Twitter Thread by Richard Murphy

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I keep hearing people complain that the 'mainstream media' does not understand economics and that we're talked down to as if everything must be explained as if the economy is a household. In this thread I explain all you (and they) need to know. Economics in one thread then....

Very few people seem to understand how money is created. Mainly that's because when they're told it seems so simple that they can't believe something that's so important that we're willing to pay a lot to get it is created so easily. This thread explains how money is created.

What this thread also explains is that if we understand money we can completely reimagine how the economy really works, which is the pathway to rebuilding from the mess we are in. Which makes this a pretty big deal. I make no apology for its length as a result.

Let's start at the very beginning. A person goes into a bank and asks for a £1,000 loan. The bank checks them out, and agrees. And that is all that it takes to create new money. Money is just a promise to pay. That simple exchange of promises is all it takes to create it.

Most people think there must be something that backs up the value of money. Gold, most likely. But there isn't. Money is just a promise to pay, and has been for almost 50 years now. Mutual promises to pay creates all the money we have.

So in the example of that £1,000 loan, the customer promises to pay the bank. So the bank opens a loan account for them. That records their promise to repay. And the bank puts £1,000 in the customer's current account. They promise to let the customer spend that how they want.

Two promises. Two accounts. And as a result we get new money. That is how all money is created. It is as simple as that.

There is no one else's money involved in this process. The bank does not lend out the money saved with them. And there are no notes and coin moved from one pile to another pile to back this all up either. There are just two promises. And then there is new money.

Making money really is as simple as promising to repay it. So why is it so expensive for some people to get hold of it? That's not because the money itself is expensive. Clearly, it isn't. That's because there's a risk that they will break their promise.

Money itself is really cheap. The pure price of borrowing money has been falling for hundreds of years. It is now officially 0.1% per annum in the UK. That's the rate set by the Bank of England. Or just £1 a year for every £1,000 borrowed. Which is staggeringly cheap.

That's the rate the government pays. Around £800 billion of money deposited by UK banks and building societies with the Bank of a England gets interest paid on it at 0.1% a year. And if the Bank decided the rate could be 0%, or even negative.

So the reality is that money is almost free. Allowing for inflation, which is higher than this interest rate, money is free to the government. In fact, in reality people are paying the government to hold their money.

But the government borrows more cheaply than anyone else. It creates the currency - the pound - and declares it legal tender. And it has its own bank - the Bank of England. This means the government can lend to itself. So it can never run out of money. It is risk free.

The rest of us don't have a bank, and can't declare the money we makes to be legal tender. So all other lending is riskier. Including the money that you lend to your bank, which is exactly what you are doing if you have a bank account that's in credit.

If you think you have 'money in the bank', think again. You have not. You just have a promise from the bank to pay you money if you demand it. And if they can pay it, of course. You're now the banker. They're the borrower. And you have the risk they won't repay.

And that risk is real. Remember Northern Rock? The government stepped in. This is why all bank deposits in the UK have to be guaranteed by the government to a limit of £85,000. If they weren't it's likely no one would trust the banks to repay.

But what this means is that for most people (not the wealthiest, and not big business) the government guarantees all the money that we have. And it even, by implication, guarantees that the banks exist so that they are there to lend if and when we require it.

How is it possible that although all money is made by promises - including yours, and mine - the government is so important? First, it alone creates the currency. Secondly, as I noted, it has its own bank. So it can always repay, because it will always lend it money.

So, it's the government and it's Bank of England, and their promise to pay that is actually behind the real value of our money. Not gold. Not notes. Not coins. Not how strong the rest of the UK banking system is. The promise that the government makes is what matters.

But why is its promise so good? Because it has the means to back it up. Having a bank is not enough. Having the means to tax changes everything. That, and the ability to pass law to make sure tax is paid. And then only in the currency the government chooses - the pound.

Tax is what gives the pound its value. If the government could just create money without limit it would soon be worthless. But it does not do that. Tax ensures that the government can control the amount of money in the economy.

A lot of that money is created by the government. Every time it spends it tells the Bank of England to pay whoever is required. And it does that, because it trusts the promise the government makes to repay it. Well it would, wouldn't it? After all, the government owns it.

But what the Bank of England does not do is check whether it's got money available to lend the government to spend. It does not need to do so, after all. All it need do is trust the government's promise to repay. And then it creates the money that the government wants to spend.

This is really important though. What it means is that tax does not need to be collected before the government spends. Instead the government always spends the money its bank creates for it when instructed to do so.

But that means something else. It means the government never spends taxpayers' money.

It also means that tax does not fund spending. That can happen without tax.

So what does tax do? It does something really important. It recovers the money the government has spent into the economy. Enough has to be collected to control inflation and make good on the promise that the government gives when it guarantees all our money.

Does that mean the government has to balance its books? No way does it mean that. Controlling inflation is the goal, and what we've learned is we can run deficits, and control inflation.

But that has come at a price. That's been unemployment, low wages and lots of crap jobs that add little value to society or the lives of those who do them. To be polite, that's the economic policy of a callous government that does not care.

Forcing people into meaningless, low paid work is a price too high to control inflation, even if that also means lower taxes and that deficits do not threaten to create economic instability. There has to be a better way to manage the value of money than this.

And there is. We could have a government promise full employment. It could create the jobs we need. It could force up the minimum wage by guaranteeing local work for anyone who wanted it. And we could improve benefits too. All using government made money. Not tax.

But would there be inflation then? Not if we then taxed enough and cut spending a bit. But people at work in good jobs do pay more tax. And they claim fewer benefits. So that condition is easy to meet. And if we still needed more tax? Well, we could do that, if needed.

