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Modern Monetary Theory (MMT)

Pierre-Alain Bruchez and Frank Schmidbauer
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- "We may all be modern monetary theorists soon" ([Steven Englander](#))
- "Modern monetary theory, or MMT, is neither modern, nor mostly about money, nor a theory" ([James Mackintosh](#))
- "To the extent modern monetary theory is true, it is unoriginal; to the extent it is original, it is false" ([Martin Wolf](#))



Background

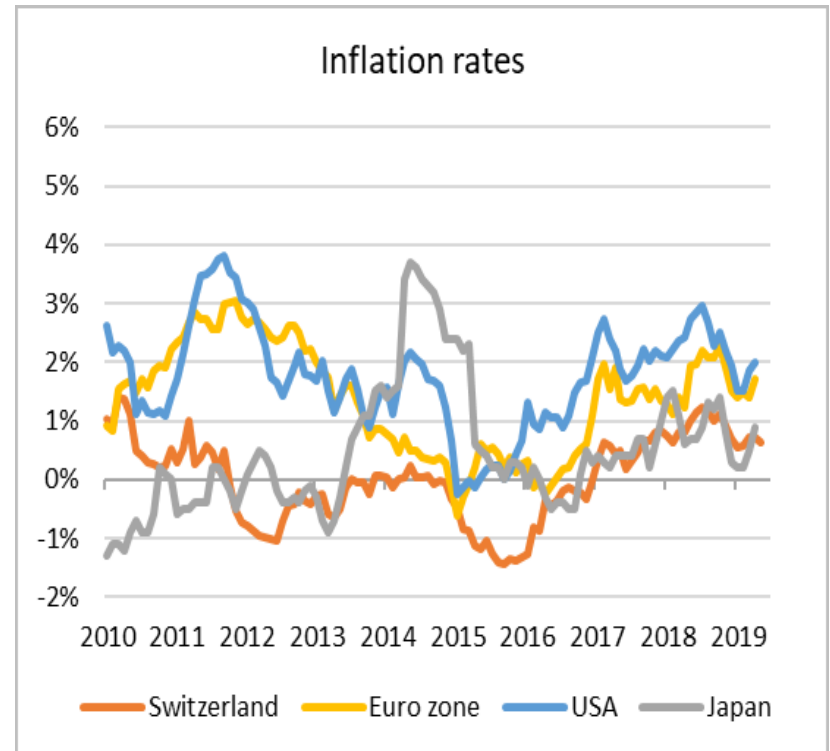
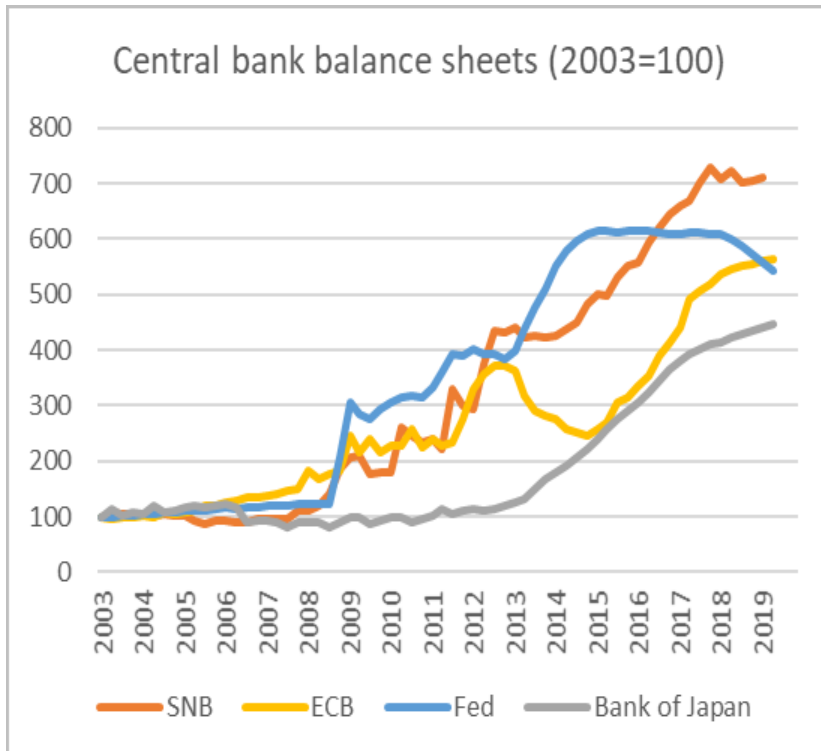
Key mainstream economic policy principles have been shaken up in the wake of the financial crisis. These are, in particular:

