THE WONKISH MYTH OF CROWDING OUT

Posts in this series

Chapter 4 of Stephanie Kelton's *The Deficit Myt*h takes up the theory that federal government deficits increase the cost of borrowing by the private sector. Here's Kelton's typically incisive description:

> In its most common form, the crowding-out myth says that fiscal deficits require government borrowing, which forces Uncle Sam into competition with other would-be borrowers. As everyone competes for a limited supply of available savings, borrowing costs move higher. With interest rates on the rise, certain borrowers — especially private businesses — won't be able to secure funding for their projects. This causes private investment to fall, leading to a future where there are fewer factories, machines, and so on. With a smaller stock of capital goods, society ends up with a less productive workforce, slower wage growth, and a less prosperous economy. It does sound ominous! P. 101-102.

Given the amount of capital floating around in the world, much of it US dollars, it's hard to see why this makes sense. The big problem is not the availability of capital for US businesses, but the insistence of the rich that they not be exposed to any risk of loss. What could be a better solution for that than Treasury securities? But the crowding-out theory requires a chain of reasoning, and so it appeals to the self-regard of our wonk class. [1]

Kelton first addresses the idea that there is a limited pool of savings. As she does throughout the book, Kelton uses this myth to discuss the overall picture of money as explained by mainstream economists. They claim that private savings are the ultimate source of the funds that are available to lend. [2] If the government borrows from that limited amount, there is less for others. As you can see, it's a pinched view of government spending. It seems to mean that government spending is lost somehow, instead of going into businesses and our own pockets, in the US and elsewhere when the government buys from businesses in other countries.

Kelton asks us to consider the flow of dollars in our economy from an accounting perspective. She starts with a two-bucket system: the Federal Government is one bucket, and Everyone Else is the second. Any dollar that leaves the FG bucket goes to the EE bucket. There is no where elso for it to go. Taxes take money out of the EE bucket and put it into the FG bucket. That leads to our first equation:

FG balance + EE balance = 0

So, if there is a FG deficit then there is an EE surplus of like amount.

FG deficit = EE surplus

Deficit spending has a good side! That's something that seems to elude the practitioners of deficit scare-mongering. On the other hand, if the government runs a surplus, we get

FG surplus = EE deficit.

That seems bad. It means we are losing some of our wealth. Where does that wealth go? Well, it's cash. Remember that cash is a debt on the government's books, so the cash it collects in taxes just offsets the debt, and disappears. That might be bad! That's something else the deficit scare-mongers never mention.

Kelton emphasizes that it's the net that counts. So, if the FG spends $100 and taxes $90, there is a surplus of $10 in the EE bucket. That's money in our pockets, increased savings. The federal government can just issue Treasuries in that amount, converting the green dollars into yellow dollars in Kelton's parlance. So contrary to the myth of crowding out, FG deficits don't eat up our existing savings, they actually increase the amount of savings. It's not an opinion, it's just simple accounting.

At this point we might ask if there was ever any real danger of a shortage of loanable funds. The Fed publishes a weekly summary of the balance sheets of all commercial banks in the US. As of July 1, total loans were $10.6 T and total deposits were $15.6 T. [3]. The Treasury has issued trillions of dollars of securities to cover deficit spending to date and there are still $5 T in available bank credit, and with the multiplier effect [2], there's much more. There's plenty more where that came from. Money Market funds have a total of about $4.6 T, all of it short-term, and much of that is available for longer-term investment if there were reasonable returns for the perceived risk. But there aren't any decent returns to cash right now. Why?

That's Kelton's second point. Step 2 in the reasoning chain for this myth is that competition to borrow money drives up interest rates. Not so, says Kelton. She explains that interest rates are a policy choice. The Fed has always been able to control interest rates, both short and long term. In the past, it has done so extensively. During WWII, the Fed kept interest rates at specific levels to help control the economy during the war. That continued until 1951. We have had other bouts of serious control, including immediately after the Great Crash, though that didn't last long. The Fed is currently keeping interest rates low for both short-and long-term loans.

At other times, the Fed has controlled short-term rates and allowed the private market to affect longer-term rates. Kelton explains how the Fed controls both long- and short-term interest rates, which I'll skip over. It's enough to say that this puts the nail in the idea of crowding-out.

