# MMT for Dummies

In the last few weeks, I've been seeing a lot of buzz about Modern Monetary Theory aka MMT. And most of what I'm seeing is reductionist to the point of absurdity. When I see critics of MMT talking about it, they're mostly using MMT as a shorthand for saying 'unbridled fiscal expansion without any concern for deficits'. I think this has been a very poor and uninformed debate. My guess is that it's been sparked by the public policy views of people like Alexandria Ocasio-Cortez, given the objections some people have to her as a political figure. I could be wrong. But, as someone who's been following this evolving conversation for several years, I thought I'd tell you how I see it.

## My introduction to MMT

Before I start in, let me tell you where I'm coming at this from. I have a lot of friends in the MMT community. And I have great respect for the leading economists. But, I am on the outside looking in.

About a decade ago, my friend Marshall Auerback introduced me to the MMT crowd. The first economist he introduced me to was Randy Wray. And the way I remember it, I was pretty rude to Randy about what he was saying. I've told Randy this subsequently. And he's told me he didn't think I was rude at all, which I appreciate. But, in my mind, what he was saying was a shock. And I was rude. It's only when I looked at what he was saying with an open mind that I began to process it and critique it objectively.

And I ended up liking a lot of what I heard. While I would never call myself an MMT adherent, I do think MMT does a pretty good job of outlining the various pieces of the macroeconomy and the constraints on fiat currency issuing governments.

My biggest criticisms of MMT are three-fold:

1. I don't think MMT takes enough into account the political and legislative realities of using fiscal policy to control inflation. I know the trauma of the 1970s is long gone. But 15, 8, or even 5% inflation can really hurt people, especially if wages lag.

2. MMT's adherents often sell MMT as a prescriptive school of thought rather than a descriptive one. They come out of the gate with all sorts of big spending policy proposals they say are based on MMT. Well, that loses half of the audience right from the start - even me! People

need to understand how the economics fits together first. Then they can buy into the prescriptions. And even then, they may not buy the policy prescriptions MMT adherents hawk. For me, MMT is not about policy prescriptions, it's about a description of how an advanced economy works for a fiat currency issuer.

3. Finally, its acolytes can be pretty 'rabid' in an almost cult-like way. It's disconcerting because, if you criticize MMT, a whole swarm of what almost seem like MMT groupies comes and attacks you. New Keynesians say they hate engaging with MMT economists, even though they share a Keynesian kinship, because the economists' online followers are often aggressive and mean-spirited.

So that's my beef. Here's my dummies guide.

## MMT's forefathers

Let me start here. Randy wrote a piece last January, whose introduction started like this:

> In recent years an approach to macroeconomics called Modern Money Theory (MMT) has been developed. In my view, it is a synthesis of several strands of heterodox—largely Post Keynesian—thought. It draws heavily on the work of Georg Friedrich Knapp, A. Mitchell Innes, John Maynard Keynes, Abba Lerner, Hyman Minsky, and Wynne Godley, to integrate the state theory of money, endogenous money, functional finance, financial instability hypothesis, and sectoral balance approaches. I would characterize it the way that Minsky (1977) characterized his own attempt at a synthesis: it "stands on the shoulders of giants."
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> - L. Randall Wray, A Comparison of the Evolution of the Positions of Hyman Minsky and Abba Lerner, Jan 2018

So, in terms of MMT for Dummies, we can stop right there. All I'm going to use is:

- Knapp for "State money" or "Chartalism"
- Innes for "The credit theory of money"
- Keynes for macro
- Lerner for "Functional finance"
- Minsky for private credit
- and Godley to describe how the sectors of the economy interact

Basically, one can boil it down to those six economists and those six areas. Let's see how quickly I can do that.

## John Maynard Keynes - Macro

On a macro level, MMT is Keynesian (or better yet, Post-Keynesian to distinguish it from New Keynesians). The name comes from John Maynard Keynes, the 20th century British economist who has probably the most famous economist name in the world.

Keynesian economics can be described as a macroeconomic school in which aggregate demand for goods and services plays a predominant role. Importantly, according to Keynes, the economy can get into a depressed state where only the government has the purchasing power and wherewithal to boost aggregate demand durably. His advice during the Great Depression was increased government spending to boost total spending economy-wide. And today, Keynesians often advocate similar policies. So when certain public spending programs advocated by MMT adherents are called 'Keynesian on steroids', that's where it's coming from.

That's all I'm going to say about Keynes since he's a known figure. I want to get into the other five MMT forefathers instead to show you how MMT differs.

## Abba Lerner - Functional Finance

Abba Lerner was a 20th century Russian-born British economist who studied at the LSE under Friedrich von Hayek. He is the father of functional finance. And I see his views as augmenting or even replacing Keynes' views for MMT.

