

MMT, Sovereign Currencies and the Eurozone – a reply to Marc Lavoie

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Marc Lavoie über MMT und die Eurozone

Thus, it is not surprising that within a session organized at the 2021 STOREP conference, I have been asked to answer to the following question: Modern Money Theory — What is new, what is good and what is relevant for Eurozone countries? The present text is thus an effort to provide some thoughts on the above question. My answer is itself organized in the form of six questions: (1) What is MMT? (2) What is the definition of a sovereign currency — an important concept for MMT authors? (3) Does the institutional setup play any role in assessing monetary sovereignty? (4) Is the euro a foreign currency for eurozone countries, that is, are eurozone countries currency users or currency issuers? (5) Why could there be a eurozone financial crisis and was it a balance-of-payment crisis, as a number of authors have claimed? (6) And as a conclusion, what is the future of the Eurozone?

Diskussion der Fragen 3-5

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2. What was wrong with the institutional setup (of the Eurozone)?

- Consolidation hypothesis (Lavoie 2022):
 - “The fact that the central bank is the fiscal agent and the bank of the government does not mean that they ought to be considered as a single institution”.
- Lavoie recently declared that **consolidation can be useful** (Armstrong 2020b, 157).
- Ehnts (2016) shows Eurozone with Treasury and NCB and ECB, Fullwiler 2020 discusses US **with all details**.
- Consolidation hypothesis is a **pedagogical tool** used after detailed examinations.

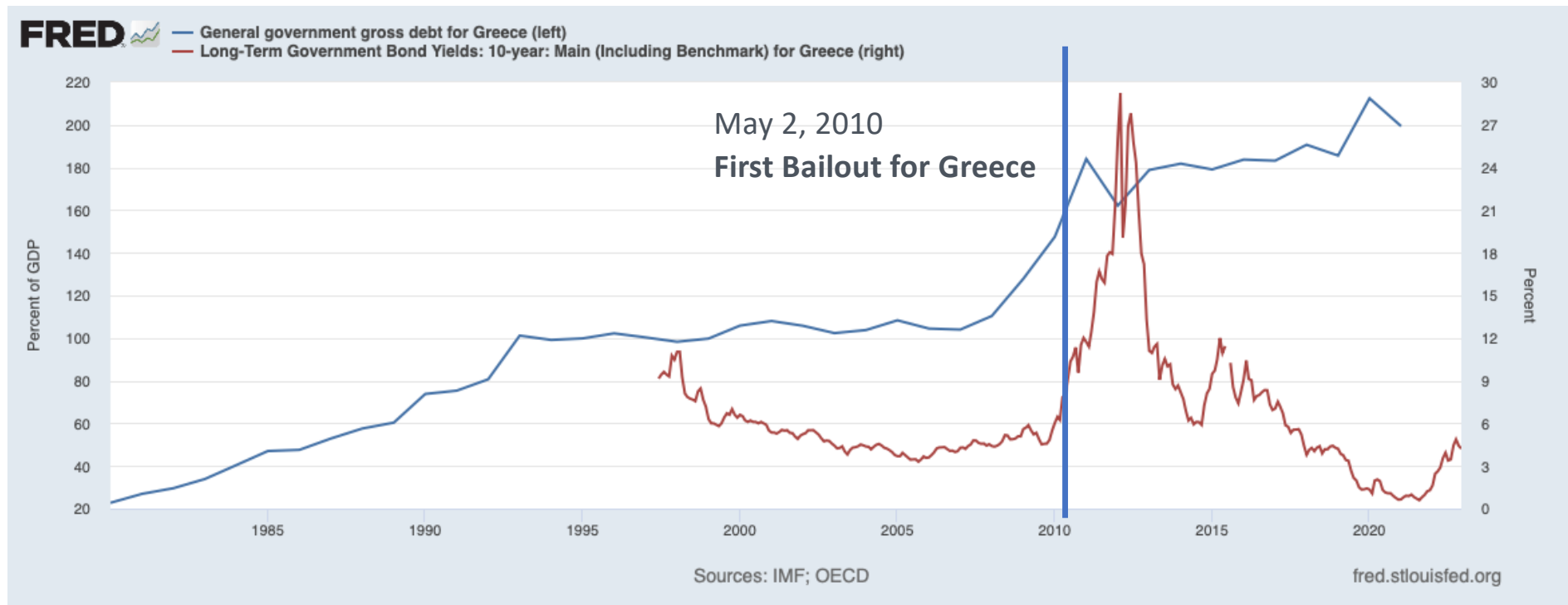
2. What was wrong with the institutional setup (of the Eurozone)? II

- Ehnts and Wray (2023): The various rounds of Quantitative Easing adopted by the USA, the UK, and Japan demonstrated that the “constraints” imposed no limits on central bank purchases of sovereign debt, that “bond vigilantes” could not raise rates on sovereign debt, and that central banks could hold rates at or even below zero for as long as they wanted.
- Ehnts and Wray (2023): By contrast, as MMT long claimed, with the Eurozone’s arrangements, only the Eurosystem could “do whatever it takes” to keep rates on member state sovereign bonds low. The pandemic finally lifted the truly constraining constraint: the limit on bond purchases by national central banks.

