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The Fiscal Summit Counter-Narrative: Part Five, Inflation and Hyper-inflation

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One of the raps on deficit spending in neoliberal circles is that it will trigger substantial inflation or hyper-inflation. Even when mainstream economists grant the MMT point about the impossibility of the US becoming involuntarily insolvent, they will still insist that sustained deficit spending is a bad idea because it will inevitably lead to unmanageable inflation. A variant of their critique is that especially ?pure deficit spending [20],? I.e. deficit spending without issuing debt instruments to absorb the increase in the money supply created by deficit spending, will be an inflation trigger.

In developing the counter-narrative of the Teach-In to the inflation/hyperinflation risk story, Marshall Auerback Corporate Spokesperson of Pinetree Capital [21], and a very well-known Modern Monetary Theory (MMT) blogger, gave the presentation on the topic in the title of this post.

Audios, videos, presentation slides, and transcripts for the presentation are available at selise's site [22] and a slightly different version of the transcripts is available from Corrente [23] as well.

Marshall Auerback's Presentation On Inflation and Hyper-Inflation

Marshall begins by acknowledging previous work by Rob Parenteau [24] and Bill Mitchell [25] on hyper-inflation in Weimar and Zimbabwe, and calls himself the hack in comparison to Rob, Bill, Randy, and the other panel participants. He then continues:

> ?So will the US turn into a modern day Weimar Germany? So let?s start, I know some of this is stuff we?ve gone through it before but I?m going to start with a few operational points that been already made, to show that we?re not the only ones making it. I?ve got quotes here from an economist called Abba Lerner, he is often known as the father of functional finance. He was a Keynesian, I think it?s fair to say that he?s one of the progenitors or forbearers of modern monetary theory.
>
> ?So his comment, and it is as Warren gave you an illustration of it before, he said, ?The modern state can make anything it chooses generally acceptable as money? It is true that a simple declaration,? as Warren showed you, ?that such and such money will not do, even if backed by the most convincing constitutional evidence of the state?s absolute sovereignty. But if the state is willing to accept the proposed money in payment of taxes and other obligations to itself, the trick is done.??

LetsGetItDone Comment: That's the very important MMT idea of tax-driven money. discussed also by Stephanie, [26] and Warren, [27] and in this important post [28] of Randy's.

> ?The other point, we talked about the purpose of taxes, we said they serve to regulate aggregate demand, not to raise money so that government can afford to spend. And again, the other idea that I think was a very important insight by Lerner is that he said that, ?The central ideas of government fiscal policy is spending and its taxing, its borrowing, its repayments of loans, its issuance of new money,? etc. etc. ?should be undertaken with an eye only to the results of these actions on the economy and not to any established traditional doctrines of what is sound or unsound.? So we look at the impact of policy, the effects of policy. That?s ultimately what we?re looking at. We?re not particularly interested in some vague notion of a debt-to-GDP ratio which is considered unsustainable or the general concept of fiscal unsustainability.?
>
> ?The constraint as we?ve said is inflation. It?s not fiscal largesse or fiscal profligacy per se.. . . . ?

LetsGetItDone Comment: And this too, is a very essential idea of MMT. When planning fiscal policy or legislation with fiscal implications, try to project the likely impact on real things like unemployment, price stability, crime, poverty, family integration, education, health, etc; not abstract financial indicators such as the debt, the deficit, or the debt-to-GDP ratio, which have no consequences in themselves for Governments like the United States which are sovereign in their own fiat currency. Marshall goes on:

> ?Okay, let?s go into the history lesson. So when we look at Weimar? let?s take a step back. When we talk about these operational realities that I?ve mentioned earlier invariably, I mean I can tell you 9 times out of 10, ah, you look at the Huffington Post blog yesterday you could, we get comments saying, Well you?re just going to get hyper inflate you're going to turn this country into a modern day Weimar Germany. So I?ve heard this so many times, and so did Rob, that we decided to actually look at the history. Clearly, Weimar Germany came into existence after WWI, a very damaging war, hugely more damaging in many respects than WWII. The country?s productive capacity was absolutely shattered, and more importantly virtually the entire world was really pissed off with Germany and as a result the war reparations claims that they imposed on the country were extremely punitive.
>
> ?And many people at the time, such as Keynes, for example, realized that this imposed a tremendously harsh economic consequences on Germany and that the imposition itself was going to be impossible to be repaid. As I say here in 1919 it was reported that the German budget deficit was equal to half GDP. Half GDP. And what are we talking about in the US today? We?re talking about 8% of GDP I think it may have peaked at 10% and that?s including TARP, so let?s get a sense of perspective here.?

LetsGetItDone Comment: Marshall's reference above is to one of his slides [29].

> ?By 1921 in Germany, war reparation payments equaled one third of government spending. One third. So I think that is an important consideration to look at and I think more importantly is that the payments were demanded in a foreign currency. They weren?t being demanded in Deutsche Marks. They were being demanded in, the governments demanded huge gold reparations.
>
> ?Now by contrast as I said in the US you?ve got a fiscal deficit this year, I think it?s projected at, I think the latest out of the CBO is about eight and a half per cent of GDP, assuming that GDP is what everyone thinks it will be.
>
> ?So the scale of the fiscal responses, although large, are nothing like they were in Weimar Germany. So there is a big difference right there. Weimar Germany then didn?t have the gold so they had to aggressively sell their own currency, buy the foreign currency in the form of the financial markets. You keep doing that over, and over again, it drives down the value of your own currency, which causes the prices of goods to go ever higher, and that starts the inflationary process. As I said earlier the US does not do this. The US gets to use debt in its own free floating non-convertible currency. You can?t exchange the dollar into anything, much as some people would like that. So there?s no external constraint along the same lines as Weimar Germany.?