Deficits have their good side, but they can create problems, like inflation or politically-driven mis-allocation of resources. MMT doesn't argue for deficits or surpluses. It argues that we should pay attention to the state of the economy and pick policies that maximize our political desires. I think the government should do more to take care of our citizens. I think everyone should have a job, good schools, decent transportation, clean water and clean air, a planet that isn't catching fire, and a world not ravaged by Covid-19. MMT supports those goals. Others think we should buy more tanks and guns and do nothing else, just let the market fix things. There are MMT prescriptions for that too.

Finally, it's worth noting something Kelton doesn't discuss: keeping interest rates low hurts savers, whether they are saving for a rainy day, for college for the kids, for a down-payment on a home, or retirement. These are funds that people mostly don't want to put at significant risk. But if interest rates are low, there is a real danger that inflation will slowly erode those savings. For example, health care costs are one reason people save for a rainy day. It's likely that inflation in that sector is higher than the overall inflation rate. Low interest rates will hurt those savers. Similarly, college costs are rising faster than overall inflation, and in some cities, house prices and rents rise faster. In each case, the saver is a loser.

We should be thinking about that if we want to see progressive uses of MMT achieve their full potential.

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[1] That’s my view, not Kelton’s. She says there is some evidence that crowding-out can be a problem for non-sovereign currencies, but not for sovereign currencies.

[2] This is accompanied by the idea that bank lending results in deposits, and those deposits fund another round of lending, etc. Each round of lending is smaller because banks are required to hold a percentage of all deposits in their reserves at the Fed. I was taught that this is the multiplier effect; it’s now called the money multiplier. We can ignore it for these purposes, because it leads to a larger number, but still one defendant on savings.

[3] Respectively, H.8, P. 2 Line 9 and H.8 P. 3, line 34.

THE NATIONAL DEBT IS SOOOOOOO BIG

Posts in this series

Chapter 3 of Stephanie Kelton’s *The Deficit Myth* addresses the National Debt. It’s a very big number, and politicians use it to terrorize voters. Kelton tells a story about Senator Mike Enzi, R-WY, complaining about a CBO budget outlook report, saying it should put in the zeros instead of using the word “trillion”. And that’s how seriously we should take the problem. Remember what we learned in the last post: money is a debt on the books of the US government, but it's also an asset in the hands of a currency user. That means that the National Debt tells us how much we collectively have received in assets from the Treasury.

Kelton says that fear of the National Debt is shared by everyone in and near government across the ideological spectrum, politicians, staffers, wonks and think-tankers. When she was Chief Economist for Bernie Sanders on the Senate Finance Committee, Kelton questioned the myth.

> One of the most eye-opening things I learned came from a game I would play with members of the committee (or their staffers). I did this dozens of times, and I always got the same incredible reaction. I'd start by asking them to imagine that they had discovered a magic wand with the power to eliminate the entire national debt with one flick of the wrist. Then I'd ask, "Would you wave the wand?" Without hesitation, they all wanted the debt gone. After establishing an unflinching desire to wipe the slate clean, I'd ask a seemingly different question: "Suppose that wand had the power to rid the world of Treasuries. Would you wave it?" The question drew puzzled looks, furrowed brows, and pensive expressions. Eventually, everyone would decide against waving the wand. P. 77. [1]

Wiping out the National Debt means eliminating Treasuries, and that exposed the contradiction at the heart of the myth of the Very Scary Debt. We can't get rid of Treasuries! But the raw number scares voters so many people continued to rant about the National Debt. They never asked why voters were scared, or questioned their role in creating that fear.

Intuitively, if deficits aren't a problem unless they cause inflation, then the national debt isn't a problem unless it causes inflation. In the same way interest on the national debt isn’t a problem unless it causes inflation. Kelton acknowledges that there may be limits on the size of the national debt, usually discussed in terms of the ratio between the national debt and the GNP. The US is nowhere near the size of the debt to GNP ratio of Japan, for example, so there’s no immediate problem. Assuming there is some limit, Kelton turns to the various ways we could eliminate the national debt.

One way would be to run government budget surpluses, as we did when Bill Clinton was President. We could easily do that by raising taxes on the rich and their corporations, slowly depleting their total wealth. That’s a good idea on its own terms, because it would reduce their political and economic power. Kelton says that in the past when the government has run surpluses for several years the result was depressions. I would add that if we did raise taxes we’d be destroyed in the shrieks of the rich saying that their money was being used to pay for social programs like Social Security.