Here's how Stephanie Kelton described his view in 1999:

> "...what Lerner advocated... was the maintenance of true full employment (i.e. employment for all who want to work), which he believed could be attained without setting off inflation.
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> While his views regarding the conditions under which inflationary pressures might begin to emerge initially differed from Keynes', Lerner, in his Economics of Employment, appears to have moved closer to Keynes on this matter. In Keynes' view, inflation was not to be associated with price increases taking place before full employment (i.e. zero involuntary unemployment) had been reached. Indeed, expansionary policy was considered inflationary only if it spent itself entirely on an increase in prices, with no further stimulus to output.

Translation: Lerner was saying that getting to full employment is the key. Until you get there, you shouldn't worry about government spending causing inflation. This is the reason that you hear MMT economists like Pavlina Tcherneva touting a job guarantee. It gets you to full employment and keeps you there. The controversy with a job guarantee is that it would prove disruptive to the existing relationship between capital and labor, especially for lower-salaried workers.

But there's a more controversial part to Lerner. Here's Stephanie again:

> The first law of Functional Finance is designed to eliminate a shortfall in total spending, while the second decrees the specific manner in which the deficiency is to be funded. Specifically, the second law calls for the sale of interest-bearing government debt only in the event that private spending would otherwise generate excessive aggregate demand. Under ordinary circumstances, Lerner argued, it is expected that capitalist economies will suffer from insufficient rather than excessive aggregate demand so that it would not be necessary to offer bonds in exchange for money as a means of tempering inflationary pressures. Instead, Lerner believed that bonds should be sold to the central bank or to private banks "on conditions which permit the banks to issue new credit money based on their additional holdings of government securities, [which] must be considered for our purposes as printing money"

Translation: You don't have to sell Treasury bonds at all. Just print money, credit accounts directly. That's a pretty controversial view. And I think this is the one that is most pilloried.

Here's Stephanie again:

> "...'Keynesians' (Blinder and Solow, 1973, 1976; Buiter, 1977; Tobin, 1961), generally agree that the economic consequences of borrowing and printing money can differ substantially from those obtained when government spending is financed solely by contemporaneous taxation. Inspired by Christ (1967, 1968), Blinder and Solow (1973) investigated the optimal method by which to finance government (deficit) spending, concluding that the expansionary effects from borrowing would outweigh the stimulative effects of financing by creating new money. Although 'Keynesians' recognize that there will be different macroeconomic consequences, depending on the manner in which the shortfall is made up, they do not generally share Lerner's preference for printing money to finance the deficit.
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> Post-Keynesians and Institutionalists, however, tend to be more amenable to Lerner's position...."

Translation: If the government is spending money to boost aggregate demand, it is doing so by deficit spending. You can deficit spend by creating lots of government debt. Or in Lerner's view, you could credit accounts directly with government IOUs.

This is where our third economist, Georg Knapp, comes into play.

## Knapp - State Money

Georg Friedrich Knapp was a late 19th to early 20th century German economist. In 1905, he published "*The State Theory of Money".* Unlike in the Metalist view where gold and silver are money, in Knapp's world, money is simply a token that has no real value. What gives it value to buy things in

the MMT world? "[I]t is the decision of the state to accept at state pay offices, and not legal tender laws, that creates a Chartal money" as Randy put it in 2014.

Basically, according to MMT,  your pound notes, your dollar bills, your euro coins have no intrinsic value. They're tokens. They only acquire value because the government says so. The government says, "you owe me taxes and you must pay these taxes using the money we create." And that proclamation alone makes state money valuable. MMT says legal tender laws only entrench state money's use.

In effect, you are paying government with your hard work via the currency. You work, then receive currency for your goods and services, and then pay a portion of that money to the government as tax in the currency the government dictates - or face the penalty of law.

Notice that, if the government is using 'tokens' it creates out of thin air as money with no intrinsic value, any debt the government has in that currency is effectively just an IOU. Treasury bonds, for example, are simply US government IOUs since the US government can manufacture infinite amounts of dollars if it so chooses. This is why proponents of MMT say a sovereign currency issuing government has an unlimited ability to repay any and all debts in its own currency.

Most people get this. The debate is what the consequences of manufacturing too much money are. Is it inflation, currency depreciation or are there almost no consequences until you hit full employment? An increasing number of people are saying there are minimal short-term consequences, including Warren Buffett. But where these people take issue with MMT is they think MMT downplays the longer term inflation and currency risks.

As a side note, if you accept that fiat money is an IOU, then the interest that government pays on bonds is like a gift to so-called 'rentiers'. Bonds' real purpose, then, is to serve as a means of helping the central bank hit an interest rate target more than anything else. If you drop rates to zero, where they are in Japan, the 'rentier subsidy' falls away. I think Warren Mosler makes this assertion most amongst MMTers.