Marshall goes on to point out there is also a big difference between the contemporary US and

Weimar in the economic and political power of the trade unions to negotiate wage increases to keep up with any inflation that might occur. He intends no negative evaluation of trade unions and says ?. . . in fact I think if we had more unions in this country, and stronger unions it would actually be better.? But he makes the point that In Weimar Germany the power of the unions created ?. . . . an automatic feedback mechanism from price inflation to wage hikes and it keeps going on and on and on.? He points out that we don't have that in the US or any other country right now, and that without such mechanisms nominal wage and salary growth can't keep up with inflation, so if prices go up, deflation, not hyper-inflation will follow. And he continues:

> ?So what finally broke down Weimar Germany, the straw that broke the camels back was by May 1921, the so-called London Ultimatum. The Germans were asked to make an annual installment in payments of 2 billion in gold or foreign currency, in addition to a claim on just over a quarter of the value of German exports.
>
> ?So an extremely punitive measure, it was a condition virtually impossible to fulfill. The Germans attempted to fulfill it. They accumulated foreign exchange by paying with treasury bills and commercial debts denominated in marks, but the mark simply went into free fall. So they finally said, ?You know, we can?t pay up anymore.? You are seeing a small parallel to, with that today in Greece, its not to the same degree but obviously its? the positions are reversed, it?s the Germans imposing conditions on the Greeks, saying ?You know you have to pay X? even though the Greeks don?t have the money, so they?re trying to get blood out of a stone. But we don?t clearly have hyper-inflation in Greece, but it is an interesting parallel.
>
> So, then French and Belgian troops occupied the Ruhr, a region employing 25% of the German workforce, the largest chunk of its manufacturing capacity, and accounting for very much of its exports, and then sums up by saying that first the War destroyed much of their manufacturing capacity, then the troops take away much of what's left of their manufacturing capacity, ?. . . and then you say, ?Now pay us the money.? And you can see why a central bank printing money in that situation, or creating currency in that situation, is not going to be able to do so, won?t be able to call forth goods and services. And you do create the conditions for inflation, and then hyperinflation. So again, it?s a very different situation from what we have today in the US.?

Next, Marshall moves on to Zimbabwe, and gives a history. Zimbabwe had a civil war lasting through the 1960s and 70s. It was a low intensity guerilla war which became more serious and ended when the British brokered an agreement. Mugabe became President in 1980, heading a coalition government, but even then ?a large chunk? of its ?productive capacity had been destroyed, even before the onset of the land reform.?

Zimbabwe recovered some under Mugabe, at first. Growth was at 11% in 1980, was positive ?.... until a severe drought in the early 1990s. Again, there was recovery, and a growing economy in spite of some problems with productive capacity. But Zimbabwe had a legacy of colonialism and the white farmers had ?. . . absolutely gorgeous palatial mansions,? lots of staff and ?. . . . a cushy life style.?

> "And 250,000 whites basically controlled over 70% of the most productive agriculture in the country, a nation of six million people, so that?s clearly a socially unsustainable situation.
>
> ?There were many attempts by the government to coax the white farmers into giving up a little then in order to make for a more equitable situation later and there was no give. As an aside, I think we talk a lot about income inequality in this country and to me, if its not something that?s addressed in a decent amount of time, you do get a huge socially unsustainable situation which will beget an even more extreme political response later. So I think it is in that regard the situation of what?s happened in Zimbabwe in terms of the misguided reforms that were subsequently introduced, it?s a legacy of the fact that we didn?t deal with the problem of inequality much earlier in that country.?

Mugabe begins a misguided land reform program. ?He seizes land from the whites, gives it to, mostly . . . . his cronies in the ZANU party.? But they don't know how to run farms, so agricultural production collapsed ?. . . by almost 50%.? So, Zimbabwe had to use foreign exchange reserves to import food, and it didn't have any reserves left to pay for ?. . . . raw materials, so manufacturing capacity absolutely collapses and the end result is that you have about 80% unemployment.? Marshall points to statistics ?. . . from Bill Mitchell, output fell by 29%? manufacturing output fell by 29% in 2005, 18% in 2006, 28% in 2007. It?s worse than what you had in Latvia over the last few years, again, though self-inflicted.?

So:

-- the land reform destroys domestic food production,
-- foreign exchange is used to buy food to prevent starvation,
-- there's no foreign currency to buy raw materials, so
-- manufacturing output collapses, and
-- you have 80% unemployment.
-- Mr. and Mrs. Mugabe use foreign exchange reserves for personal shopping trips to London
-- the government uses the rest of the foreign exchange reserves to increase net spending without adding to productive capacity
-- So, then Mugabe starts printing money, with no productive capacity to back it, and an inability to collect taxes to drive the value of the currency, and we have the famous hyper-inflation.

The situation there, of course, is wholly different from the US case. ?There are other examples of this. The loss of taxing authority during the civil war by the Confederacy is another example of a situation where a government?s inability to impose a tax ultimately did create hyper-inflationary conditions.?