Or, the Fed could get rid of all of the Treasuries with just a few clicks on a keyboard, by reducing the number in the Treasury Securities account and increasing the numbers in the bank account of the holders of the Treasury securites. Economists call this monetizing the debt.

Or, we could do it by continuing to spend as we see fit subject to the inflation constraint, but stop issuing new Treasuries. As the old ones mature, the Fed pays them by crediting the accounts of the holders with green dollars. We could stop that at any time we reached a level of debt that wouldn’t frighten even the most fearful Americans. or at some higher level. [2]

Once getting rid of Treasuries would have caused a problem, because the Fed used the market in Treasuries to control interest rates. That is no longer the only control mechanism available to the Fed. [3] But then what? Kelton discusses an article by Eric Lonergan, an economist and fund manager. Lonergan asks what would happen if Japan monetized all its bonds. I quote his analysis in full:

> First, let's go through the balance sheet effects: 1. The government now has no debt. 2. The value of the Japanese private sector's assets is unchanged – they used to hold JGBs [Japanese Government Bonds], now they hold the same value in cash. So overnight, the government's debt is eliminated, and the private sector's net wealth is unchanged.
>
> The income effects are also interesting: 1. The government's budget position improves. 2. The income of the private sector falls because bonds paying interest have been replaced with cash holding none.
>
> So what happens to the economy?
>
> Most people tend to say, "hyperinflation", but that makes little sense. Why on earth would the Japanese household sector rush out and buy things when their interest income has fallen, their wealth is unchanged, and they are used to falling prices. The private sector already has a high wealth to GDP ratio and are spending less than they produce (which is precisely why the government runs a deficit).
>
> The Yen might weaken because the yield on overseas assets has risen relative to Japanese assets, but this spread is hardly offering much compensation for exchange rate risk. My conclusion is that nothing would change in Japan if you had 100% monetization of the stock of JGBs!

The takeaway is that getting rid of Japanese government debt wouldn't affect the economy at least in the short term. Two possible problems:

a) less spending because bond income disappears from the economy; and b) weakening of currency in international markets because there are higher return available on the bonds of other countries. In the case of the US, we can add that cash previously held as Treasuries suddenly isn't producing any return, so its owners look elsewhere for returns. That might mean an increased purchases of assets by foreigners; purchase of the debt of other countries; or something else. But that's not all bad, and I don't know enough to work it out.

Kelton accepts Lonergan's logic. Paying off US Treasury Securities is possible and likely would have minimal short-term effects. Late in the Clinton Administration the US ran budget surpluses, to the point that White House economists prepared a draft report title*d Life After Debt*. Here's a discussion by David Kestenbaum of Planet Money. This report got labeled PRELIMINARY AND CLOSE HOLD OFFICIAL USE ONLY", and Planet Money got it through FOIA. Then the Republicans cut taxes for the rich, with the usual pennies for the rest of us, so the problem evaporated.

In sum, the national debt isn't a problem as long as it doesn't lead to inflation. A lesser constraint might be the impact on the value of the dollar, which might affect international trade in unpredictable ways.

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[1] This is a good example of Kelton's style. As you can see, it's clear, simple, and direct English prose, the highest praise my high school English teacher, Brother Daniel, ever bestowed.

[2] Here's a recent tweet from Scott Fullwiler, an MMT economist:

> The core point is it should be done by the [Central Bank]—there's no reason why the appropriate (for mkt conditions)

> change in risk-free, liquid securities should equal size of govt debt/surplus, & no reason for appropriate maturity structure to be same as what cost-minimizing [Treasury] chooses.

[3] For example, the Fed began to pay interest on the reserves commercial banks are required to keep at the Fed. There is a full explanation starting at P. 117.

[4] There are, of course, distributional issues for both Treasury Securities and for the interest they pay. This is a normative issue best dealt with by politicians, and not economists. One consideration is that many people benefit indirectly from interest on Treasuries through money market funds, investments by pension plans and direct purchase, because Treasuries are absolutely safe.