The caricatured quip is that "MMT says deficits don't matter." A nuanced back and forth goes like this:

> Federal Reserve Chairman Jerome Powell took a shot this week at the philosophy known as modern monetary theory in a Senate hearing.
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> “I have heard pretty extreme claims attributed to that framework and I don’t know whether that’s fair or not,” said Powell. “The idea that deficits don’t matter for countries that can borrow in their own currency is just wrong. I think U.S. debt is fairly high at a level of GDP, and much more importantly than not, it’s growing faster than GDP.”
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> One leading advocate of MMT, Stephanie Kelton, the former economics adviser to the 2016 Bernie Sanders presidential campaign and professor at Stony Brook University, told CNBC on Thursday that he’s looking at it wrong.
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> “What Chairman Powell is saying when he says, ‘I don’t believe that it’s true that deficits don’t matter,’ well neither do I, deficits do matter. But they don’t matter in the ways we’ve conventionally been thinking about them,” she said.
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> “The way we usually think about a deficit is that it is evidence of excessive spending. And that’s just wrong, evidence of excessive spending is inflation. So I would argue you don’t have a deficit problem or debt problem unless you have an inflation problem.”

Translation: MMT says the deficit results from an accounting identity. It's a measure, an outcome that shouldn't even be the target of policy. The real problem is inflation. And that comes from spending even when all real resources - capital and labour - have been exhausted.

## Innes - Credit Theory of Money

Here's our fourth MMT forefather, Alfred Mitchell-Innes. He was a 19th century British economist and a leading proponent of the view that money and credit (or money and debt) were effectively the same thing. Here's how he put it:

> The Credit Theory is this: that a sale and purchase is the exchange of a commodity for credit. From this main theory springs the sub-theory that the value of credit or money does not depend on the value of any metal or metals, but on the right which the creditor acquires to "payment," that is to say, to satisfaction for the credit, and on the obligation of the debtor to "pay" his debt and conversely on the right of the debtor to release himself from his debt by the tender of an equivalent debt owed by the creditor, and the obligation of the creditor to accept this tender in satisfaction of his credit.

So, like Knapp, he rejected the concept that gold and silver are money. But whereas Knapp was focused on where money got its value, Innes was focused on the broad definition of money. After all, as soon as the bank grants me a loan, it creates a deposit for me. I can withdraw from that account immediately. That's money. But it's also debt that I have to pay

back. The more loans banks grant, the more deposits those debtors have to spend or invest. But the more they have to repay as well. MMT holds this view.

## Minsky - Private Credit

The fact that debt is effectively money creates an inherent instability. The more credit that gets created, the more people can invest and spend. And so, the economy grows faster. But this can only go on for so long. More credit in the economy also means more debt must be repaid. And so, at some point, someone will run short of money and be unable to repay. When enough people fail to repay, banks are forced to cut back on new credit supply. And the economy slows or contracts.

But, according to the late American economist Hyman Minsky, this business cycle is exacerbated by animal spirits.

Randy wrote about Minsky's view (bold added for emphasis by me):

> **With his 1975 book, …Minsky distinguishes between a price system for current output and one for asset prices**. Current output prices can be taken as determined by "cost plus mark-up", set at a level that will generate profits…
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> There is a second price system, that for assets that can be held through time; except for money (the most liquid asset), these assets are expected to generate a stream of income and possibly capital gains…The important point is that the prospective income stream cannot be known with certainty, thus is subject to subjective expectations…. **Minsky argued that the amount one is willing to pay depends on the amount of external finance required—greater borrowing exposes the buyer to higher risk of insolvency. This is why "borrower's risk" must also be incorporated into demand prices**.
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> Investment can proceed only if the demand price exceeds supply price of capital assets. Because these prices include margins of safety, they are affected by expectations concerning unknowable outcomes. In a recovery from a severe downturn, margins are large as expectations are muted; **over time, if an expansion exceeds pessimistic projections these margins prove to be larger than necessary.Thus, margins will be reduced to the degree that projects are generally successful.** Here we can insert Minsky's famous distinction among financing profiles: hedge (prospective income flows cover interest and principle); speculative (near-term income flows will cover only interest); and Ponzi (near-term receipts are insufficient to cover interest payments so that debt increases).**Over the course of an expansion, these financial stances evolve from largely hedge to include ever rising proportions of speculative and even Ponzi positions**.

Translation: Stability breeds instability. The longer any business cycle continues, the more risks we take. The more risks we take, the more likely the whole thing falls apart.

As someone who likes Ludwig von Mises' malinvestment dictum, Minsky rings true. MMT looks at this as the core way to view private credit dynamics.