And he follows with:

> ?Any bad government can wreck an economy if it wants to, that?s quite evident. A sensible government using fiscal, the path of fiscal capacity provided by a fiat monetary currency system can always generate full employment and yet sustain price stability. Now I know we?re going to be talking about this later, but one of the things I?d like to talk about briefly is productive capacity.
>
> ?We talk about calling forth productive capacity and, as a few people have mentioned earlier, the most effective means of calling forth productive capacity is by ensuring that you have a productive labor force. And one of the means by which you insure that you have a productive labor force is by establishing a government job guarantee program, which I think will be discussed at greater length later. The point is that if you have a government that has shovel-ready labor, ready to be piled back into the private sector when private sector demand arises, not only is this good social policy but it actually means that you do create non-inflationary conditions because it means you are effectively retaining productive capacity, which can be used.
>
> ?If you have long-term unemployed, the social pathologies build up and you actually? these types of workers lose their productivity. So in fact even though you might have significant output gaps via unemployment, if you have long term unemployment it does create, it can potentially create difficulties if you don?t have these people in a position where they can actually call something back, bring something back into the economy as a whole. So I think that?s an important conclusion to draw as well.?

Marshall then points out that he and Warren Mosler often talk to people who compare the US to Greece and Portugal and who say that the US will eventually ?default? on its debt. They then ask then whether they mean the US will fail to make SS or bondholder payments when due.

The doubters of debt then reply by saying: ?No, no what we mean by that is that the currency is going to fall so much that you?re going to get huge amounts of inflation and therefore that is tantamount to insolvency.? Marshall and Warren have heard this from Caroline Baum of Bloomberg, Martin Wolf of the Financial Times, and also Charles Goodheart, and Marshall says:

> ?The only point I?ve made to these people is that if you buy a credit default swap in a country like the US or Germany, or any country in fact, you don?t get paid out if they run a rate of inflation. It?d be nice, I mean I?d love to, I?d buy credit-default swaps in every single country that I could find, actually, because anytime they run an inflation, any rate of inflation I can get paid. But clearly that?s not the way that we define default. So again, misleading terminology, misleading hints, are all examples. You can always call people on that and I think we should do so much more aggressively in the future.?

LetsGetItDone Comment: So, that's the answer to the causes of hyper-inflation. ?Printing money,? may be one ingredient in causing hyper-inflation; but it is not sufficient to cause it. Also, necessary, is the destruction or loss of a large percentage of a nation's productive capacity, and, a strong need to get foreign exchange for some essential purpose. In addition, it helps to feed hyper-inflation if labor is in a position to increase wages in response to price increases, creating a feedback loop feeding price increases. Under these conditions, both demand-pull inflation, and cost-push inflation can feed hyper-inflation.

Marshall Auerback's talk was followed by a Q and A session. I'll go through that and add comments. But before I do, I'll provide some follow-up references on the subjects treated in Marshall's presentation appearing since the Fiscal Sustainability Teach-In. Marshall Auerback hasn't written very much on inflation and hyperinflation that I could find since the Conference. However, Bill Mitchell, Randy Wray, and Scott Fullwiler have written some excellent posts.

Here, [30] here, [31] and here, [32] are Bill's posts.

Here, [33] here, [34] and here, [35] are Randy's.

Scott Fullwiler also made contributions: here, [36] and here. [37]

John Harvey [38] and Eric Tymoigne [39] contributed two posts on the quantity theory of money.

Cullen Roche also did an important paper [40] using 10 case studies to examine the claim that printing money causes inflation.

Finally, I've done some posts relating to MMT and Inflation too: here, [41] here, [42] and here. [43]

SESSION 4: ?Inflation and Hyper-inflation? - Q&A[22]

Warren Mosler:

> ?Maurice [Samuels] and I went to Rome in 1993, after coming up with the idea that governments don?t default because, in their own currency, because all they?re doing is spending first and then collecting later. The securities function for interest rate maintenance and not to fund the debt. And a paper came out of that called Soft

> Currency Economics, and afterwards, I ran into Randy and Bill and Pavlina and then they all started looking up the history of these ideas. And so it?s interesting we came up with ideas first and then found the history afterwards. Which is not necessarily normally the way things work. We then discovered Lerner, we discovered Knapp, we discovered Innes.
>
> ?Now we?ve discovered somebody last week, Ruml, is that his name? From 1946 the Federal Reserve president of New York, who said the same thing we?ve been saying about quantitative easing. You notice things, we see how they work, then we go back in history and find reasonably prominent people who?ve said the same thing. Secretary of the Treasury Memminger, from the Confederacy, said the same thing about how currency worked and explained that?s how he was going to set it up. So what happens is, I think historians who don?t know how the currency works don?t find these things because they?re not looking for them. You have to have enough knowledge of what, when you?re looking at something, about circumstances to be able to recognize them as any kind of value.
>
> ?What?s that thing that was found back, the ball with the holes in it from some four thousand years ago, which they?ve all said was a means of accounting. It was a clay ball with holes in it where pebbles would fit in. And I?m saying no, those were used for money because you would, what you do is you have the clay ball and the stone would fit in when you took it out and spent it that would be the thing you?d accept for taxes. You knew it was the same stone when it fit into that clay ball. Now that?s a monetary mechanism. All the record books show that this thing was an accounting mechanism to keep track of things with these stones you stuck in. I think history is going to more and more find the things we?re talking about.?

LetsGetItDone Comment: This reminds me of a story told of Karl Popper. [44] (I read it, I believe, in work from Bill Bartley [45], or Peter Munz [46], but can't locate it right now. Anyway, it is said that Popper would begin his class on scientific method, by walking to the lecture hall and saying to his students ?observe,? and then walking out. Some moments later he would come back into the room and get the inevitable question: ?observe what??