- (1) Too much money in circulation inevitably leads to inflation
- (2) Financing government expenditure by central banks generates inexhaustible fiscal policy desires and leads to currency collapse and hyperinflation in the long term

- ⇒ Strict institutional separation of monetary and fiscal policy
- ⇒ Independence of central bank guaranteed by law
- ⇒ Ban on monetary state financing



Money glut from central banks but hardly any inflation

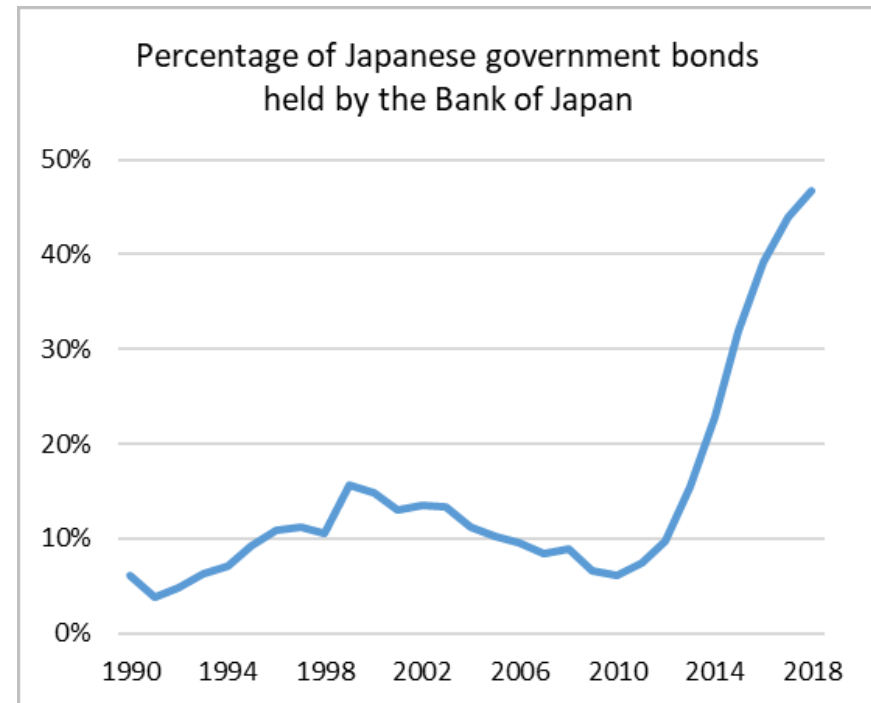
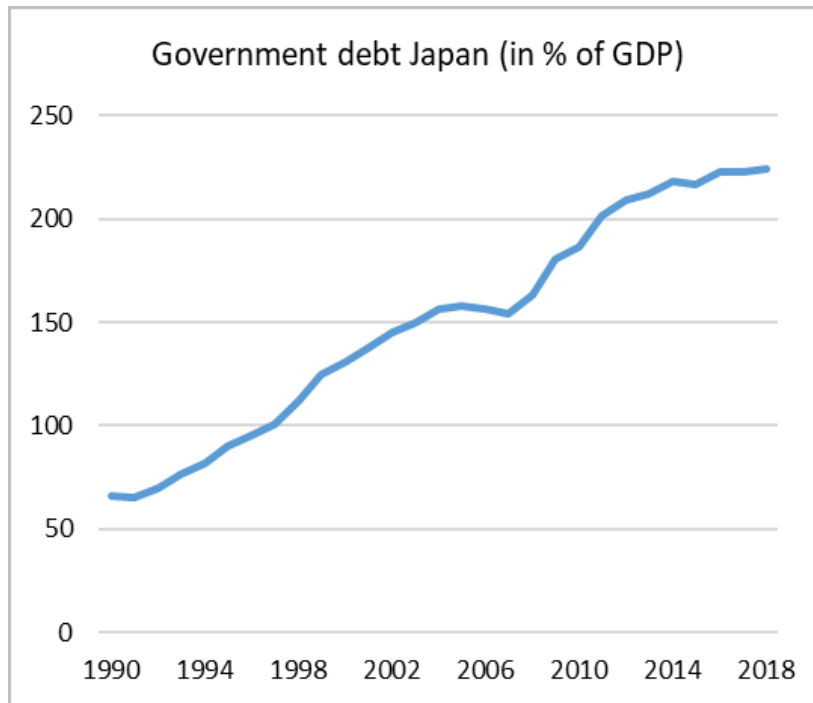




