WHY MODERN MONETARY THEORY (MMT) IS WRONG ON DEBT AND INFLATION: AN AUSTRIAN PERSPECTIVE

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Abstract

This paper considers the pitfalls of modern monetary theory (MMT) from an Austrian economic perspective. MMT is firmly rooted in the economic power of the printing press and therefore relies heavily on the state rather than the free market to allocate resources. This constitutes a dangerously irresponsible approach to monetary and fiscal policy. The budget constraints are minimal, the deficit is left unchecked, and inflation is misunderstood. This is all done in order to justify a strange fetishization with full employment. MMT supporters believe that they can somehow unlock the untapped potential of the economy via the printing press or fractional reserve banking. However, it is highly problematic. This paper also explores the student debt debacle, in that one of the goals of MMT is forgiveness of these loans.

Keywords: Modern Monetary Theory; Inflation; Deflation; Deficits; Business cycle.
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¿Por qué la Teoría Monetaria Moderna (TMM) está equivocada con respecto a la deuda y la inflación? Una perspectiva austriaca

Resumen

Este artículo aborda las trampas conceptuales de la teoría monetaria moderna (TMM) desde una perspectiva económica austriaca. La TMM está fundamentada en el poder de la impresión de dinero y, por lo tanto, cree en el poder del Estado, en lugar del libre mercado, para asignar los recursos. Esto constituye un enfoque peligrosamente irresponsable de la política monetaria y fiscal. Las restricciones presupuestarias son mínimas, el déficit no se controla y la inflación se malinterpreta. Todo esto se hace para justificar una extraña fetichización del pleno empleo. Los partidarios de la TMM creen que de alguna manera pueden desbloquear el potencial sin explotar de la economía a través de la imprenta del Banco Central o de la banca de reserva fraccionaria. Sin embargo, todo ello resulta muy problemático. Este documento también explora la debacle de la deuda estudiantil, en el sentido de que uno de los objetivos de la TMM es la condonación de estos préstamos.

Palabras clave: Teoría Monetaria Moderna; Inflacion; Deflación; Déficits; Ciclo económico.
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1. Introduction

Modern Monetary Theory (MMT) has taken the progressive wing of the Democratic Party by storm, and it is not difficult to understand why. In a 2019 Business interview with Representative Alexandria Ocasio-Cortez she told interviewers that MMT "needs to be a larger part of our conversation".[1] In an NPR interview the same year AOC stated that "the first thing that we need to do is kind of break the mistaken idea that taxes pay for 100% of government expenditure".[2] MMT flips the paradigm that in order to spend money it is probably a good idea to have the wherewithal at hand -i.e., first taxing and only then spending. Instead, it presents the counterintuitive perspective that it is government spending that should come first; it creates a deficit which is not necessarily problematic.[3]

Stephanie Kelton, former chief economist for the Democrats on the U.S. Senate Budget Committee member, and Senior Economic Advisor to Sen. Bernie Sanders' 2016 presidential campaign states that a "deficit is not evidence of overspending"; evidence of overspending she says is "inflation"[4]. She also went on to say that how close the country is to full employment is a good indicator of how much inflation that spending would cause.[5] MMT makes it much easier to answer the question asked so often of politicians who are pushing for free college and universal basic income: "How do you pay for it?" For MMTers, the simple answer is that the U.S. government has the legal ability to issue an unlimited number of U.S. dollars, and so "paying for" anything is never a problem, the way it would be for households or businesses. In the following section we will criticize MMT for its reliance on the state and debunk the same archaic arguments for central planning of economies. Afterwards we will show how MMT's so called indicators for overspending are almost entirely flawed.

[1] Matthews, Dylan. Modern Monetary Theory, explained. Vox. 16 April 2019. https://www.vox.com/future-perfect/2019/4/16/18251646/modern-monetary-theory-new-Moment-explained

[2] Horsely, Scott. This Economic Theory Could Be Used to Pay for The Green New Deal. NPR. 17 July 2019. NPR.Economy. https://n.pr/3pZLuft

[3] Rothbard, 1982A, provides an alternative view of this phenomenon:
"Deficits, therefore, should be eliminated by drastic slashes of government spending. But where and how? The answer: anywhere and everywhere. There is no mystery about it. Just slash with a hefty meat axe. Go down, for example, the Eisenhower budget and reduce every item back to it. Or better yet, the Roosevelt budget of the 1930s. Still better, the Grover Cleveland budget. Still better yet, return to the average annual budget of the Federalist period of the 1790s: $5.8 million dollars. If that was good enough for the statist Alexander Hamilton, it should be good enough for our 'libertarian' Reagan Administration."Of course, my most preferred position is that the United States budget go back, or rather go forward, to a nice round Zero. But, to demonstrate my devotion to moderation, I could live with a transitional level of $5.8 million for a year or two." See also Rothbard 1982B; other deficit "hawks" include Buchanan and Wagner, 1977; Cochrane, 2020; Shostak, 2016.

