced that they would likely wreak havoc on the economy and undermine or cancel out the benefits of implementing the PM concept. This point is in response to Bill Mitchell's critique that by restricting lending to a fixed amount of loanable funds you will merely send interest rates through the roof. Mitchell's critique holds, unless you do something to keep interest rates down without simply allowing unlimited money creation to fund lending. Interest rate caps seem the most obvious solution to me. Fortunately we have historical precedents for imposing interest rate caps and this is therefore likely feasible from a technical perspective. The clearest case where interest rate caps would be necessary is for mortgage lending with private funds if mortgage lending did not qualify for public funds. Otherwise interest rate spikes would defeat the purpose of withholding unlimited public funds for mortgage lending, which is basically to keep mortgage debt down. Similarly, interest rate caps might be necessary or just advisable if there were quantitative credit controls. It is also still unclear to me whether interest rate caps would be a good idea for other lending of private funds.

What I learned from MMT:

How we think about public debt of monetarily sovereign countries is completely wrong.

A key MMT concept that the PM crowd, to my knowledge, has yet to integrate into its thinking is that because monetarily sovereign governments have negligible default risk associated with their debt due to their ability to create money, their debt should not be thought of the way we think of private debts which carry the risk of default, or even debts of governments without monetary sovereignty. Instead, the debt of monetarily sovereign governments should be thought of more as a kind of interest bearing money, which bears some liquidity risk. MMT often compares government bonds to savings accounts. This is apt in the sense that the holder's money is safe and they receive a higher interest rate than on their checking account, yet there is the chance of a penalty if you want to withdraw your balance early. This penalty would come from illiquidity of the bonds forcing the seller to accept a reduced price.

Accordingly, it is incorrect to think of government bonds as needing to be "paid back" in the sense that private debts do. The best illustration of this is the fact that central banks routinely buy up government bonds by creating new reserves. As QE showed, this is not inflationary because all it really entails is a swap of one government liability for another with a slightly different interest rate. While reserves and not bonds are the standard means of settlement in the banking system, there are other financial institutions that actually do use government bonds as a means of settlement. In any case, the more liquid government bonds are, the more interchangeable they are with reserves. Ultimately, it is helpful to think of government bonds as being to cash as a $100 bill is to a $20 bill. Just like if you try to spend a $100 bill at a corner store, the clerk might not have enough change to accept your $100 bill, the same is true of government bonds. This doesn't mean that the $100 bill or the bond is not money, it just means you have to break it into smaller denominations in order to use the purchasing power it contains in certain places. This means we shouldn't look at public debt as a burden that our grandchildren will one day have to pay off. Instead it is actually just a measure of net money creation by the government (net because it measures money spent into circulation that has not been offset by taxes).

"Taxes don't fund spending" is not just a framing gimmick.

This brings me to the next concept. An often used MMT slogan is "taxes don't fund spending". While it contains the insight that the government has the ability to create money and therefore doesn't need tax revenue to fund itself, it is nonetheless a much stronger claim. Coming from a PM informed perspective which recognized that governments had the ability to create money, the claim still seemed excessively strong to a point that was even bizarre to me. While I saw how one could think of it that way (all public spending is money creation and taxation merely removes money from circulation) it seemed like an inconsequential framing gimmick that would just alienate people with its bizarreness rather than an actual important point. I've come to completely abandon this perspective and embrace the MMT framing for the following reasons.

First, this framing is useful for clarifying our thinking with regard to fiscal policy. The most illustrative example is taxing the rich. If you think that taxes fund spending, and you want the government to increase its spending on education or health care or infrastructure, you are then likely to think that it follows that taxing the rich is key to fulfilling your agenda. You might even want to try to scour the world's tax havens for stashed wealth, or be willing to offer corporations a tax break if they repatriate their money held overseas so you can at least extract some tax revenue out of the deal. You might think all of these things even if you are aware that the government can create money. "Sure the government can fund some of its spending through money creation," you might think, "but still, most of it is funded with taxes, so taxing the rich is therefore helpful to increasing public spending". What this seemingly reasonable line of thinking does however, is take your eye off the ball. MMT teaches us to keep our eye on the ball by reminding us that taxes don't fund spending and that we should focus on real (biophysical) resources and the inflation constraint. If there are adequate real resources for the government and recipients of its proposed spending to draw on without causing inflation, then raising taxes on the rich is unnecessary to do in tandem with authorizing the spending you want to do. If there are not adequate real resources for the spending you want to do to be benign in terms of inflation, then the question becomes: would taxing the rich actually help check the inflation caused by the spending you want to do? The

