Modern Monetary Theory:

”Spending does not have to be “paid for” ….

with tax increases, now or in the future”

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Introduction: After general comments about the meteoric rise of MMT through the blogosphere, my paper focuses on Warren Mosler, the hedge fund owner and unsuccessful candidate for the US Senate. He made some $50million in profits for his hedgefund by speculating on Italian Lira and Japanese bonds (*The Economist* 2011).

Mosler's story expands the context of MMT's view of federal debt as profitable for Wall Street, hedgefund speculators, and rent seeking. I find this aspect intriguing and as the basis for MMT's foundational misconception of debt. My next topic is a discussion of debt based on the work of the Italian Public Finance theorists, James M. Buchanan, Richard Wagner, Robert Barro, and Alberto Alesina in implementing austerity programs. I conclude with Buchanan's insights on debt and a cautionary note about Keynesian capture of democratic processes for debt.

The invisible college of the "college of bloggers."

Modern Monetary Theory (MMT), a "heterodox" branch of economics in the post-Keynesian tradition, made a meteoric rise as a topic in the presidential debates..

- It has great appeal to progressive presidential candidates seeking to broaden their base by promoting an expansive socialist agenda.
- MMT exemplifies the power of social media and the Internet to market and mainstream fringe ideas.
- MMT was an obscure idea, but through the blogosphere became the vehical for an obscure idea which few were familiar It provides a medium of expression and a venue for drawing together like-minded colleagues.
- Mosler took it a step further by running for the US Senate. Many adherents run for political office with little more depth than the blogs they read.

Deficits don't matter

The idea behind MMT is the premise of ever-increasing deficits to finance current political benefits at the expense of hard to foresee future economic costs.

The political appeal is obvious – a painless redistribution unencumbered by economic realities of rising interest rates, crowding out of private sector investments, and losses to politically weak opponents in states, industries, and employees in adversely affected areas.

The role of Money – micro score keeping – final score is what matter!

Proponents analogize the role of money as the electronic dots in a score board – with little mean of themselves aside from micro score keeper.

A newish, appealingly glossy product of the blogosphere, it has many adherents among economist seeking an appointment in the ultimate ivory tower of The White House Council of Economic Advisors. Professor Stephany Kelton is on the record for needing a team of economists for six months to figure out the details of MMT.

Until January 2019, there was little support for MMT other than little known economists such as Stephanie Kelton, MWW, and others including Warren Mosler. In 2016, Kelton was a staff economist to the Senate Budget Committee while on leave from teaching at the University of Missouri-KC. She is now at State University of New York at Stony Brook. Most recently she served as an adviser to Senator Bernie Sanders. Her views were summarized in an interview with *Barrons* (Sept 18, 2018:

- She argued that saying spending comes from taxes puts those with money to take through taxes has the effect of putting rich people at the center which she argues is wrong focus:
    - The role of Congress is to determine spending –
    - The role of Treasury is to print the money to pay for it

In Kansas City "she told her listeners, because the conventional wisdom in the capital is that money "grows on rich people" and you pay for nice things by taking it from them.
"Don't look at me," she instructed her audience to tell lawmakers. "*That's* where the money comes from. And you point at the Treasury. You point at Congress." And she won the room over. Insisting that government spending comes from taxes, she says, puts the rich at the center of American policy-making in an unhealthy way. And the very rich, Kelton's experience shows, are pleased to hear that you don't have to tax to spend.
Here's what else she had to say in an interview in *Barrons*.

Barrons: The way the federal government works is it takes in money from taxes, and then it spends it. Right?

Kelton: …. Congress is writing down numbers and saying, "This is our intention, to spend in these amounts." And the budget authorization is given that allows the heads of these agencies to go out and start hiring, engaging in contracts. It's the authorization from Congress that provides the funding. That triggers the spending.

Barrons: The conventional wisdom about deficits is that we should always be worried about them. When do you worry about deficits?

(Note the slight of hand in deficit size versus purpose of the debt created. Current purpose trumps future costs.)

Kelton: I worry not just about the magnitude, but about the purpose. We could add $1.5 trillion to the deficit over 10 years, as we just did with tax cuts that go disproportionately to people in the top-income distribution, and we could have done, for instance, student debt cancellation at virtually the same price tag. We could have done massive infrastructure investment, or R&D investment.

Mainstream economists' concerns of MMT:

- Fed Chair Jerome Powell,
- Former Treasury Secretary Larry Summers,
- Former IMF chief economist Kenneth Rogoff.
- The Microsoft founder Bill Gates is also an opponent.
- Universally they attack MMT's politically appealing message
  - that spending does not have to be "paid for" with tax increases,
  - now or in the future.
- Incidence of political and economic costs is on future generations.

  (Buchanan, Barro, and others.)