[4] Context TV, Does the rising deficit matter? Youtube. Context TV. 10 May 2018. 6:47. https://www.youtube.com/watch?v=fOirnxb_2UE&t=166s

[5] Ibid

2. The State and Currency

It is no wonder why Modern Monetary Theory is so reliant on the good works of state actors, when their unorthodox theory of money is revealed. It is not solely that they are supporters of fiat currency, it is that they aver that it is simply equivalent to "tax credits" (Lucarelli, 2014). These tax credits or what we call dollars are only sought after because of the artificial demand that the United States government creates in the form of taxation. What is fundamentally wrong here is that MMT has found a way to use the state to pervert the idea of money from being simply a means of exchange, more so than has been done already.[6] They would like to create a system in which the only reason why their currency is valuable is so we can participate in the involuntary action of taxation.[7] The advocate of free enterprise would argue that this is theft, but MMT cannot even take cognizance of this point, because it asserts that this money was the government's in the first place.

There are other problems with the claim that currencies derive their strength from the need to pay taxes in that format. For one thing, *at best* this principle could only establish why a particular currency has a non-zero purchasing power; it could never explain why it takes 10 or 100 or 10 billion units of the currency in order to purchase one hour of labor. To see why, just think through the logic of the MMT claim: The U.S. can ensure that people will want to hold U.S. dollars by demanding each citizen hand over (say) $1,000 every April 15. Yes, it is true that such a standing policy will ensure that people clamor to obtain U.S. dollars. *By itself*, this observation does not pin down how much a U.S. dollar can buy in the marketplace. For all we know, people might have to perform merely one hour of work to obtain $1,000, or, for that matter, maybe they must work six months to earn that sum.

Another problem with the MMT explanation is empirical: When governments slash tax *rates,* it usually *strengthens* the currency. For example, in the wake of the Kemp-Roth income tax rate reductions during the first Reagan Administration, the dollar's strength against other currencies rose some 50 percent.[8] The standard explanation for this was that investors rushed to obtain U.S. financial assets once the relevant tax on them had been reduced, and this increased demand led to a higher equilibrium exchange rate of the USD against other currencies. Do the MMTers really want to argue that if the income tax and all

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[6] Rothbard's Monetary Thought: Rothbard advocated for "hard money" advocating not only a gold standard, but a "100-percent gold standard." First, the dollar would be defined as an amount of gold; and second, any paper money or bank account money not backed 100 percent by gold would be made illegal by the government as an act of fraud. See Rothbard's Monetary Thought https://mises.org/library/rothbards-monetary-thought

[7] Some people claim that taxes are voluntary, akin to paying a fee to join the tennis club. Schumpeter (1942, 198) puts paid to that erroneous notion: "The theory which construes taxes on the analogy of club dues or of the purchase of the services of, say, a doctor only proves how far removed this part of the social science is from scientific habits of mind."

[8] For a history of U.S. marginal income tax rates and the Reagan-era reductions, see: https://taxfoundation.org/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets/. For a series showing USD strength against other currencies, see: https://fred.stlouisfed.org/series/DTWEXM.

other U.S. taxes were removed entirely, that suddenly *nobody* would want to hold U.S. assets anymore and the dollar's value would crash to zero?

Contrary to the MMT explanation of taxation as the origin of money and the source of its purchasing power, the standard economics explanation has to do with the so-called "double coincidence of wants." Everyone who has had some familiarity with economics has learned this basic lesson in one form or another. It goes like this: A wheat farmer wants eggs so that he can use those eggs to go along with his toast for breakfast. The problem is that the other farmer selling eggs has no need for his wheat and he demands that you give him cattle. The solution to this not to get into the cattle business, but to create a medium of exchange which we call money. Sometimes this medium is precious metals, other times it is shells, or cigarettes. Regardless of the medium chosen this is what currency is, a facilitator of indirect exchange, a solution to the "double coincidence of wants" challenge.