answer at the very least is not necessarily, because while the excess millions and billions in wealth held by the rich may contribute to inflation on yachts, rare paintings and exotic derivatives, it isn't necessarily relevant to inflation on the things you are concerned about like food and consumer goods as even a tycoon with a taste for conspicuous consumption can only consume so much food and electronics. So, in either case, the taxes you thought would be helpful to your spending program may actually be irrelevant to it. Taxes as funding for spending is at best a highly imperfect proxy for managing the inflation constraint as we spend. Quibbles about the details of the absurdly convoluted balance sheet operations entailed in public spending are ultimately beside the point. MMT quite helpfully instructs us to think of these details as "under the hood" and reminds us that if the government authorizes spending, the central bank will clear the check.

Second, having now established the technical validity of the claim, there is also potentially immense political significance to it in my view. If we believe that taxes fund spending then we think of public spending as largely a process of redistributing wealth. While this may not bother you if you are on the left, for many this carries the taint of forcibly taking away the wealth of the more productive in society in order to give handouts to the less productive. Needless to say our societies are deeply ambivalent about whether this is fair and right. By introducing the (technically valid) framing that taxes do not fund spending, all government spending is transformed from a questionable exercise of state authority to redistribute wealth, into the exercise of the public power of money creation on behalf of the public interest. I think this reframing could prove to have major political significance, particularly in conjunction with the idea that banks and other financial institutions have been allocating our public full faith and credit on their own private behalf.

Separating the power of the purse from the power of (net) money creation is problematic and may not be worthwhile.

A tenet of the PM proposal which my engagement with MMT has called into question for me is the idea that monetary policy can and should be conducted by an independent monetary authority that decides how much new money to create. This aspect of the PM proposal I believe was always a defensive accomodation of the concern that if politicians had the power to create money their profligacy would quickly lead to hyperinflation. MMT shows us that the politicians already have this power, whether they know it or not. Further, because the ability to issue bonds is tantamount to the ability to create net money, there would have to be a balanced budget requirement to take this power away from the fiscal authorities. The problem with this solution is that there are programs which by nature can't be subject to a budget. For instance, unemployment insurance simply has to be funded at whatever cost and you can't know how much it will need in advance because you don't know how many people will become unemployed. So, in order for there to be a monetary authority with the ability to check public spending there would likely need to be an exemption for this kind of automatically triggered spending. The MMT response would then be that we don't want our public spending subject to technocratic constraints which would likely be imposed by technocrats with a bias toward austerity. While this need not necessarily be the case, one can see the danger of it. So depending on what we are more afraid of (austerity or excessive inflation) we could either insist on salvaging the monetary authority concept or dispense with it. One can imagine ways of seeking a balance between the two concerns.

"All money is debt" is true, if you use the broader MMT definition of "debt".

A common point of contention between MMTers and PMers is over whether "debt-free money" is a coherent term. Notably, Randy Wray has spilled a great deal of ink critiquing the coherence of "debt-free money". My conclusion is that the term is not coherent if we use MMT's definition of debt, though even if we use the MMT definition and abandon the term "debt-free", we can still describe what PM means in terms that are coherent within an MMT vocabulary. Another way to say what PM means by "debt-free" is: money that is created through public spending rather than through some form of lending. For MMT, even this kind of money is a kind of debt because the government owes the bearer (whoever has the money) release from their tax liability. Coming from a PM perspective this can seem like a tortured semantic contortion, but this doesn't really matter. Sure, when we think of debt we typically think of debt incurred through borrowing. Still, it is perfectly coherent to enlarge our concept of debt to anything anyone owes for any reason. Under this concept we can say the government owes the bearer of its money release from their tax liability. This is to say, when you pay your taxes, the government owes it to you to recognize that you have paid your taxes and therefore not prosecute you for tax evasion. It may be counter-intuitive because typically when we make good on a debt we pay money rather than receive it as the government does in this case, but the concept is nonetheless coherent. I don't see any reason to fight MMT on this point. We can say what we mean just as easily in the alternate terms I described above.