He would then use that as a jumping off point to teach the lesson that ?observation? could not be performed without theoretical presuppositions [47] guiding us toward what it is we're supposed to observe. To observe, we must know what we ought not to see, and what we ought to see. Above Warren tells us that the MMT theory about how currency works leads people to observe and find things they would never have observed otherwise.

Bill Mitchell:

> ?I think the point about Marshall?s talk is very clear and really easy to understand in terms of the public debate now and the simple way of saying it. Not to say that Marshall wasn?t exquisite in his oratory [laughter] but the simple way of saying it, if you take an economy, you trash about 60 or 70% of its productive capacity then any

spending will start to generate inflation. And if you wanted to avoid hyperinflation in Zimbabwe then you would have had to have had mass deaths of the population from starvation. Private investment would have had to come to virtually a sudden halt, because you?ve just lost all that supply side. So, whenever anyone raises at your dinner parties about Zimbabwe. It had nothing to do with demand. It was a supply issue. They trashed their supply.

> ?And the last I know, in the US you?re doing a pretty good job of trashing your supply at the moment, running down the capacity of your work force and your industrial structure, but you haven?t done it yet and the companies are still out there, there are still workers that will work for them if there?s enough demand for the products and all you need to do is get the production, your supply side working again. In Zimbabwe they lost it. It was non existent. About 60-70% was lost. That?s why they had hyperinflation.?

LetsGetItDone Comment: Bill's summary is admirably simple. If you trash your supply and then try government deficit spending, then you risk hyper-inflation. But in the two years, since the Teach-In, the US and other industrial nations have been ?trashing their supply,? in the name of ?fiscal responsibility,? and also avoiding deficit spending which they think will lead to inflation. If they continue to do that for a decade without taking decisive action to create full employment, we may create the preconditions for serious inflation and have only the neoliberals to blame.

L. Randall Wray:

> ?I?ll add something on the Confederacy because it helps to drive home points we?ve made in every one of these sessions. So yeah, the Secretary of the Treasury was trying to tell the government, look we need the taxes to support the currency, because taxes drive the currency. But the government was saying, well hold it, we?re already putting such a huge burden on our population because they?ve got to fight the war and we?re taking all the resources away from them for the war effort and we don?t want to burden them also with the taxes. Okay, but see, our point is you?ve got to have the taxes in order to match the resources that you?re withdrawing. Okay, it?s in real terms. You?ve got to reduce the demand with the tax system and you also have to have a reason why people will accept the currency. And so people would not accept the currency and that is why they had to just continually print out more and more and more.?

Pavlina Tcherneva:

> ?On the point of hyperinflation, I think the key components here are a supply shock, a tax collection fall out, but also I think you have to have a ratchet that you could have something that fuels additional expenditure. And in most cases that you observe around the world that have hyperinflation, what was the initial inflationary shock was

> fueled by some sort of indexation, whether it was of wages or prices. And I think that falling off of the tax base will do that too, but you could fuel it artificially as opposed to what we were saying earlier that you have to let inflation dissipate by one mechanism or another through the economy.?

LetsGetItDone Comment: Pavlina adds the general idea of ?the ratchet,? which Marshall talked about in the particular historical case of Weimar Labor Unions. There's no ratchet in the US with the power to stop the bursting of an inflation bubble long before hyper-inflation is reached.

Next, came two questions from **Edward Harrison** and the ensuing dialogue. His first question is how the indexing of SS and ?things of that nature? plays into the possibility of hyper-inflation. Warren replied that the real issue is whether it causes a shortage of real resources or not due to ?over-provisoning? a sector of the population? Randy agrees that it might be a problem in the future once full employment is reached.

Ed's second question relates to whether a country with a sovereign currency that issues debt could have an increasing interest rate scenario that would cause ?imported inflation via currency depreciation?. Warren replied that the Federal Reserve could set interest rates ?politically,?and that Japan has kept them ?at zero for 20 years.? to which Ed replies:

> ?Then, you know, they set the short-term rate but the long term rate is effectively the imputed Federal Reserve funds rate going forward.?

Warren Mosler: replies by saying "Right, right. But let me suggest they also can set the long rate if they want to." Ed, says he just said that, but it is ?an ideological, a political decision.? Warren reiterates that if the Fed says that the Fed Funds Rate will stay at zero for 10 years, than a 10-year bond will be at zero. And Ed, again agrees but says that he wouldn't support that, and lots of other people wouldn't either, and that he thinks that's a political problem. And then Warren says:

> ?Okay, and the Treasury does the opposite when it issues long. It?s setting rates higher than otherwise, so either way the government is setting long-term rates now ? either by default or by active policy, or lack of it.?

