Modern Monetary Theory: Economic Savior or False Prophet?

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From all the confusion that swirled around the 2008 financial crisis and the unexpected economic trends in the recovery, a novel way of looking at the American economy was born. A hodgepodge of Keynesian principles and outside-the-box economic rationalization built on an unconventional interpretation of deficits, Modern Monetary Theory (MMT) emerged as a theoretical solution to unemployment. Though the theory has been developing for the past decade or so, it has in the past few years entered the public consciousness on never-before-seen levels, largely because of its recently gained foothold with progressive Democrats: major MMT proponent Stephanie Kelton, for example, was Bernie Sanders's economic advisor, and Representative Alexandria Ocasio-Cortez has advocated for implementation of the theory to fund the healthcare and climate change programs proposed under her

Green New Deal (Mayeda and Dmitrieva). Though not always mentioned by name, MMT principles have become ingrained in the country's political consciousness, and MMT-leaning lingo has become more and more common in light of the downturn triggered by COVID-19. Indeed, some believe it may be America's economic savior.

MMT has also received significant criticism from multiples sectors, ranging from Lawrence Summers, a former Secretary of the Treasury under President Obama, who accused MMT of being "fallacious at multiple levels," to Larry Fink, CEO of BlackRock, the largest asset managing company in the world, who labelled it "garbage" (Mayeda and Dmitrieva). Not surprisingly, fierce debate swirls around MMT and whether it is a viable alternative to fiscal austerity in the U.S. economy. Economist and George Mason University professor Scott Sumner once remarked on the debate, "MMT has constructed such a bizarre, illogical, convoluted way of thinking about macro that it's almost impervious to attack" (Coy et al).

Indeed, Modern Monetary Theory is built on several fundamental economic errors, including its conception of how government money creation works, why government deficits matter, and the causes and prevention of inflation. These glaring issues are proof that voters should be mindful of what economic policies, not merely candidates, they are voting for on election day, especially in this unprecedented and uncertain time in American history.

MMT, at its core, is the belief that the government has access to nearly unlimited funding. Since it can create its own currency, government need not worry about escalating levels of debt as long as inflation is kept in check insomuch as the government cannot legally declare involuntary bankruptcy (Coy et al). This is true, but what advocates of MMT fail to realize is, inflation aside, excessive money creation in this manner does not actually provide a "free lunch," as IMF's chief economist Gita Gopinath put it (Harvey; Mayeda and Dmitrieva).

Kelton argues that economists' tendency to shy away from deficits is simply a matter of perception, claiming they merely represent nongovernment surpluses. In other words, deficits are an account of how much money the government paid into households and did not tax back out (Kelton, "Sanders' 2016"). This, however, is precisely why government money creation will not have the desired effect of free funding. If the government needs additional funding and decides to issue more currency through the Treasury, according to Kelton, this extra money finds its way into households. MMT proceeds on the assumption that this money will be spent and subsequently boost production and the economy; however, it is not unreasonable to assume the public will deposit much of the excess in commercial banks. Now banks have extra currency, which they deposit in the Fed as bank reserves. The Fed, like in most countries, pays a market interest rate on these bank reserves. So in this scenario, the extra government expenditure is financed by "forced borrowing from the banking system," and the government still ends up paying interest on its debt, merely through a different process than usual (Grenville). If the government still must pay for its debt, it makes more sense to do so through the established method of issuing US Treasury notes than through burdening the Fed with extra expense. Indeed, unlike what MMT proposes, there really is no "free lunch" for the American government.

A common misconception of MMT, stemming from its seemingly haphazard attitude towards money creation, is that MMT advocates believe deficits do not matter. Kelton, speaking on behalf of all MMT advocates, firmly rejected this claim on Twitter in 2018:

The misconception stems from *why* MMT advocates think deficits matter. Usually, large deficits precede bankruptcy, but MMT disregards deficits in this sense because the U.S. is not legally subject to this danger (Harvey). Yet MMT advocates still recognize that deficits can trigger inflation, which they view as the primary hazard of excess government fund creation and thus have designed plans to keep price levels in check (Kelton, "Sanders' 2016"). MMT fails to consider a third risk to growing deficits, however: how they affect the U.S.'s reputation for fiscal sustainability and appeal to foreign investors. The article Kelton attached to her Tweet claims that "the notion of 'fiscal sustainability' or 'solvency' is not applicable to a sovereign government" such as the United States (Wray). This statement is true in that the government cannot go bankrupt but, on a global economic scale, foreign investors tend to shy away from excessively increasing deficits. The reality is, even if the U.S. government can handle excessive deficits, the country could be hurt from developing a reputation around the world for fiscal irresponsibility. If the U.S. loses the confidence of international investors, it will be harder for the country to issue debt, and international demand for money holdings and debt prices will drop, culminating in the dollar plummeting and wreaking havoc on the economy (Coy et al). Perhaps a successful, longtime implementation of MMT could assure the world that excessive deficits will not trigger inflation and win back the confidence of investors; however, as MMT stands currently, a novel theory many believe to be nonsense, dollar depreciation (a harbinger of inflation) would be a very real danger if MMT was implemented.

The notion of a government creating its funding at whim depends heavily on controlling inflation, which will inevitably occur if the government continues to create money past the point where the economy can absorb the excess. Kelton shuns the most conventional solution: "I reject the idea that MMT is about using taxes to fight inflation" (Kelton, "Sanders' 2016"). Instead, advocates of MMT propose using automatic stabilizers to combat demand-pull inflation. Since the main problem MMT seeks to solve is unemployment, the primary stabilizer proposed is a job guarantee for all Americans, which has become a central tenet of the theory (Harvey; Cohen). This solution, however, would tend to drive up inflation, not combat it: if everyone is making at least the minimum wage, the minimum wage is worth less in real terms.

The other method by which MMT proposes to curb inflation is by breaking up large businesses, since they attribute inflation primarily to their pricing power (Coy et al). This process, too, would be inflationary because MMT advocates tend to look at big businesses the wrong way. Many businesses nowadays become large because of their ability to compete on price and sell goods cheaper than their competitors, not the other way around. (Just consider Amazon and Walmart, prime examples of this concept.) Consequently if large, efficient businesses that can afford to sell goods more cheaply were to be replaced by a number of smaller, less efficient companies, the price of goods would increase, a manifestation of cost-push inflation. Thus, MMT proponents lack a feasible plan for lessening inflation effectively, the greatest and most inevitable danger of creating government funds whenever needed.

Though some may see MMT as a creative solution to the current economic downturn, the risks associated with a full-scale implementation are too great. An MMT system would fail to provide interest-free government funds, rendering it incapable of financing excessive government spending to boost the economy. Furthermore, should the United States adopt MMT principles in the long-term, it would struggle to maintain the dollar's international appeal as the global economy recovers. But most importantly, MMT has the potential to cause a crippling level of inflation, which has already begun to take root in the United States as government spending and the money supply continue to increase.

Such issues with economic policies like MMT, as well as all other proposed policies, should be familiar to voters when they go to the ballot box. This rings especially true as the country faces an unprecedented period of major fiscal challenges and potentially generational changes in government budget priorities. The stakes are high: the future of this country after this crisis will undoubtedly look far different than the past, and voters have a significant role to play. Indeed, it's largely up to them to shape this future.

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