

Modern Monetary Theory (MMT) and the Federal Budget Deficit

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- 1 Some Recent Discussion of MMT

The New York Times



Is This What Winning Looks Like?

Modern Monetary Theory, the buzziest economic idea in decades, got a pandemic tryout of sorts. Now inflation is testing its limits.

[My emphasis added.]



- “What Stephanie Kelton sounds like, circa early 2022, is the star architect of a movement that is on something of a victory lap.”



- “Buzziest economic idea in decades”?
- “Victory lap”?
- Many other inaccuracies in the article, e.g., the NYT journalist’s labeling of Kelton’s “school of thought” as “brackish economics” is 100% nonsensical.

The NYT article on MMT is really bad

The fringe ideology's star is falling, and puff pieces will not resuscitate it



Noah Smith
Feb 7

♡ 102 💬 38 ↗



- “This article aroused the anger of just about every macroeconomist on Twitter, and with good reason.”
- “[I]t demonstrates very little understanding of the issues at play or the state of the policy debate, and it rhetorically elevates a fringe ideology to a position of importance and centrality that it neither occupies nor deserves.”

- “Suffice it to say that I consider MMT the cryptocurrency of macroeconomics:”
 - ▶ “It sounds edgy and forward-looking, but when you press its devotees on what exactly is its point, what it can do that you can't do better using more conventional approaches, the response is a lot of bombast but no clear answer.” [More on this later.]

Updated Feb 8, 2022 - Economy & Business

Male economists are freaking out over a NYT profile



Emily Peck

- Includes a quote from the NYT's external communications director: “[T]raditional economic thinkers are reckoning with an upstart approach, generating diverse reactions that range from criticism to support to bewilderment.”
- “Reckoning”? 🤔
- Janet Yellen in 06-17-2021 testimony to House Ways & Means Committee: “I do not support modern monetary theory.”

② MMT Enters the Public Consciousness

- Broke out circa early 2019.
- Big factor behind it's arrival on the scene was enthusiastic acceptance of its main tenets by Bernie Sanders and Alexandria Ocasio-Cortez (and many of their allies/supporters), who arguably found that MMT provides an analytical foundation for financing their policy goals.
 - ▶ In her 2020 book, Kelton claims she destroys many “myths about deficits that are hobbling us as a country.”
 - ▶ FWIW: Kelton was a senior economic advisor to Sanders' 2016 and 2020 presidential campaigns.

- MMT has played no role and continues to have no role in standard undergraduate teaching on and PhD training in monetary theory and policy.
- There is zero attention paid to MMT in a vast array/range of academic research on monetary theory and policy.
- But maybe mainstream teaching of economics & economic research is wrong to ignore MMT?

③ MMT and Printing Money

- I'm going to borrow from Greg Mankiw's 2020 review titled "A Skeptic's Guide to Modern Monetary Theory" and focus on some key ideas from the 2019 MMT textbook *Macroeconomics* written by William Mitchell, Martin Watts, and L. Randall Wray (MWW).

- MWW: “The most important conclusion reached by MMT is that the issuer of a currency faces no financial constraints.”
 - ▶ “Put simply, a country that issues its own currency can never run out and can never become insolvent in its own currency.”
 - ▶ “It can make all payments as they come due.”
 - ▶ Accordingly, “for most governments, there is no default risk on government debt.”

- Mankiw: “When reading these words, my reaction alternates between languid concession and vehement opposition.”
 - ▶ Yes, a currency-issuing government can always print more money.
 - ▶ But at some point, such a policy will be inflationary (if not hyperinflationary).

Hyperinflation in Weimar Germany

- At some point in early 1920s in Germany, it was cheaper to burn money than wood or coal for fuel:



Hyperinflation in Venezuela

- The price of chicken in bolivars in Venezuela on August 17, 2018:



- Any money printed by the government to pay its bills will end up in the banking system as “reserves” (deposits in commercial banks’ accounts at the Fed):
 - ▶ The Fed will need to pay interest on these reserves.
 - ▶ MMT proponent will note that more money can be printed to pay that interest, and the new interest of the associated additional reserves, and again, and again, etc.
 - ▶ But the ever-increasing increase in reserves \Rightarrow even-increasing expansion in the “monetary base” \Rightarrow increase in “aggregate demand” \Rightarrow eventually increasing inflation.