REFLECTIONS ON THE DEFICIT MYTH

Posts in this series

The first three posts in this series address the Introduction and the first two chapters of Stephanie Kelton's *The Deficit Myth*. In this post I add her definition of money and some of my thoughts, and invite readers to do the same, either questioning points she made or applying her ideas to our society.

1. Modern Monetary Theory starts by asking one question: how does money work in a fiat currency

nation. Kelton defines money in her first published paper: The Hierarchy of Money. This is a very readable discussion of the range of opinions on this subject, focused on the argument between the Metalists and the Chartalists, which began over 400 years ago. [1] Kelton starts with a definition of money. [2]

> Money represents a debt-relation or promise to pay that exists between human beings. It cannot be identified independently of its institutional usages, because money represents a *social* relationship. … The creation of money, then, is simply the balance sheet operation that records this social relation. (Emphasis in original.)

According to Kelton, the Chartalists called money any token representing a debt relationship. Thus, a postal stamp is a money: it represents an asset to the owner and a debt to the Post Office which is satisfied by delivering a letter. A plane ticket is money: it represents the obligation of the airline to fly the holder to a particular place at a particular time. Bank deposits are money: they are a liability of the bank which must deliver money at the direction of the account holder. The rule for creation of money is the agreement by one person to hold the debt of another. [2]

Now consider the dollar. The dollar is a creation of the federal government. Kelton writes:

> Thus, State money is created when the public agrees to hold (as an asset) state-created money (a liability to the State) which is required in payment of taxes.

This explains why currency and other forms of dollars (bank deposits, treasury securities, and bank reserves at the Fed) are liabilities of the federal government. We users agree to hold these dollars as assets. We can use them to acquire different forms of assets from sellers, obtain services from providers, and pay taxes. When the government collects taxes, it matches that asset with a corresponding liability and clears to zero.

The point of this exercise is to demonstrate that money is a balance sheet representation of the debt/asset relations between human beings, a social relationship. That understanding is crucial to the arguments advanced in *The Deficit Myth*.

2. Kelton calls for a Copernican Revolution in the way we think about money. This, of course, is a reference to the Copernican Theory, which said that the earth revolves around the Sun, and not vice versa, despite what we see with our own eyes. The ramifications of the Copernican Revolution eventually led to a complete change in our understanding of the nature of reality. [3] The revolutionary change she describes is that US government spending is not constrained by its ability to tax and borrow, but by the actual resources available, labor, material, and the organization of production. One important part of *The Deficit Myth* is the description of the kinds of changes we have to make in our own thinking. But there are many more revolutions. Here are three.

a. Congress ducks policy arguments by turning them into discussions of budgets or into political games. That never made sense, because all budgeting is about priorities. Games like pay-fors or one-upmanship on military spending were always perverse, but both parties pretended these were real arguments. They aren’t. MMT strips away one more layer of pretense.

b. Mainstream economists refuse to look honestly at MMT. Marion Fourcade and her colleagues at Berkeley published a paper examining the economics profession titled *The Superiority of Economists*, a devastating critique of their pretensions. Among other things, economists tell us that markets should make our decisions about allocation of resources, and that anything that interferes with the operations of markets is harmful to society. When government spending is between 35 and 45% of GNP prior to the pandemic, it’s stupid to argue that markets are the best form of allocation of resources. When capitalists exercise outlandish control of government spending priorities, it’s stupid to argue that markets should determine what we can and can’t have.

Many economists hold themselves out as experts on all sorts of things, including the pandemic. In the MMT world, as Kelton points out, economists would concentrate on predicting the inflationary effect of spending choices, and get completely out of the business of telling us how we should make decisions about allocation of resources.

c. Historically, people thought that the most important problem facing an economy was to accumulate capital and turn it to productive use for the benefit of society. The chosen solution was Capitalism, and to encourage capitalists to invest, we allowed them to reap outlandish profits through monopoly, grants from the Crown, and other favors, while ignoring the fraud and corruption those policies entailed. This continued in the US, with gigantic giveaways to railroad and mining companies, ludicrous levels of patent protection, and grotesquely unfair tax rules, while mostly ignoring or even praising graft, corruption and fraud. The results of coddling capitalists are rubbed in our faces every day.