## Wynne Godley - Sectoral Balances

One way to tell that private credit dynamics have got out of whack is the sectoral balances. For example, look back to the 1990s. A lot of people say US budget surpluses led to low interest rates that fuelled a boom. And they say that was a **good** thing. MMT would say the causality goes the other way i.e. the Clinton surpluses were due largely to a booming economy fuelled by a capital spending binge in the telecom sector and business more generally, mixed with an unsustainable decrease in household savings. That's a **bad** thing, a perfect example of stability breeding instability.

And MMT got the idea of looking at things this way from the late British economist Wynne Godley.

The FT's Martin Wolf explained Godley's insight this way in 2012in a now-deleted blog post:

> … I look at this through the lens of "sectoral financial balances", an analytical framework learned from the work of the late Wynne Godley. The essential idea is that since income has to equal expenditure for the economy, as a whole, (which is the same thing as saying that savings equals investment) so the sums of the difference between income and expenditures of each of the sectors of the economy must also be zero. These differences can also be described as "financial balances". Thus, if a sector is spending less than its income it must be accumulating (net) claims on other sectors.
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> The crucial point is that, since sectoral balances must sum to zero, a rise in the deficit of one sector must be matched by an offsetting change in the others. It follows that if the fiscal deficit is increasing, the sum of the surpluses of the other sectors of the economy must be increasing in a precisely offsetting manner.
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> These are tautologies. But the virtue of this framework is that it forces us to ask what drives what: are, for example, fiscal deficits in the US (or UK) driving the surpluses in other sectors or are the surpluses in the other sectors driving the fiscal deficit? We can obtain answers by examining what behaviour is changing…

Translation: When the private sector needs money to pay down debts, it moves aggressively toward a net savings position. And that likely means bigger government deficits.

In addition to Wolf and the MMT economists, Goldman Sachs economist Jan Hatzius also uses the Wynne Godley sectoral balances approach.

## My take

I think most of this is within the mainstream. The part that stands out like a sore thumb is the part from Abba Lerner where he says governments should simply print money when boosting aggregate demand. If you combine that with Knapp's theory of state money, anything is 'affordable' in money terms.

Every single controversy involving MMT revolves around this one concept - boosting demand with new spending or by cutting taxes, and thus ballooning the deficit -- and doing so without seeming to worry about the deficit consequences. Even 'Keynesians' say you have to worry about the consequences of deficits, less now than at other times; but you still have to worry.

I reckon MMT folks would respond that money is a token. As a result, they would say, financial resources are infinite for the state. It's the deployment of real resources, labor and machines that matter in that view. So until you near full employment and inflation begins to pick up, it's full steam ahead.

Moreover, MMT folks might also say there isn't a requirement to advance fund any major investment. When you buy a house, you get a mortgage. When Tesla builds a factory in China, it gets a loan from the Chinese government. MMTers would say its no different here for the government.

Also, in terms of what's happening with the excess reserves that quantitative easing produced right now, Scott Fullwiler has a very important paper on this. It shows the strength of MMT economists on central bank operational issues.

In that same vein of excellence on central banks' operational issues, the MMT folks have been very good in predicting that supply-demand issues have almost no bearing on interest rates. For me, this is the most market-relevant part of the school of thought. They say that in a fiat currency world where the currency floats freely, so-called bond vigilantes have very limited power. Domestically, state money is the safe asset because there's no default risk. And so yields there are always the lowest for any fixed income asset. And bond vigilantes have basically been powerless to bid those prices down too far, because the prices and yields reflect consensus estimates of what the central bank will do with base rates. Going back to Japan, if bond investors understand that there is no inflation that would the central bank to lift rates for ten years, then 10-year rates will be near zero. And in Japan, they are. Investors that don't like that can simply get out of Japan and sell yen and the currency adjusts accordingly. That's how it will work in the US too.

Finally, many of the constraints that MMTers get called out on are legal and institutional in nature. If you change the law, you change what constraints government is under. Ostensibly, those legal and institutional constraints exist for a reason, like fear of inflation or currency depreciation. In the end,

I think it's better to look at the real constraints - inflation and currency depreciation - rather than fight over artificial operational constraints. I'm a leveraged finance guy So I think it's sort of like what a private equity company does with a company's balance sheet with its debt/EBITDA ratio, not looking at the company as it is today, but how it could be when refinanced.

So, that's my stab at describing MMT. I'm not sure what the MMTers will think of my description. But I'm sure I'll find out soon. If you leave out the part about not worrying about how to pay for deficit spending, 'Keynesians' would be 100% onboard with MMT. People like Paul Krugman say this all the time.  Libertarians and conservatives simply dismiss Keynes' view of boosting aggregate demand with government deficit spending. The closest they get is with 'supply side economics' where tax cuts increase investment as opposed to consumption.

In terms of who I find most compelling of MMT's economist forefathers, this is my rank order - at least for now:

1. Minsky
2. Innes
3. Godley
4. Knapp
5. Keynes
6. Lerner

Let me know if that was useful.

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