But that need would not be to fund the spend. Tax is never needed to fund spending. Always remember that. It's needed to control inflation. And to redistribute income and wealth, and other social reasons. But not to fund spending. Ever. Money does that.

So, I hear you say, why do governments borrow then? After all, if they can create all the money that they need why do they have to borrow other people's money? Doesn't the fact that they borrow prove me wrong? No, it doesn't. Because they don't need to borrow.

The government did have to borrow when money was in short supply. That was when it was backed by gold. That system ended way back in the last century. Since then, remember, all money is just a promise to pay. But also remember, the government has by far the best promise.

So, people who are cautious, like big pension funds, large companies, the wealthy and banks themselves want somewhere as safe to save as ordinary people - those with less than £85,000 in their bank account - have right now. And that means they want to save with the government.

But they can't not in ordinary bank accounts. Because the government has set a limit in them. So the government has adapted, fairly surreptitiously, a gold standard era savings mechanism to meet this need for a safe savings account in the modern world of money.

That mechanism is 'the gilt'. Gilt, of course, is gold. Once, these gilts were gold backed savings products. Not any more they are not, of course. Remember, everything about money is just a promise to pay now. Gilts, or government bonds, are like everything else in this regard.

And money is not scarce for the government now, either. It could have all it needs on overdraft at the Bank of England if it wanted. And it need not pay interest on that. So why doesn't it go for this cheapest of all funding options? Because people need safety, that's why not.

So, just as the government guarantees most people's money in the bank, it also offers gilts (or government bonds) for those with millions or billions to save because they too want guarantees on their money. And they will accept a low rate of interest to get it.

Government bonds are not, then, real borrowing by the government. They are instead a savings mechanism. Sure, they look like a loan. But then so too is a building society bond a loan to a building society. But it's also a savings account in reality.

And that's what government bonds are: they are just savings accounts. That's all. And, as I noted when I explained how money is created, savers' money is not involved in money creation by lending, at all.

In the same way, government borrowing is not in involved in the funding of its spending. Sure, the government borrows. But then all savings institutions do, all the time. But they don't lend savers' money out. And the government doesn't fund spending with borrowing either.

And before questions are asked about quantitative easing (QE) and where this fits in, let me address that one. QE is a process that involves the government buying back gilts. So, it is a mechanism to control the amount of savings it makes available. That's it. No more.

QE also controls the amount of money in the banking system. QE forces money out of government gilts because the government buys them back, making them more scarce. The flip side is that government pays for these bonds using free money that the Bank of England creates for it.

This money creation puts more money into commercial banks, backing up the government guarantee that they will be solvent. That money injection is pretty important in that case.

But just to add to the list of what QE does, it also shatters the myth that governments are under the thumb of bond markets, for good. Now if bond markets get uppity about anything the government simply has the power to buy its debt back and bond dealers are left high and dry.

And another QE fact; by controlling the money supply into commercial banks the government gains almost complete control of short term interest rates, and through QE it has a massive influence on long term rates too. QE delivers protection from economic shocks as a result.

I'm not saying QE is a universal good, by the way. It's forced money into the stock market, and overinflated it. That has increased inequality. Neither is good news. But it does add a powerful weapon to the government armoury for controlling the economy.

So, the government can now create money at will, control how much of that is in commercial banks and in government backed savings accounts at any time, control inflation through the tax system and deliver full employment if it wants, all if we understand money. Pretty cool, then

But to make sure this is clear, where does this new knowledge that comes from the very simple understanding of how money is created (not printed, or made - created is the right word) leave us?

First, it says the government underpins the value of all our money, because whilst all money is a promise to pay, the government's promise is the best, and our banks could not function without the support of that promise. We need to remind arrogant bankers of that, often.

Second, whilst cash saving is important to people it's also pretty important to realise that it is much like dead money. It is not used to fund bank lending or to pay for government spending. That does really mean the state should not be subsidising it with things like ISAs.

Third, spend comes before tax, always.

Fourth, the government always spends its money, and not taxpayers'.

Fifth, tax does not fund government spending. Tax is instead used to control inflation, redistribute income and reorganise the economy, but never to fund spending, and that's true in any country with its own central bank and currency and that never use another country's currency.

Sixth, the government does not need to borrow because it can always create the money it needs on overdraft at the Bank of England.

Seventh, the borrowing it does do is a favour to those who want to save with the government. It does never need the money people save with it.

Eighth, that means we need never have a debt crisis. If we don't need people's money, because the government can always create its own, where's the debt crisis? Especially when a government can always repay on demand, simply by asking the Bank of England to make the payment?

Ninth, the amount of savings a government wants to accept, and the interest rate it now has to pay on it, can always now be controlled through the QE system. All this does is regulate the government backed, cash based, savings system. Nothing more, and nothing less.

Tenth, I stress, that means all interest rates are now heavily influenced by the government and many are under its direct control. So where is the interest rate panic?

Eleventh, inflation is not now controlled by interest rates - because we don't want them to rise. It's going to be controlled by tax. I admit, right now no one has an ideal tax to achieve this goal. I am working on it. It is possible. And it's progressive, and so fair.

Twelfth, we can have full employment at fair wages, and it pays for itself.

Thirteenth, there is no need for austerity, at all in that case.

Fourteenth, please go and talk about this. By really understanding something as simple as how money is created - and by being aware that it is never in short supply as a result - we can rebuild from the mess that we are in. We can have the sustainable world we want.

Sorted. The End.