PM has not yet adequately adapted its concept to the shadow money world in which we live.

It took me several years to wrap my head around shadow banking to a point where I feel like I basically get it. I think this is partly a function of the fact that it is convoluted by design, which is to say, market practitioners design their instruments to be unintelligible on purpose so as to protect their niche in the market, both from competitors and regulators. Now that I understand shadow banking as well as I do (which I'm sure my understanding is by no means complete) I can see that PM has not yet responded to the full difficulty of the technical challenge of enforcing its concept. This is not to say that meaningful enforcement is impossible, or not worth attempting. It is only to say that PM has yet to develop an approach to enforcement which is likely to be adequate to the task of preventing shadow money creation from circumventing enforcement of our concept. While laying out the key aspects of shadow banking for the purposes of enforcement of the PM concept and my ideas for potential approaches to enforcement are beyond the scope of this article, you can read my paper which does so here. In the meantime, I have developed a metaphor for conceptualizing the challenge. Essentially, private allocation of the public's monetized full faith and credit for non-public interest uses is a rentier problem. While financial rentiers will never be eradicated once and for all, this is not a reason to give up on our concept anymore than the fact that disease will never be eradicated once and for all is a reason for the medical profession to abandon its efforts to promote health. The challenge is to establish for our economies a robust immune function against financial rent-seeking, at the very least of the variety entailed by privately allocating the public's monetized full faith and credit for non-public interest uses.

Many if not all of the necessary building blocks for assembling a policy regime based on the core PM concept already exist within the MMT framework

One of the major obstacles to convergence between MMT and PM is that we have different vocabularies to articulate largely the same things. My (I'm sure highly controversial) contention is that all the elements for a coherent MMT-adapted version of the PM analysis and proposal already exist within the MMT framework.

Robert Hockett's account of the financial system positing that the financial sector effectively allocates the monetized full faith and credit of the US government is essentially what PM is referring to when it says that the banks have privatized money creation. MMTers quibble with the PM version of this claim because for MMT defining "money" is so problematic that they now generally prefer to avoid even using the term. For them, because of the ambiguity of the term, it is misleading to say the banks have privatized money creation when the banks were creating something that might also be referred to as money before they managed to co-opt the public's full faith and credit in order to support the value and stability of their otherwise private bank money. In my view, we can simply concede their historical and semantic quibbles and focus on the important concept, on which I believe we can agree: the financial sector is allocating the public's monetized full faith and credit for non-public interest uses.

MMT also supports the use of credit controls to limit bank lending to public interest uses, though this is not an urgent priority for them and accordingly they don't have a hashed out proposal for what a comprehensive credit controls regime would look like. I'd argue we don't really either. But the important thing is that imposing credit controls to limit the allocation of the public's monetized full faith and credit by banks to public interest uses has a functional equivalent within the PM proposal. Lack of clarity on what the credit controls regime would look like aside, this is largely a case of "six one way, half a dozen the other", as far as I can tell. The Modern Money Network, which is Grey's organization, even advocates requiring the banks borrow central bank money to fund these loans, among other reasons because it would make explicit the fact that when the banks make loans they are effectively allocating public funds.

MMN also supports central bank digital currency which of course is part of the PM proposal. While some have theorized that CBDC would render bank deposits obsolete and force banks to fund their loans entirely with central bank money, if a requirement that banks fund their loans with central bank money were already in place, CBDC would still serve as another illustrative, simplifying reform, making explicit that our deposits are fundamentally public. This would do away with the convoluted, vestigial nature of the current deposit insurance system which exaggerates the private nature of deposits. It does this by leaving them on the banks balance sheets and by having banks pay deposit insurance premiums, while having public backing take the form of a line of credit from the treasury. These touches serve to minimize the appearance of the significance of public support of deposits when the key point is that the deposits are guaranteed by the government and payments can be counted upon to clear.