Instead, what we get from MMT is the denial of this basic element of economics. They then assert that money should be a public monopoly. The monopolistic ability to be the price setter is what allows the government to unlock the potential of "idle workers and businesses that are producing well below their full capacity" (Kelton, 2019a). Many would-be advocates of MMT are not at all fond of monopolies in other circumstances. Of course, when it comes to this one it somehow becomes acceptable because it follows the word "public". What they do not realize is that money too can benefit from competition. This means treating money like any other commodity and privatizing it. Once this is done and money is separated from government we will no longer have to worry about erratic behaviors of consumers when the prices of goods change due to an increase in the money supply.[9] This will be because the money will have value as a commodity when it is not a medium of exchange. Gold has been used as money for thousands of years but even after governments left the gold standard it retains its value. The government will never allow this to happen of course because controlling money gives the central planner immense power over our daily lives.

3. The State and Planning

The more immediate issue beyond theory is that it leads policy makers to believe they can spend irresponsibly and nearly as often as they would like in order to achieve their utopian dreams. Supporters of MMT portray their critics as intellectually dishonest, and that their theory is being misunderstood as a blank check. However, this is hard to take seriously when MMT defenders such as Yeva and Wray mock their opposition by saying that MMT does not call for "helicopter drops of cash" while in the same article they say that no matter how heavy the debt accrued by the government "the sovereign can never run out of finance—

[9] On the optimal supply of money, see Barnett and Block, 2004, 2012

period" (Nersisyan & Wray, 2020). If they were arguing against endless spending, they are doing it in a way that sends off mixed signals, at the very least.

There has already been a host of excitement regarding MMT because it provides a path forward for the central planner. Take the debate involving the cancellation of student debt for example. MMT policy advocates such as economist Stephanie Kelton favor this policy. She and her colleagues cite in their study on the "Macroeconomic Effects of Cancelling Student Debt" that 44 million people have accumulated around $1.4 trillion in outstanding debt (Fullwiler, Kelton, Ruetschlin, & Steinbaum, 2018). She draws upon the economic consequences people face when strapped with debt. They spend less, consume less, and invest less. Kelton (2019b) notes that college is getting more expensive, yet it has increasingly become one of the best ways for individuals to gain social capital and a higher income. These authors say this is viable because cancelling debt will provide a stimulus in the economy through increased consumer activity. In addition to this Kelton provides a variety of accounting logic and loopholes, that Modern Monetary Theorists are so fond of, that involve the crediting and debiting of certain accounts within the Federal Reserve and the department of education.

To Kelton's credit she is right in some aspects. Education is very valuable socially and financially. Overwhelming debt is burdensome for the life of individuals trying to succeed financially. What she fails to realize or even question is how we got here in first place. The problem is quite simple and can be summed up in two words: government loans. In 1965 the government decided that not enough people were going to college.[10] So they decided to create the Federal Family Education Loan which guaranteed student loans by entities such as banks and lenders. They also got into the business of making direct loans but for now let us focus on guaranteeing loans. Imagine you're a bank and when previously lending to students you would probably be quite careful, and consider factors such as the major they are choosing, their academic record, the predicted job market once they graduate, collateral, etc. Now things have changed. The government created a situation in which your risk in accepting students as borrowers has almost entirely vanished. It does not make a difference in whether you give out a loan to a straight A student who wants to major in aerospace engineering or a mediocre one majoring in the arts and is only going to college to appease his parents. The bank will make a profit either way. Under this regime we have a situation where practically anyone can obtain a loan for tens of thousands of dollars and have no realistic way of paying it back. The government has created the problem of the student debt crisis and then instead of getting out of the lending business and leaving it to the private which only account for roughly 7% of student loans,[11] it doubles down. This not only affects students but also every other industry or business or individual who now does not get a loan because the government failed to realize that "credit diverts production" as Hazlitt (1979, p.

[10] Student Loan History - Education Policy: Topicswww.newamerica.org

[11] The Measure One Private Student Loan Report June 2020: https://www.measureone.com/resources

40) put it. They only learned to see with their eyes and as a result they only see A and not B.[12] No matter how supporters of the state justify their spending, whether they follow Keynes, MMT, or even Marx it brings up the same issues. Kelton despite the amount of t-accounts and balance sheets she uses in her justification for diverting production it does not change anything. Modern Monetary Theory as hard as it tries using accounting magic does not hide the flaws of the central planner.

4. The Deficit

The deficit allows us to uncover the heart of Modern Monetary Theory. This is its assertion that deficits do not matter as long as they are constrained by two indicators for overspending: full employment and inflation. Even though we disagree with the idea of money being anything other than a facilitator of indirect exchange, it is not necessary to criticize their theory of money in order to dismiss their deficit beliefs. To recap, MMT is based upon the unwarranted claim that money under a sovereign government that issues its own fiat currency is and should be a public monopoly. This means in effect that any money in the economy consists solely of outstanding tax credits.