- MWW: “capitalist economies are rarely at full employment. Since economies typically operate with spare productive capacity and often with high rates of unemployment, it is hard to maintain the view that there is no scope for firms to expand real output when there is an increase in nominal aggregate demand.”

▶ In other words:

- ① They agree that financing government expenditures by printing money will lead aggregate demand to increase.
- ② But there's typically so much slack in the macroeconomy ⇒ those increases in aggregate demand won't be inflationary

④ MMT & Models



- Back to Noah Smith's critique of the 02-06-2022 NYT piece:
 - ▶ “MMT proponents almost always refuse to specify exactly how they think the economy works. They offer a package of policy prescriptions, but these prescriptions can only be learned by *consulting the MMT proponents themselves.*”
 - ▶ “**There is no model here** — no set of equations or definite formal statements that a layperson could use to generate their own MMT policy prescriptions without appealing directly to the gurus.” [My emphasis added].

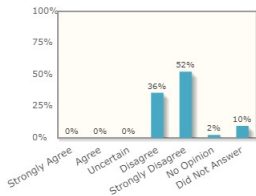
- "Now, arguing with the MMTers generally feels like playing Calvinball, with the rules constantly changing: every time you think you've pinned them down on some proposition, they insist that you haven't grasped their meaning."
 - ▶ "So I was glad to see Stephanie Kelton responding to my attempt to clarify my problems with the doctrine in a way that seems to make at least some key differences in view clear."
 - ▶ "The problem is that I don't understand her arguments at all. If she's saying what I think she's saying, it seems just obviously indefensible."
 - ▶ He ends with: "Yes or no answers, please, with explanations of how you got these answers and why the straightforward framework I laid out above is wrong. No more Calvinball."

- ⑤ Representative Take on MMT by Economists

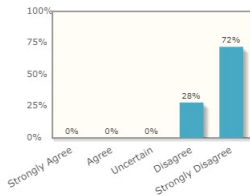
Question A:

Countries that borrow in their own currency should not worry about government deficits because they can always create money to finance their debt.

Responses



Responses weighted by each expert's confidence

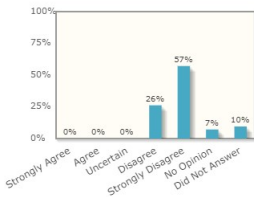


Source: <https://www.igmchicago.org/surveys/modern-monetary-theory/>

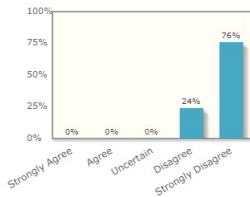
Question B:

Countries that borrow in their own currency can finance as much real government spending as they want by creating money.

Responses



Responses weighted by each expert's confidence



Source: <https://www.igmchicago.org/surveys/modern-monetary-theory/>

6 Concluding Section

- It'd be nice if MMT were a sound theory that's backed up by actual policy experience.
- However, there are many real-world counterexamples to the central claim of MMT that “the issuer of a currency faces no financial constraints.”
 - ▶ So in addition to there being no clear theoretical foundation for MMT, there's ubiquitous evidence against MMT's core conclusion.

- Note: It's perfectly consistent to support lots of “big spending” programs, e.g., the Green New Deal and Build Back Better plans, while also thinking MMT is nonsense. For example, Krugman, who strongly identifies as a political progressive, supports such programs.
- So why is there so much enthusiasm for MMT (outside the economics profession)?
 - ▶ I think political scientists, sociologists, psychologists, anthropologists, philosophers, etc. are better qualified than I am to answer this question.

–Thank you for your time and attention–