State financing by central bank

Extreme example: Japan

- Rising government debt which is increasingly held by the Bank of Japan (bond purchase programmes)
- Still no sign of inflation or rising interest rates





How to deal with the next downturn

- Growing doubts about the effectiveness of monetary policy
 - Expansionary measures in recent years have had less effect than hoped for
 - Limited scope for further interest rate cuts and stimulating effect on investment and consumption unclear
 - Risks of undesirable side effects (financial stability)
- Fiscal policy under pressure to consolidate

What might a way out of the dilemma look like?

- Expansionary fiscal policy, financed by monetary policy -> MMT



Positions of MMT (main)

- **Under-employment situation**
In a situation of under-employment, increasing public spending by pure creation of money (without increasing taxes or debt) does not lead to inflation. There is no real crowding out. In many countries, under-employment is the usual situation.
- **Full employment situation**
In a situation of full employment, increasing public spending by pure creation of money (without increasing taxes or debt) leads to inflation. To avoid this inflation, the money supply must be reduced by taking money through taxes or borrowing.
- **Policy mix (fiscal policy/monetary policy)**
Stabilising the economy (avoiding unemployment; interest rates have little impact on savings and investment), but also *stabilising prices* is a matter of fiscal policy (inflation is rarely a monetary phenomenon). Monetary policy aims to *stabilise the interest rate*. The public treasury plays an important role in monetary policy by issuing and purchasing its bonds.



Positions of MMT (other)

- **Low imported inflation**
Monetary creation has little influence on the exchange rate, which has even less influence on the price of imports.
- **Public deficits as a counterpart to private surpluses**
In a closed economy, the state must run deficits if the private sector wants to run surpluses. In an open economy, the state must run deficits if the private sector wants to run surpluses and the rest of the world has a net investment in the country (as in the USA).
- **Job guarantee**
This programme guarantees all those who so desire employment that is paid at the minimum wage. It ensures that the minimum wage is respected. It is an important automatic stabiliser.
- **Discipline of politicians**
Implicit hypothesis: Politicians can be disciplined enough to compensate for money creation through taxes and borrowing as the economy approaches full employment.