It is also important to recognize that when MMT says, "we need a public sector deficit in order to have a private sector surplus" they are essentially touting the advantages of money creation through public spending, exactly what PM does. This said, it is clear that MMT does not prioritize cutting back on money creation through private lending in order to create additional space for money creation through public spending the way PM does. However, part of their aversion to this is that for them the more urgent

priority is that the economy operate at full employment. From this perspective it doesn't make sense to cut back on bank money creation when we have yet to achieve full employment, as pointed out by Warren Mosler. However, if we present what we want to do (crack down on private allocation of the public's full faith and credit for non-public interest uses) as a way of checking inflation once we have already reached full employment and the inflation constraint, they tend to find the idea much less objectionable. At this point, the question becomes whether there is a viable enforcement mechanism.

While MMTers balk at the idea of "stopping the banks from creating money", they fully support asset side regulation, which is essentially credit controls, which as I went over earlier amounts to restricting the banks' allocation of public funds to public interest uses -- exactly what PM wants. The major technical challenge of implementing our concept for MMTers is to limit the banks' allocation of public funds to public interest uses without merely pushing the undesired money creation into the shadow banking sector. This is a concern derived from Minsky's famous observation that regulation promotes attempts to circumvent the constraints it aims to impose. And, in my view, we must admit that MMT makes a strong case that enforcing this aspect of the proposal would not be as simple as enforcing a prohibition on counterfeiting. But this does not mean the task is hopeless, and in my view this is where the metaphor of establishing an immune function needs to be invoked. Perhaps the least controversial measure for suppressing shadow money creation (so as not to leave increased shadow money creation to defeat the purpose of credit controls) is to impose a financial transactions tax. Hockett himself has proposed using an FTT as a way of checking inflation should we reach the inflation constraint. While there are a variety of other avenues to potentially pursue in order to make the immune response against this form of financial rent-seeking more robust, they are beyond the scope of this article. Nonetheless, the probability of an FTT being a feasible minimum solution suggests that this last kernel of the core of the PM concept could also be reconciled with MMT.

Remaining questions:

In closing, it remains to be seen whether crackdowns on private allocation of public full faith and credit to non-public interest uses could create space for further money creation through public spending, and we will likely never know until we try, though there are decent suggestions that it could. Among these suggestions is Hockett's proposal to impose an FTT to check inflation, and Mosler's own claim that imposing 100% capital requirements would be deflationary (if it would be deflationary prior to reaching the inflation constraint, it would seem that it could be used to check inflation once we reach the inflation constraint). Still, we would be wise to respect the MMT warnings as to the difficulty of enforcing our concept, and accordingly open up as an avenue of research the exploration and development of various ideas for establishing and strengthening this crucial immune function on behalf of our economies. Last, it may be a great complement to the core PM concept to establish public banks to perform at-cost lending to public interest uses. This could serve as an anchor to interest rates by forcing for-profit private banks to compete with the public, not-for-profit model in the allocation of the public's monetized full faith and credit to public interest uses. This would allow the government to largely outsource the job and thereby avoid taking on excessive responsibility (and the hazards that come with it) by socializing the entire banking sector, which in any case would seem to be politically more difficult than may be necessary to achieve the desired effect.

MMT is impressively strong in the US as the mainstreaming of their Job Guarantee proposal attests. Yet even politicians they advise have yet to unambiguously invoke their messaging in response to the “how do you pay for it?” question that has been omnipresent since a number of Democrats began embracing a public spending agenda that is as ambitious as any since the New Deal. While the public is probably still too unfamiliar with the claims that taxes don’t fund spending or that the deficit is just net money creation for politicians to pull off invoking them in defense of their proposals, the idea that banks allocate the public’s full faith and credit for private uses may be easier for the public to latch onto as it seems easier to understand and prove. In conjunction with the PM concept, this messaging could provide MMT-influenced politicians with a key advantage: after advocating increased deficit spending and putting the focus on the inflation constraint, they could pivot to cracking down on private allocation of the public’s full faith and credit for non-public interest uses as their proposed way of checking inflation. This seems infinitely preferable to proposing raising taxes to check inflation as MMT now typically does, as this response runs the risk of sounding like more of the same (taxes funding spending). Instead, politicians could say: “we are going to pay for it the same way banks fund their loans -- by allocating the public’s full faith and credit. As of now banks allocate our full faith and credit on their own private behalf without anyone raising an eyebrow about inflation. Shouldn’t we the public be able to allocate our own full faith and credit on our own behalf?” Exploring and refining messaging in this vein may therefore be another avenue to pursue.