

# What is Modern Monetary Theory and is it THE answer?

A once obscure economic theory is now being hailed as the answer to economic woes. Is it?

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In these days of rampant acronym proliferation – from LOL to WFH\* – one three-letter acronym keeps rising to the fore: MMT, or Modern Monetary Theory. (\* *Laugh out loud, working from home.*)

The set of economic ideas has been around for a while but has risen to prominence recently through the work of American economist and adviser to Bernie Sanders' 2016 presidential campaign, Stephanie Kelton, whose book *The Deficit Myth* was released in June.

But it is an Australian economist, Bill Mitchell, from the University of Newcastle, who is credited with coining the term.

A word of warning: a trip down the lane of MMT involves countenancing some truly mind-bending and somewhat pointy-headed concepts.

Ultimately, it's a trip into the very heart of what money *really is* and the role of government in society. So, strap in and don't say you weren't warned.

What is MMT? Why does such an obscure economic theory keep cropping up? Why do some people think it offers a solution to our current economic woes of rising joblessness and spiralling government debt? And, crucially, does it?

## What is money, anyway?

According to MMT proponents, governments create "money". Thanks to their mastery over the money supply, governments could – if they chose – create enough money to eradicate the scourge of joblessness immediately.

It is certainly true that governments print currency – the rectangular plastic sheets and circular gold coins that you and I exchange at cafes and stores.

For a long time, economists thought such currencies – backed by the power of a scarce commodity such as gold or silver – held the key to the value of money in the economy. Fierce debates raged in economic circles throughout the 20th century about the correct design of a global system for money.

But MMT proponents reject the idea of money as a scarce commodity. Money – and the value it holds – is a construct of governments. They call this "fiat money".

Because governments control the money supply, any debts issued in their currency never have to be repaid.

## Do you still have to pay taxes under MMT?

According to mainstream economics, governments must match their spending by raising tax revenue, and borrow the rest. Because there is a limited supply of loanable funds in the world, when governments borrow, they "crowd out" private borrowers and ultimately push up interest rates.

But according to MMT, government creates new money every time it spends. There is no need for government to borrow offsetting funds through the process of issuing bonds (essentially, borrowing).

But you still have to pay taxes under MMT. Although in MMT governments are not constrained by a need to raise sufficient tax revenue to offset spending, taxes still definitely exist. Why? To both encourage citizens to conduct their exchanges in the currency denominations of their government so that they can pay their tax bills (and not use an alternative such as bitcoin or foreign government currencies) and to control inflation (which is where prices go up, eroding the value of wages) by sapping the purchasing power of citizens, as needed.

## What about hyper inflation?

Critics of MMT accuse proponents of giving no thought to inflation, and the potential for unlimited money supply to create the sort of hyperinflation that brought Germany's interwar Weimar Republic undone.

In reality, MMT proponents worry about inflation too. Just not as much.

Should inflation arise, MMT proponents say governments should step in to reduce the purchasing power of consumers by increasing taxes.

Additionally, governments could curb inflationary pressures by imposing caps on private lending. Sounds weird, until you remember that's exactly what our prudential regulator did during the last housing boom.

## What is the role of a central bank in MMT?

Not much. Ironically, although MMT has "monetary" in the title, proponents actually have little appetite for what is conventionally known as "monetary policy" – the setting of official interest rates. In the MMT world, official cash rates should just be set to 0 per cent and governments should, under the advice of Treasury departments, take sole responsibility for managing demand in the economy with "fiscal policy" – government tax and spend decisions.

Such an idea goes against decades of policy orthodoxy, in which governments have delegated power for smoothing fluctuations in the business cycle to an independent central bank.

## Why is MMT getting so much attention now?

Perhaps because the world MMT proponents prescribe increasingly resembles the one that exists today.

Globally, interest rates are at, or close to, zero. Central banks have, to a large extent, run out of ammunition to boost economies, bringing the role of fiscal policy to the fore.

Furthermore, central banks are now in the business of creating money, by buying government bonds. Cut out the middle man, MMT proponents say, and just get governments to expand the money supply by spending.

More recently, as governments have sought to ward off mass joblessness arising from coronavirus shutdowns with job subsidies, they have also come close to implementing another of the MMT policy prescriptions: that of a universal jobs guarantee.

## What is an MMT job guarantee?

MMT proponents think that every adult citizen should, as a birthright, be guaranteed a job, albeit at a minimum wage.

Full employment is both the aim of the game and a moral imperative for MMT advocates. According to them, joblessness is evidence that a currency monopolist – the state – is deliberately restricting the supply of money, to the detriment of its citizens.

So what would a jobs guarantee look like? That is less than clear. Interestingly, most MMT proponents see their jobs guarantee as a tool for keeping a lid on wages, not for empowering workers. One of the ways that inflation is controlled in an MMT world is by pegging many workers to a relatively lowly paid, albeit guaranteed, job.

What jobs would workers do under a jobs guarantee? That is also unclear. Most MMT supporters think that, unlike the concept of a universal basic income, a jobs guarantee should provide people with active work. Some left-wing critics of MMT have noted that this concept almost resembles a “work for the dole” style of welfare.

## What are the limits of MMT?

So, do governments really exclusively control the money supply? And do they really possess the power to tax citizens in an unlimited way?

No, MMT critics say. In theory, there would be a point at which citizens might reject the coercive power of taxation by revolting or, at the very least, voting out a government that demanded such coercive control.

And while economies have evolved a long way from the days of simple barter and exchange, the option of black markets is still open to private citizens. Indeed, cryptocurrencies such as bitcoin demonstrate the ability of citizens to develop alternative systems of exchange.

Indeed, if a populace lost faith in its government’s ability to control the money supply, citizens would still have it in their means to go about their business – albeit in a limited way – by bartering and exchanges in kind.

The root impulse of capitalism is the desire of people to trade with one another. Money sits at the heart of that system of exchange. And at the heart of money is trust.

How much trust could there be in a system where policy makers, and ultimately politicians, hold the power to create unlimited money? Not much, critics say.

And then there’s the question of whether governments granted a blank cheque would spend it in ways that actually reduced unemployment and improved the lives of citizens, as promised.

Just as it is possible to overestimate the ability of free markets to deliver good outcomes, it is also possible to overestimate the omnipotence of public servants to make good decisions. History provides examples of both.

## So, is MMT the answer?

Most economists think not. MMT certainly challenges the idea that governments must flip the switch to austerity after unleashing fiscal stimulus.

But, just as critics of MMT oversimplify it into a straw man, so to do MMT advocates appear to underestimate how much of their objectives could also be achieved within the mainstream framework.

Governments of both stripes have chosen to unleash massive fiscal stimulus packages during both the GFC and coronavirus to help manage the economy.

It is now commonplace under mainstream economics that governments should intervene to support private demand when it fails and to invest in assets that will increase the productivity capacity of the economy overtime.

In reality, much of the desires of MMT proponents – for less joblessness and an expanded role for fiscal policy in economic management – can be achieved and are being pursued by governments within mainstream economic frameworks.

The only real and present danger would be if policymakers or politicians came to believe that such policies, such as fiscal stimulus and job support, were incompatible with the orthodoxy and dismissed them.

But there is little evidence of that, yet.

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