2. What was wrong with the institutional setup (of the Eurozone)? III

- Lavoie's three approaches to the relations between a central bank and a treasury:
 - neo-chartalist view
 - post-chartalist view
 - “overdraft economy”, or “anti-Chartalist case” (no bond purchases of CB whatsoever!)
- Lavoie agrees with the MMT logic that the state (as sovereign currency issuer) spends (or lends) first.
- Lavoie (2022, 638) writes: “If banks or other financial institutions decline to purchase the newly-issued bonds or refuse to rollover existing stocks of bonds, there is nothing that the central bank can do to stop the price of these bonds to fall or to stop bond yields from rising.”
- We think that this anti-Chartalist case is not stable (Ehnts 2014, 2016, 2020)
- ECB ensures demand for government bonds, which allows national governments to spend via a green light at their central bank (bringing Treasury account back to 0)
- Eurosystem acts as dealer of last resort

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2. What was wrong with the institutional setup (of the Eurozone)? IV

Lavoie (2022, 639) **Table 2.** The anti-chartalist case: Treasury bills are never purchased by the central bank.

Central bank		Commercial banks	
Assets	Liabilities	Assets	Liabilities
		Treasury bills +100	Government deposits +100
Advance (repos) +100	Government deposits +100	Treasury bills +100	Advance (repos) +100
Advances (repos) +19	Banknotes +10 Deposits of banks +9	Treasury bills +100 Reserves +9	Household deposits +90 Advances (repos) +19

Ehnts and Wray (2023) Table 1: Government spending in Germany

Central bank		Commercial bank	
Assets	Liabilities	Assets	Liabilities
	Reserves +100	Reserves +100	Deposits +100
	FGA -100		
	Reserves -100	Reserves -100	
	FGA +100	Bunds +100	

3. Is the euro a foreign currency for eurozone countries?

- Christine Lagarde, November 2020: “As the sole issuer of euro-denominated central bank money, the Eurosystem will always be able to generate additional liquidity as needed,” (Reuters)
- Clearly, NCBs are currency issuers (like the ECB).
- Ehnts and Wray (2023): Mosler (2010, written in 2001) had argued from the beginning that the trigger of a Euro area crisis would be a **private sector financial crisis**, not unlike the US Savings and Loans crisis of the 1980s. As each member nation tried to deal with its crisis of private debt, it would run up more **government debt that would scare markets** and cause interest rate divergence. [...] The surplus countries in the Eurozone were forcing big government deficits in the current account deficit countries (since the government balance must equal the sum of the private and external balances). We added the understanding of the function of Target2 and argued that the **current account deficits by themselves were sustainable, but the budget deficits were not.**“

4. Why could there be a eurozone crisis and was it a balance-of-payments crisis? I

- Ehnts and Wray (2023): „We need to return to Godley’s sectoral balance approach, not to Thirlwall’s balance of payment constraint. **By identity, countries with bigger current account deficits will have either bigger government deficits or bigger private sector deficits.** The first would not be a problem for a country like the USA, but it was a problem for countries constrained by Maastricht criteria, for the reasons discussed above (Kelton and Wray 2009). Bigger private sector deficits exposed both the USA and the Euro nations to the possibility of financial crises. **Only in the Eurozone could a private sector financial crisis cause a national government to run out of money.** In the US, though some pundits compared the US to Greece, that was never possible.“

4. Why could there be a eurozone crisis and was it a balance-of-payments crisis? II

- Ehnts and Wray (2023): „ **The problems lie in the Stability and Growth Pact with its deficit limits and the refusal of the ECB to act as dealer of last resort when needed.** Fortunately, the two real restraints of the Eurozone set-up were dealt with early-on in the pandemic. In March 2020, the **general escape clause** of the Stability and Growth Pact was activated, and the **ECB started its PEPP** to ensure demand for government bonds. That has returned sovereignty to the national governments: the ability of each to **mobilize its own domestic resources.** No MMT advocate has ever claimed that a currency issuer can command foreign resources with its own currency.“

4. Why could there be a eurozone crisis and was it a balance-of-payments crisis? III

- Ehnts and Wray (2023): „ **The “external constraint” is something that is not connected to sovereignty.** The hierarchy of currency and international debt relations do exist and they do matter (Fritz et al. 2018), but a country still can maximize its ability to mobilize its own domestic resources by using its own currency. Only if there were no domestic resources left (because they are fully employed or are all claimed by foreigners) would this would not help, but surely there is no country where things stand like this. In addition to resource constraints there can also be political constraints and barriers posed by corruption and incompetence, something that MMT has never denied. However, Eurozone member states can also pay for imports. **The German government has recently appropriated €100 billion, of which it will spend a little less than €10 billion on F-35 fighter jets from the US.**”

Schlussfolgerungen

- Good news: the Euro can be fixed!
- (1) “European Solidarity Mechanism” presented at Annual Research 2022 conference by the Joint Research Centre (JRC) and the Directorate-General for Economic and Financial Affairs (DG ECFIN) to make ECB dealer of last resort.
- (2) Replace SGP with full employment targets
- Both are relatively easy to implement, as today’s situation shows (SGP is off, ECB has announced TPI). Even in 2019, deficit targets were not enforced (well, 1 out of 10). Today, unemployment rate in the Eurozone is at a record low.
- Debate about fiscal framework reform is on-going – be bold like Keynes: G up!
- Sondervermögen has shown that federal government can always spend more money – there is no excuse for the federal gov of “not having the money”.