> "Paying it back refers to nothing more than the debiting of securities accounts and the crediting of reserve accounts, all on the books of the central bank. Therefore, any constraints on spending are necessarily self-imposed and subject to immediate revocation of the government responsible for the payments. Typically, these constraints include budgeting limits, debt ceilings, and restrictions on treasury transactions with the central bank." (Lucarelli, 2014).

The primary argument that MMTers like to make is that the deficit is simply an outcome of spending more money than they tax out of the economy; no more no less (Nerisisyan, & Wray, 2020). They argue that most laymen and even economists and policy advisors are being foolish in worrying about how high the deficit is. In nearly every article they belittle those that treat the government budget as if it were a household budget. In a household if the parents rack up a thousand dollars in credit card debt and they die, this reduces the inheritance they can pass on to their children. This leaves them financially worse than they would be otherwise. The MMT logic attempts to refute this by saying that unlike the household, Uncle Sam can simply create new dollars and always satisfy its creditors. To view the federal government's finances the same way we view a typical household's commits a fundamental mistake, according to the MMTers.

It is certainly true that the federal government need never explicitly default on its outstanding Treasury obligations since it can always resort to the printing press. Yet this merely pushes back the problem one step. Creating new dollars effectively transfers purchasing power from

[12]Ibid

all other dollar-holders and puts it in the hands of the money-printers; this is why people in the private sector would gladly counterfeit $100 bills if they could get away with it.

So when “budget hawks” complain that government deficit finance is irresponsible, a sympathetic and accurate interpretation allows for the fact that printing money might solve the *immediate* crisis, while merely pushing the economic fallout into other arenas. After all, even a typical household doesn’t *need* to balance its budget—the desperate husband could announce to his wife, “I’ll just go rob a 7-11, and that’s how we’ll pay our bills.” Yet would anyone think this “insight” shows that economists are wrong for thinking households face budget constraints?

5. Full Employment and Inflation

The last tenets of Modern Monetary Theory that will be dispelled is the idea that surpassing full employment and excess inflation is the only roadblock to spending. MMT does not deny that inflation is real and that there are consequences for it being too high. As Kelton (2019b) puts it:

> “As every economist knows, inflation — not a budget deficit — is the tell-tale sign of an economy that is under pressure from excessive spending. If prices aren’t accelerating, you don’t have an inflation problem. And if you don’t have an inflation problem, you don’t have a spending problem.”

While this is debatable since inflation is very complex and factors such as the velocity of the money can be analyzed, it becomes rather unimportant when we consider the other Keynesian indicator of over-spending, full employment. For central planners full employment has become a goal that they have never stopped striving for. Even today there is a strong effort to implement a federal program that guarantees jobs for everyone (Kelton, 2018). Here full employment is something that MMT strives to meet as well. MMT argues that unemployment is evidence of underspending because in this scenario there are idle resources that are simply not being put to their full potential. This often happens during recessions such as the one in 2008. What is not being seen here is that full employment should not be the desiderata. As Hazlitt (1979) puts it, employment is merely a means to achieving production. It is not an end in itself. This is because full employment could easily be achieved by making production less efficient. For example, we could give every office assistant and assistant of their own or tear down traffic signs and replace them with crossing guards, or even bring back elevator operators. The reason this is not desirable is because it would cause society to regress drastically.

At the opposite end of the spectrum, we have over employment. Nersisyan and L. Randall Wray’s (2020) explain this as follows: A country lives beyond its means only when it goes beyond full employment, when more government spending competes for resources already in use—which could cause inflation” (p. 1).

The problem with this viewpoint is that they become close to being self-aware and realizing the root of the spending problem, which is competition. When the government overspends there is competition, but what is far more important to realize is that every time the government spends it is competing with resources that are already in use or that would have been put to use elsewhere. Government spending has negative consequences in every situation. So therefore, the second marker for overspending being inflation does not even matter because we should never get to that point if we realize spending to full employment is highly problematic.

6. Conclusion

Not only is Modern Monetary Theory unable to withstand scrutiny, it fails to distinguish itself from the common mistakes of mainstream economics and therefore falls into the same traps and economic misconceptions.[13]

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[13] For other critiques of MMT see Grass, 2020; Hendrickson, 2019; Mueller, 2019; Murphy, 2019A, 2019B, 2019C; Shostak, 2019; Sieron, 2019; Deist, 2020; Blumen, 2020

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