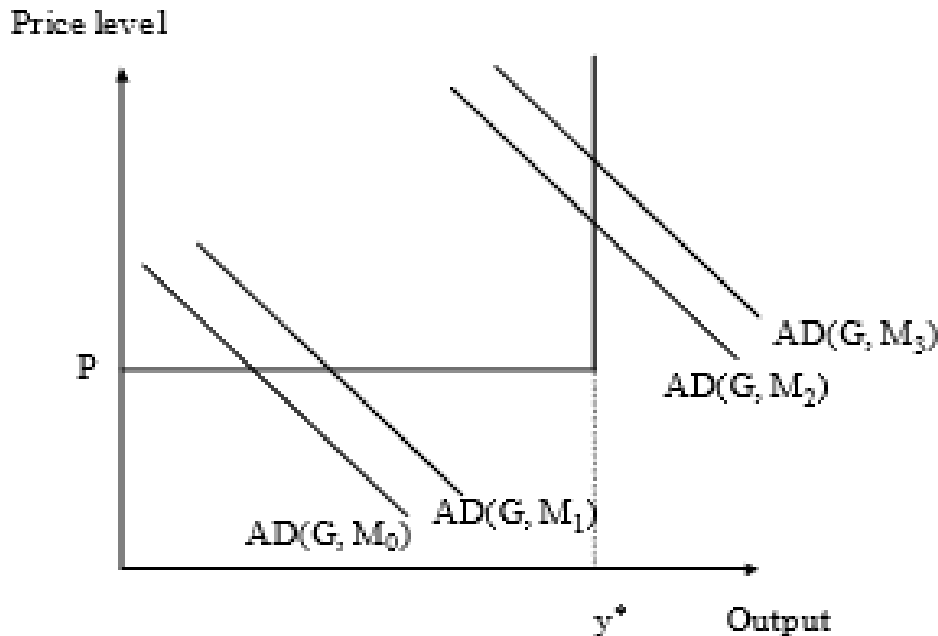


MMT: Monetary creation in a situation of full employment => Inflation

According to MMT, monetary creation generates inflation or not depending on whether or not there is a situation of full employment.

Figure 3. The implicit MMT model of price level and output determination ($M_0 < M_1 < M_2 < M_3$).

Source: [T. Palley](#)



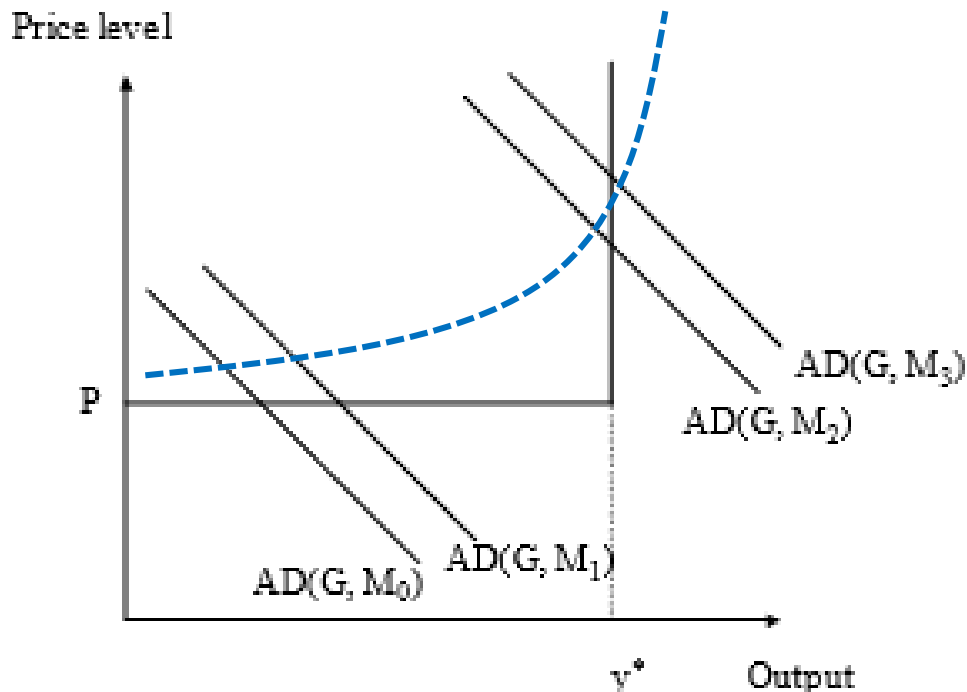
Taxes and public borrowing are not used to finance public expenditure, but to avoid inflation in a situation of full employment