Promises, promises, and intergenerational transfers

Until the 2019 presidential debates, politicians appeared slow to see the viability of MMT since it did not emerge from mainstream schools. However, although somewhat skeptical, noncommittal, and not anxious to endorse "debt doesn't matter,"

Sen. Elizabeth Warren (D-MA) noted, "we need to rethink our system in a way that is genuinely about investments that pay off over time." Its appeal is obvious: government doesn't need to levy any taxes to pay for such programs as Medicare-for-all and "the green new deal."

MMT offers a way to justify passing politically appealing big priorities like the Green New Deal and single-payer health care or free college without resorting to the major middle-class tax hikes feared by politicians.

“Crowding out”

- Deficits drive up interest rates in the loanable funds market =➔ reducs business investment.

- Collaterization of government debt as investment assets.
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- And just as a surge in demand for, say, tickets to a newly cool band should increase the going price of those tickets (black markets emerge along with StubHub), a surge in demand for loans makes loans more expensive:

- The average interest charged rises. For the government, the increased interest rates and prices is an additional expense incurred in debt service But the higher interest rate applies to private companies and individuals too. And that means fewer families taking out mortgages and student loans, fewer businesses taking out loans to build new factories, and just generally slower economic growth due to “crowding out”.

- MMT advocates rely on an accommodating Federal Reserve System to expand the money supply which at some point will be legislated into law.

Expanding politics of government and rent seeking (competition for special privilege).

A new monetary constitution - doesn't much resemble Leland Yeager's work. MMT would be changing bundle of government securities for which congressional connections would be an asset.

Yeager's proposal for a new monetary constitution was to replace government-issued fiat monies with a monetary unit that would be defined by an unchanging bundle of commodities selected to ensure the stable purchasing power of money over time. Throughout the last few decades of his career, Yeager's proposals for free market currencies had common objective to sever any link between governments and money.

MMT’s debt pivot.

”Spending does not have to be “paid for” with tax increases,
now or in the future.”

MMT’s argument is both politically attractive and simple: countries that issue their own currencies can never “run out of money” as experienced in the private sector among businesses and individuals.

Regarding the difference between individual and public debt will be explored through the work of the Italian public finance (contemporary and their antecedents) theorists, James M. Buchanan, Robert Barro, and Richard Wagner.

Ricardian Equivalence.

Buchanan’s criticism of public debt entails more than the shifting of cost forward in time to future generations of taxpayers. Buchanan, Barro, and others have shown that the possibility of intergenerational shifting is dubious because public debt really entails a shifting of cost among a current set of taxpayers. The "Ricardian Equivalence Theorem" was first used by Buchanan (1976) in a comment to Robert Barro’s 1974 paper. Buchanan argues that the method of financing any particular level of government expenditure is irrelevant. In that the choice between levying taxes and issuing public debt to finance a given amount of government expenditure does not affect households' consumption nor does it affect capital accumulation. In other words, future taxes are capitalized into the behavior of the current generation.

While public debt represents an asset to bondholders, it represents a liability to the taxpayers who must pay the interest and, eventually, redeem the principal. These assets and liabilities exactly offset each other. Apart from any distributional effects, the existence of public debt does not affect the consumption-investment decisions of rational agents. Ricardo (1817, 1820) addressed the question of whether government borrowing would have shifted the burden of extraordinary public spending on future generations.

When government budget deficits are persistently high and the level of government debt is rising rapidly as a percentage of GDP, households expect the government to levy large tax increases on them, either imminently or sometime in the future, in order to service the government's debt burden. Fiscal consolidation programs that reduce government spending as a percentage of GDP decrease short-term uncertainty about taxes and diminish the specter of large tax increases in the future. In turn, higher expectations for permanent disposable income create a positive wealth effect among households. Consequently, households will purchase more homes and durable consumer goods such as motor vehicles in the short term.

Landau (1983, 1986) , Grier and Tullock (1989) , and Barro (1991) found a consistently negative relationship between government spending as a percentage of GDP and the real GDP growth rate --- that increasing government spending slows economic growth. Examining the effects of government size and fiscal volatility on growth in OECD member-countries and EU member-states from 1970 to 2004, Afonso and Furceri (2007) found that larger government and fiscal volatility reduced real growth per capita of GDP for both sets of countries. In particular, they conclude that "a percentage point increase in the share of total revenue (total expenditure) would decrease output by 0.12 and 0.13 percentage points respectively for the OECD and for the EU countries."

Based on an analysis of 107 countries between 1970 and 1985, Engen and Skinner (1992) found that increasing tax revenue by 10 percentage points of GDP reduces the medium-term (15 years) real GDP growth rate by 3.2 percentage points annually. Moreover, Engen and Skinner also found that a 10% increase in government spending as a percent of GDP that is fully paid for through higher taxes would reduce the medium-term real GDP growth rate by 1.4 percentage points.

To sum up.

The dismal economic potential for MMT is Engen and Skinner refute the Keynesian contention that it is the government budget deficit, not the level of government spending that is the drag on economic growth.