And then Warren goes on to argue that zero rates are likely to be deflationary. It is a long and good argument and you should see the transcript or the video for it at selise's site [22]. He ends with:

> ?A monopolist always sets price and lets quantity adjust. With a currency monopoly we do the opposite. We set the budget and let the price adjust, well of course it?s going to be chaotic like it is, but we have the ability to set price and let quantity adjust. In other words just be on the bid side of the market and not pay the offered side. And that?s where Bill?s JG and Randy?s ELR comes in, where in a market economy you

> only need to set one price, in this case it?s the price of unskilled labor, and we can get into that later, I think it?s . . . .? [inaudible]

And then Bill Mitchell adds:

> ?Well if I keep talking I?ll stay awake, so [laughter]. There?s just a couple of points I?d make and Ed, your first premise is disputable. It?s the premise that?s always wheeled out, but it?s not necessarily inevitable.
>
> ?First of all, a depreciation in the currency is not inflation. It?s a once-off price adjustment, inasmuch as import prices are weighted in your CPI or whatever your measure of inflation is, it?s just a once-off. For that to become inflationary there has to be some secondary effects where the participants in the real income distribution don?t agree to share the real income loss. . . . .
>
> ?Yeah. So depreciation isn?t inflation; that?s a myth. That?s a myth that?s commonly put out there.?

Ed replies with ?If your currency goes down, doesn?t that almost naturally mean?: and Bill replies: ?It doesn?t naturally do anything.?

There follows an exchange among Ed, Warren, and Bill, about the price of real resources going up. With Bill and Warren pointing out that Ed is talking about a one-time price shift upwards and Warren saying that inflation means continuous rice increases. Ed points out it's a definitional question, and Warren and Bill agree with this but stick with their definition.

LetsGetItDone Comment: This exchange over definitions didn't quite get to the point as I see it. Here are some price increase phenomena: 1) one-time price adjustment to a shock to the economy; 2) a constant rate of price increase from one time period to another, say 3%; and 3) an increasing rate of the rate of price increases, say 3%, 4%, 5% etc, every time period. Now, the historical cases we call hyperinflation correspond most closely with 3). When it comes to inflation, historical cases we can point to seem to fit 2). But usually we don't view 3% a year as ?inflation,? no matter how long that rate of increase continues. In fact, we'd probably call that ?price stability.? 1) is a price increase. It may be a substantial one. It may trigger 3), but, in itself, it seems a pretty loose use of terminology to call it ?inflation.? To do so, seems more like labeling an event with a pejorative, rather than offering a reasonable proposal abut how to use the term ?inflation.?

Bill Mitchell expands on the subject of ?myths? about inflation.

> ?. . . That?s one of the myths out there that should be addressed. The second point is that there?s no intrinsic or inevitable relationship between a deficit position of government and the exchange rate. All the empirical work shows that there?s no systematic relationship between the fiscal balance and the exchange rate. And it?s

> quite plausible that you could have a strengthening exchange rate with very large deficits as a percentage of GDP if those deficits were creating conditions that allowed the capital account to improve. And if you really want to think about a country with ? and I think Warren mentioned it ? with a very strong currency and huge public debt, the highest in the world, and ongoing relatively large deficits think about Japan. They haven?t had any systematic meltdown in their currency; they?ve had deflation all of those years.?

Ed then points out that the yen did fall to 150 to the dollar and then rose later to 94, and says that's a reduction in the real income of people, which Warren answers by saying that it was active policy caused by government intervention. When they abandoned the policy it went to 94. **Randy Wray** then joins in and offers:

> ?Can I try a different way of responding? Let?s put it in the framework of how does the central bank tend to react to inflation and currency depreciation? I think that you?re correct that they do tend to raise the interest rate, because they accept two ? what we?re calling ? myths. One is that if you raise interest rates that fights inflation, and that they should fight inflation that could result from currency depreciation and rising price of the commodities that you import for example, because raising interest rates is going to increase government spending on interest. And so you might actually stimulate the economy thinking you?re going to slow it down to fight inflation. And then the second belief is that raising interest rates helps your currency to appreciate and what Bill is telling you ? there are no variables out there that economists have ever been able to find that are correlated with the currencies. There is no model that works. So there actually is no evidence that raising your interest rate appreciates your currency and as Bill was saying there?s no evidence that budget deficits are correlated with currency depreciation. Just plot the US budget deficit against our currency and there just isn?t any correlation. Sometimes currency appreciates with a budget deficit, sometimes it appreciates with a budget surplus. There just isn?t a correlation for this. But yes, I agree with you, central banks think this way and so these are to try to dispel.?

Bill Mitchell and Warren then provide a couple of jokes, about Australian currency appreciating, before the next question.

Dennis Kelleher, Rebel Capitalist: ?I have a hypothetical question ? I don?t know if I should have disclosed that, but ? let?s assume that a government has been enlightened and started practicing modern monetary operations and understanding it, and the link between wage growth and productivity was restored. What impact or potential impact would that have on inflation?? Warren then asked Dennis to clarify which ?link? he meant, which Dennis then said is the ?. . . . linkage between wage growth and productivity,? which was severed in the 70s or 80s.

> ?It?s the same the world over. And the empirical studies have never been able to

come up with a systematic relationship between wage share movements, which is what you?re really talking about, because the wage share is just the ratio of the real wage to labor productivity, and that clearly in all countries has diverged in ? depending where you start ? but in the eighties and nineties clearly, and there?s never never been? prior to that, you had a very close correspondence with that. I mean that was in a way the capitalists, if you like the terminology, they were smart enough to realize that you had to have someone to buy the stuff, and in the eighties and nineties they worked out a different way and that was to load the workers up with debt, and get a double whammy: steal the productivity in the first place and then load them up with debt so they could still realize the production. But we didn?t have major inflation breakouts in the fifties, in the sixties, in the seventies when there was an extremely close correspondence in all of our countries between real wage growth and productivity growth. The wage share in Australia used to be 62%, now it?s 51%. And that?s been a systematic erosion of workers? entitlements. And prior ? when it was 62% for years ? I mean Nicholas Kaldor used to call it one of the stylized facts ? the constancy of the wage share. And it?s only in this neoliberal era that that is no longer a stylized fact. We saw no inflation during those periods. Inflation occurs ? sorry Warren ? inflation occurs if expenditure nominal demand growth outstrips the real capacity of the economy to respond to that.?What?s that? . . . .