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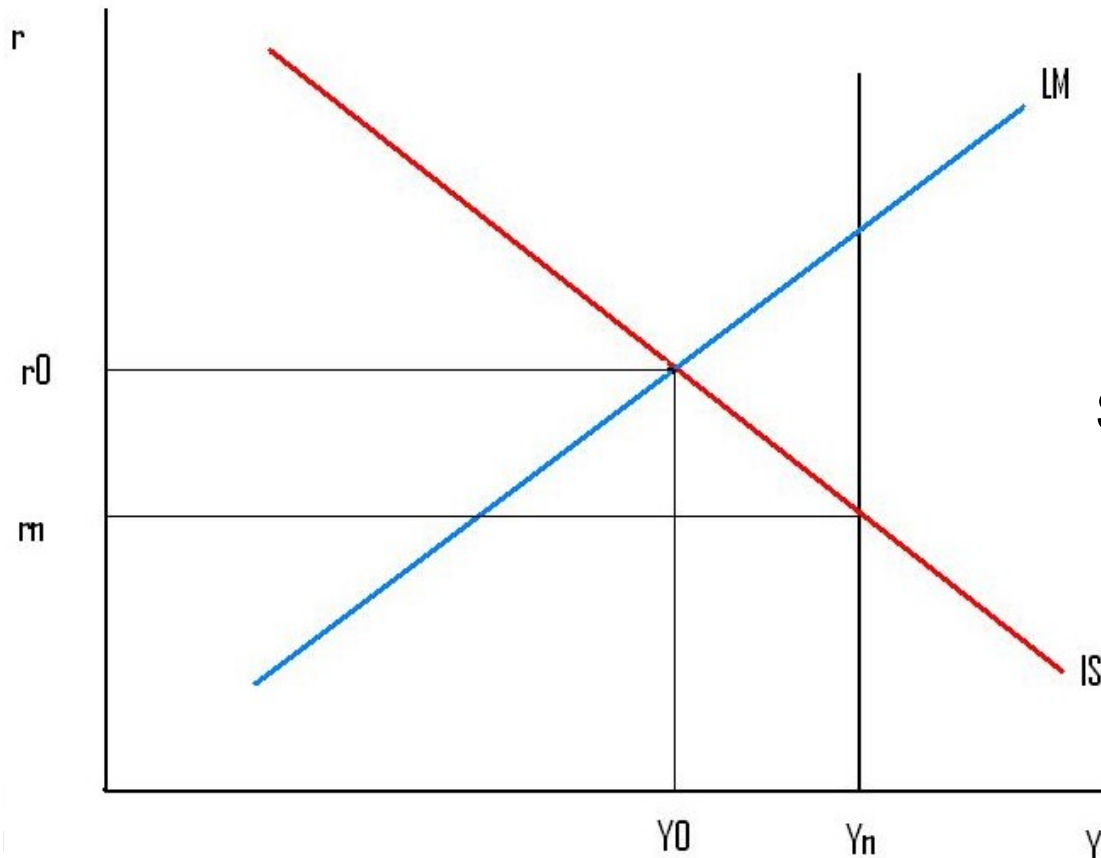
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The ineffectiveness of monetary policy in influencing the economy

Proponents of MMT recommend not using the interest rate to influence GDP, as they consider the link between the interest rate and demand to be weak or inconsistent.