?. . . Or a supplier price shock that?s not isolated from the distributional system. And it?s quite possible that if workers are enjoying? You know in Australia we?ve had a system of national arbitration, national wage determination like a Scandinavian system, and it?s always considered that real wage? productivity growth provides the real space for nominal wage adjustments. And as long as the real wages don?t grow faster than productivity growth, you?re unlikely to get nominal demand outstripping real capacity. And the only way you could actually get ongoing aggregate demand growth that will engage your real capacity without indebting your household sector is to make sure real wages do grow in line with productivity growth.?

Warren Mosler:

?Do you know the game theory story? The other thing is, it?s a basic mainstream game model ? the first year, week, of game theory tells you that the labor market, whatever that is anyway, isn?t a fair game, because people have to work to eat, and business only hires if they feel they can make an acceptable rate of profit. So the idea is, as the unemployment goes down, then people who are left unemployed, their bargaining power goes up and they?re able to negotiate higher wages, and therefore as we get to lower? you know, there are productivity differences also, but the fact is, if you?re the last guy waiting for a job, and everybody else has one, and you?re offered a job and you don?t take it, you?re still going to starve. So you don?t have any more bargaining power because the unemployment pool is lower. And we saw unemployment fall below four percent in the late nineties even with the core inflation coming down, so that whole idea that there?s this NAIRU, etc ? I don?t see the support for it either in the data or in mainstream theory itself, where once you take a look at rudimentary game theory, there?s no reason to expect real wages to do anything except stagnate, unless there?s some kind of support, either through some kind of Australian type of thing, or some kind of support to at least make it more of a fair game.?

Bryce Covert: ?Hi, I?m Bryce Covert, I?m with New Deal 2.0, ... I understand the differences between the hyperinflation of Zimbabwe and Weimar Germany but in the US, how much of a risk do we have of that, and are there things that should be done or can be done to prevent inflation that we?re not doing? Are we going to run that risk or do you think we?re pretty safe??

Warren Mosler:

?Let me just say I think we?re very safe. But the risks of inflation are political, they?re not economic. If we?re wrong and inflation goes up to four or five percent, when we thought it was going to go to one or two, we don?t lose any wealth as a nation, we might lose at the ballot box. We don?t lose anything in terms of employment and output, and in fact most studies show it?s actually more likely to improve things. And we don?t get hurt in terms of investment or anything else like that. Again, studies show that it helps those things. But you do lose at the ballot box. So we do come up with policies that will cater to what voters want and how voters feel good about living their lives.?

Marshall Auerback:

?I?ll make an additional point. Jamie Galbraith makes this point very well, I?ve seen him make it a number of times, and he talks about the asymmetry of risk. And he simply says that, look, if you don?t spend enough, there?s a major danger of a relapse and that?s coming at a time when we already have, officially, nine and a half percent unemployment, unofficially by any honest measure it?s close to twenty percent. You have very high debt levels in the US, you still have an ongoing housing crisis. So that?s the? you have a possibility of a significant relapse, 1937 style, if you don?t spend enough. Now, if you spend too much, what?s the risk? Well you?ll get fuller employment, you?ll get a lot more capacity being used, and you might eventually get inflation. Okay, you get the inflation, you can solve that through a tax. It?s a very easy problem to solve. Or you simply stop spending, or, equally likely, the automatic stabilizers start taking care of themselves; the economy begins to grow again, more revenues come into the government, social welfare expenditures come down. So that in itself will start to create a fiscal drag on the economy so it seems to me that risks are so stunningly asymmetric in regard to not spending, and that can be done either through direct government spending or by massively cutting taxes, that if I was a trader making a bet right now, inflation-deflation bet, I think it?s still heavily weighted towards the deflation side for all the reasons I?ve outlined.?

LetsGetItDone Comment: These points by Warren and Marshall are very important. The idea that people who have no job have a weak bargaining position even in a strong economy so long as there is unemployment is right on its face for those sectors of the economy in which there's no skill shortage. Your bargaining power is about your being able to eat and pay rent without that job offer that's grossly inadequate.

If you can say no because you're working for a Job Guarantee program that already pays a living wage and good benefits, then and only then is there any kind of freedom in the bargaining relationship between an employer and a prospective employee. You have to be able to say to the unreasonable employer: ?take your job and shove it,? or "freedom" becomes only the freedom of the employer to coerce you.

And Marshall's point about the asymmetric risk between continuing to have an economy with real UE rates at nearly 17%, rather than having one with zero UE and the risk of inflation at say 5% per year, is an essential one that gets very little attention. During the years between the end of WWII, and the 1970s, the public clearly preferred lower UE and substantial minimum wage rates with a risk of inflation that was not too great, but above 3%, to a stagnating labor market with very little inflation. The oil-driven cost-push inflation of the 1970s scared people, however.

And even though it wasn't demand-pull inflation caused by Government deficit spending, which under Jimmy Carter was very low. And even though it was made much worse by the ratchet of the Fed under Paul Volcker, trying to control the money supply rather than the interest rates to break the inflation, those points escaped people, and an opening was created to sell people on the idea that inflation was a more important enemy than UE, and that fiscal policy in the form of government deficit spending on job creation wasn't an appropriate tool for Government to use.

This was successfully done by the market fundamentalists during the Reagan Administration. And that idea has governed politics in most ?advanced? Western countries since the Reagan/Thatcher successes made neo-liberalism the economic ideology of choice. Since then very few people have talked about the asymmetric level of risk between maintaining a high level of UE and having FE with some risk of moderate non-accelerating inflation, exceeding 3% annually. It's a story we have to tell more often, because the imagined enemy of inflation has frightened Americans into accepting the real and much more dangerous enemy of high UE, lower wages, labor market stagnation, excessive inequality, and developing plutocracy.

L. Randall Wray:

> ?Yeah, see, we really need to get into what we mean by inflation, and we need to distinguish between different things that might cause prices to increase, even sustained price increases. So Keynes had this definition, ?true inflation?. True inflation only occurs when aggregate demand is too high, that is where you?ve already fully employed your resources and you continue to increase spending. That is true inflation, and the way to fight that is by reducing aggregate demand. So that is when you need to raise taxes, cut government spending, or somehow get the private sector to stop spending, maybe clamp down on banks so they can?t lend, so people

can?t borrow and spend. Okay. That?s how you fight that.

?Now what happens if you have an oil price shock? Do you fight that by reducing demand? No, that would not make any sense. You have to find another method. Now, as Bill keeps alluding to, in the kinds of institutional arrangements we have in the United States, an oil price inflation is going to end itself very quickly, because we don?t have very much indexing of wages in our society, or of government spending in our society, that is going to cause an oil price shock to lead to a wage-price spiral, or something like that. But we could have those and if we did, then the way to fight that is through institutional change, not by clamping down on aggregate demand. You want to change the institutions, maybe centralize wage bargaining would be a way to do it, and figure out how you?re going to share the costs of adjusting to higher oil prices.

?So we really need to identify why we got the inflation. If it?s because the currency is depreciating, again, in the United States this isn?t very plausible; in a country like Mexico, they have very high feed-through impacts of currency depreciation into rising prices, so they?ve got to deal with that problem, something that we don?t have to deal with. And then finally, what everyone is talking about is the current outlook, the current situation in the United States, it?s just about impossible to identify a way that we could get inflation going even if we wanted to. And this is where Japan has been for a very long time. We have to remember that we just had two billion people come into the market economy, and they all want to produce stuff and sell it to us, and they?re willing to work at very low wages, and their firms are willing to sell at very low prices. It?s just not a plausible argument, even if we got closer to full employment, that we?re going to get significant inflation pressures, other than, yes, commodities prices could go up and we could have a very short-term increase of prices, which is what Bill was trying to get to, that?s not inflation, but it is going to cause a redistribution of income.?

Bill Mitchell:

?I think it?s really telling that ? and it?s sort of building on Warren?s point ? that we?re always talking about inflation threats, when you?ve got, maybe ? I?m not sure in America, it?s about 17.2 percent currently, I?m not sure, you use six measures? In Australia it?s 13.2. In some countries, in Spain it?s at least 30 percent once you add in underemployment ? of your labor resources unemployed. And we?re worried about inflation. I mean, one of the greatest successes of the neoliberal period has been able to convince us, and as relates to ? Marshall said that the risks are just asymmetric, well, so are the costs. The costs of unemployment dwarf any other economic costs you can possibly identify. And this goes back to a famous interchange between the American economists Arnold Harberger and Arthur Okun, and I think it was Tobin who said it, yes?, ?How many Harberger triangles can you fit into one Okun gap?? And, for non-economists, the Harberger triangles were these measures of inefficiencies, microeconomic inefficiencies, of the sort that you might get with some inflation. And

> the Okun gap was the lost output from having unemployment below ? above full employment. And the answer to the question, ?How many of these microeconomic inefficiency measures can you fit into one macroeconomic inefficiency measure,? the answer is ?Lots.? [laughter] And the point about it is that the macro costs of unemployment and lost income and all of the related social pathologies and intergenerational pathologies that follow are massive. And you?re sitting here in this country, and my country, and other countries idly sitting by wasting forever billions of dollars of income generation every day. And the only thing you can come up with is worrying about inflation. Even if inflation was a risk I wouldn?t worry about it right now because the relative costs are just not even commensurate. And that?s the big success of the neoliberal era, to get us to, to disabuse us of the notion that unemployment is a cost, and unemployment should be a policy target. We now under our central banking inflation-targeting, inflation-first type policy emphasis, we now use unemployment as a policy tool. We?re now using the most costly pathology of market-based economies as a tool to discipline something that is nowhere near the scale of cost. And that?s the success of the neoliberal era, and it?s a damn shame.?

L. Randall Wray: ?You?re giving our presentation.?

Bill Mitchell: ?Sorry.? [laughter] [applause]

Warren Mosler:

> ?It?s probably fair to say that the losses from unemployment over the last two years just in terms of lost output are far higher than all the costs of all the wars the US has ever fought in its history combined. Seriously. That?s just gone forever. Plus the ongoing losses because it?s all path-dependent. Once you change your path, you?ve lost it, the growth rates have to be much higher to get back onto path.?

Bill Mitchell: ?And millions and millions of dollars a day, every day, our countries are forgoing. Millions of dollars a day. Inflation will never go anywhere near that.?

Warren Mosler: ?Well, if we have twenty percent unemployment, I known not everybody?s equally valuable, but it wouldn?t surprise me if the losses are twenty percent of GDP every year, or something close to it.?