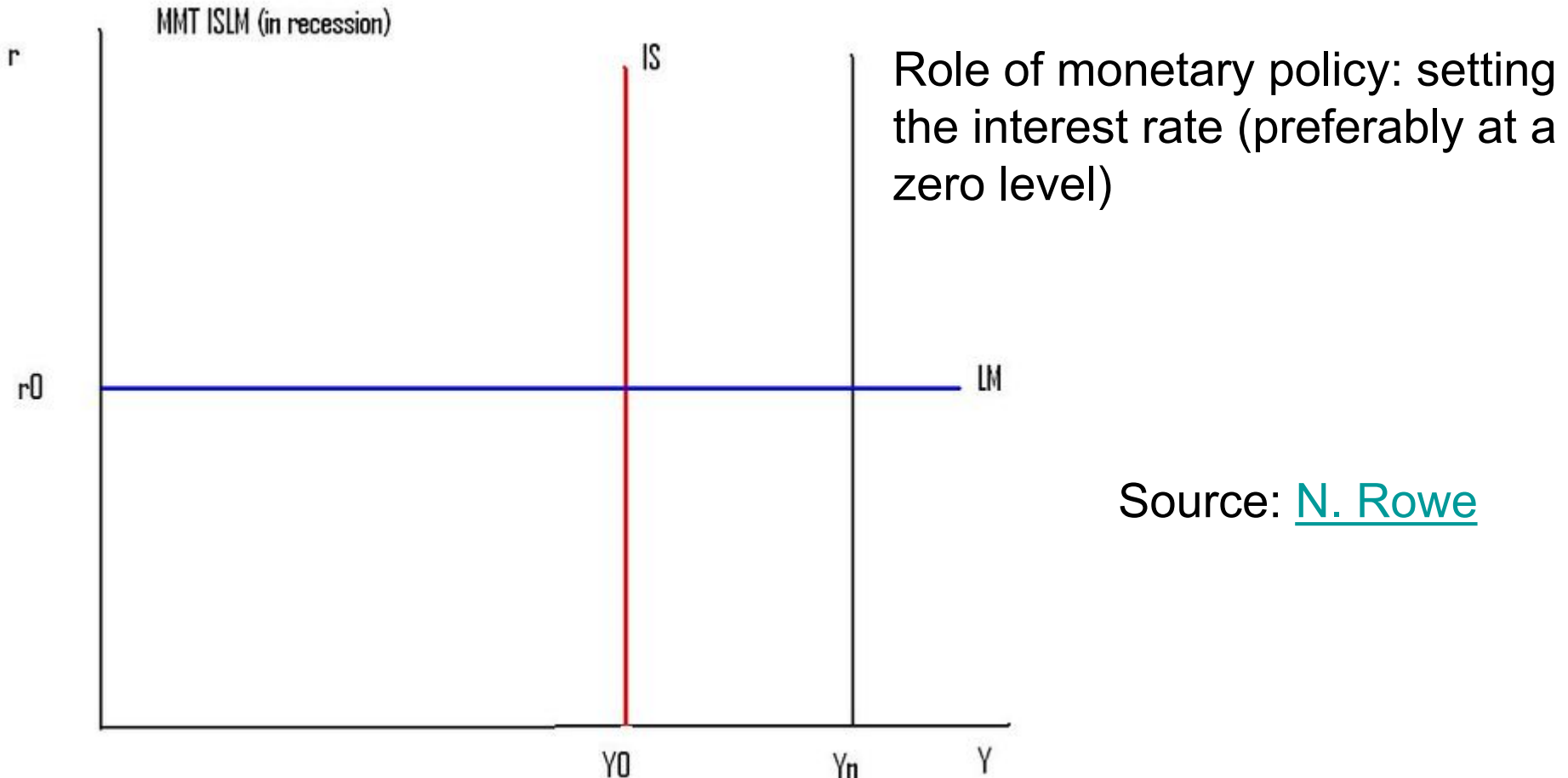
Textbook ISLM model (in recession)



Source: [N. Rowe](#)



The ineffectiveness of monetary policy in influencing the economy (continued)





Conclusion

- **MMT is less different from mainstream than one might think**
MMT is different from mainstream, but not as much as some newspaper articles might suggest. Thus, MMT recognises that financing public spending through money creation (without taxes or public debt) in a situation of full employment leads to inflation.
- **MMT is currently not relevant for Switzerland**
MMT's recommendations do not differ from those of mainstream economists for Switzerland when it is in full employment or when it is solely affected by weak external demand.
- **MMT stimulates reflection on policy mix**
MMT stimulates reflection on the distinction between monetary and fiscal policy, as well as on the respective roles of the state and the central bank.