Bryce Covert: Maybe that?s the graph we need.

Warren Mosler: ?Yeah, well, the output gap. So what they do, is when they compute the output gap, is they assume some minimum level of unemployment for inflation control. So even the output gaps, which are huge now, far underestimate what the actual output gap is if they didn?t have that artificial constraint of five percent unemployment, for what they call the NAIRU. And now they?re talking about moving that up to six and seven and eight percent, where Europe?s been at nine for how long? Forever, right? Ten, yeah.?

Unidentified: "I think it was Keynes who used the example of paying people to dig ditches and then paying other people to fill them up again, and I always thought it was curious that it was politically acceptable to discuss something as useless as that in a serious idea, and I gather that one of the reasons for that is that the thought of government paying people to do something useful which would compete with the private sector is kind of what makes you go into that sort of nonsense realm. And basically what I?m thinking is that there is a sort of minimum profit margin that the private sector demands, and they don?t want government competing and employing people and lowering their profit margins. And where I?m going with this is that we have repealed the laws against usury and made profit margins in certain financial endeavors very very high, and everything pales in comparison. People who would become engineers instead become bond traders. And if we?re ever going to focus people on doing useful work at perhaps lower margins, don?t we have to get a handle on usury??

Warren Mosler: ?I?ll be the first to say that the financial sector is, by and large, a total waste of human endeavor [laughter], but I?ll let Randy ? my tag line is ?the financial sector?s a lot more trouble than it?s worth? ? but I?ll let Randy comment on putting Keynes in context. But the other thing is, the size of government is a political choice, how much we want, and it?s there for public infrastructure. Digging holes and filling them in is not public infrastructure. Go ahead and put Keynes in context.?

L. Randall Wray: ?He was being sarcastic, he was saying, if you guys are so stupid you can?t think of anything useful for these people to do, we could at least hire them to dig holes and bury money, so that wasn?t his proposal. He wanted to hire people to do useful things. And let me just tell you, the next panel we?re going to talk about the job creation program, and so the people will do useful things. But the other thing is, they won?t compete with the private sector. You want to ensure that they won?t compete with the private sector; you want to complement the private sector. So I just want to clear that up, but that will be addressed in the next panel."

Unidentified: ?Do you have any notion that by repealing the laws against usury is part of what?s wrong??

L. Randall Wray: ?Well of course, what Keynes wanted was full employment, and euthanasia of the rentiers. Euthanasia of the rentiers. He wanted to drive the overnight interest rate down to zero, and I think many of us up here support that. And I think that that is a way to put finance back into its place. It?s only part of the answer. So downsizing finance, we agree with you, well I think we all agree with you, probably all of us.?

Conclusion

If and when the mainstream and the Petersonians accept the MMT view that a government sovereign in its own currency cannot become involuntarily insolvent, then they will still cling to the dogma that ?printing money? causes inflation and hyperinflation.

That's why it was an important part of the development of the MMT counter-narrative to examine this old quantitative theory of money, which Keynes refuted during the 1930s. Marshall's presentation considered that question and presented plenty of reasons to think that much more is necessary than simply ?printing, it also made very plain the very important ways in which the US and other currency sovereign nations differ from nations that don't have their own sovereign currencies; including most visibly today, the nations of the Eurozone.

I think the most striking thing about this 4th session of the FS Teach-In Counter-Conference of 2010, is the very nuanced MMT view of the causes of inflation and hyperinflation, in contrast to the remarks about inflation you find in the Petersonian narrative, that came out of it. The distinction between demand-pull and cost-push inflation is very important because Government deficit spending or tax cuts are often blamed as sources of inflation and hyper-inflation, but supply problems caused by cartels or monopolies receive little discussion. Institutions which may create supply bottlenecks, and institutions which don't regulate the development of bubbles in supply markets also don't receive much attention. Also, the importance of a ?ratchet? in keeping inflation going is often a key element in either hyperinflation or serious, but less than hyper cases.

The discussion also pointed out how inflation debates suffered from a regrettable vagueness and ambiguity when the ?inflation? meme is used against policy proposals that involve deficit spending. If the types we called 1), 2), and 3) earlier aren't distinguished, then it's much easier to sound reasonable when claiming that government deficit spending causes inflation or hyper-inflation. But if one is restricted to type 3), an accelerating rate of price increases from time period to time period, then we can quickly understand that there hasn't been a historical case of hyperinflation or even serious inflation in a nation like the US since fiat currencies were adopted. It also becomes plain that type 1) really isn't inflation either; but only a substantial one-off rise in the cost of something that will just work its way through the economic system without triggering a damaging positive feedback leading to a sustainable inflation process.

Finally, the presentation and discussion were very successful in raising the issue of the trade-off between the risk of inflation under full employment vs. the reality of heavy costs paid by working people, when Government supports fiscal policy that allows an unemployed buffer stock to continue to exist. A UE "buffer stock" isn't just some statistic. It represents millions of people who can't find jobs for protracted periods of time, who can't pay rent, who must be dependent on others, and frequently whose lives, education, family life, and future well-being are damaged severely by the experience. If the Government can do something about that, then I think it is obligated to do so, even at the risk of inflation.

In Part 6, I'll cover the 5th and last session of the Fiscal Sustainability Teach-In Counter-Conference, in which Professors L. Randall Wray, and Pavlina Tcherneva presented major MMT policy initiatives including the Job Guarantee.

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