MMT gives us space to think about the way society could operate to make our lives better. It allows us to make decisions about what we need and want. We do not have to accept whatever is on offer from Capitalists. We can decide based on our principles, morals, values and dreams. MMT puts us in charge, and frees us from the domination of the rich. It opens the door to the “euthanasia of the rentier”, as Keynes calls it in *The General Theory of Employment, Interest* *and Money*.

> Now, though this state of affairs would be quite compatible with some measure of individualism, yet it would mean the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital.

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[1] Fun fact, Adam Smith may have held Chartalist views. Kelton quotes him thus:

> A prince, who should enact that a certain proportion of his taxes should be paid in a paper money of a certain kind, might thereby give a certain value to this paper money.

[2] Kelton doesn't go into the history of money, but this BBC article is a fascinating picture of trade in Ancient Sumeria, and gives a tantalizing hint about the origin of money in record-keeping and accounting for trade.

[3] For a fascinating and occasionally comprehensible discussion of this new understanding, see *Reality Is Not What It Seems*, by Carlo Rovelli.

MMT ON INFLATION

Posts in this series
The Deficit Myth By Stephanie Kelton: Introduction And Index
Debunking The Deficit Myth

The second chapter of Stephanie Kelton's *The Deficit Myth* deals with inflation. In Chapter 1, Kelton explains that the deficit is not a constraint on government spending. Instead, inflation is the important constraint. A deficit does not prove that the federal government is overspending. Only an increase in inflation proves Congress is overspending. Kelton says Congress shouldn't tax and spend so as to deliver a balanced budget. Congress should spend and tax so as to deliver a balanced economy, one that serves all of us. She says that historically we have not done this, that we have chosen to focus of deficits and in so doing our economy has not served us well.

Definition and Description of Inflation

> Inflation means a continuous rise in the price level. A bit of inflation is considered harmless and even something economists like to see in a healthy, growing economy. But if prices start rising faster than most people's incomes, it means a widespread loss of purchasing power. Left unchecked, this would mean a decline in society's real standard of living. In extreme cases, prices can even spiral out of control, gripping a country in hyperinflation. P. 44.

The danger of eroding incomes explains why everybody worries about inflation, and explains why politicians can use the threat of inflation to terrorize voters. It works, even though the problem for more than a decade hasn't been too much inflation, it's been too little. Ever since the Great Crash inflation has been less than 2% annually despite efforts of the Fed.

Kelton says that economists think of inflation as either cost-push or demand-pull. Demand-pull inflation occurs when consumer spending rises faster than the economy can produce goods and services. That hasn't been a problem for a long time. Cost-push inflation can arise from disasters, which reduce the supply of something; from pricing power, as in the case of Big Pharma with its patents and trade secrets; or from workers gaining market power and demanding higher wages which businesses pass on to consumers. That last one is the only fear mainstream economists suffer, as far as I can tell.

The dominant theory of inflation stems from Milton Friedman's monetarism:

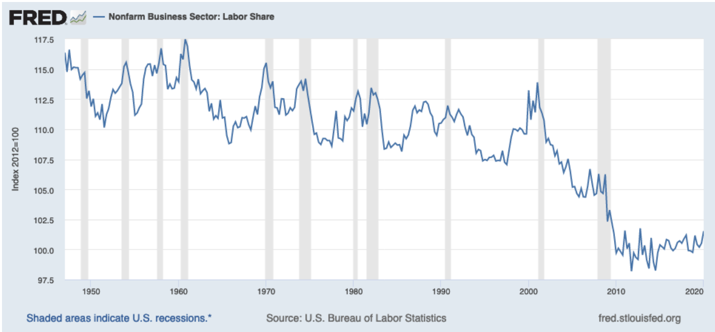
> According to Friedman, "inflation is always and everywhere a monetary phenomenon." What he meant was that too much money is the culprit in any inflationary episode. If prices weren't stable, it was because the central bank was trying to force the economy to create too many jobs by allowing the money supply to increase too rapidly.

The early neoliberal Friedman insisted that the Fed must never interfere with the workings of the market. Specifically, the Fed should not try to reduce unemployment below a certain level, which came to be called NAIRU, the non-accelerating inflationary rate of unemployment. Friedman thought there had to be some minimum level of unemployment in the economy. [1] The Fed bought into this view, as did politicians of all stripes. They all agreed that to keep prices stable, the US has to accept a certain level of unwanted unemployment. And to be on the safe side, maybe a bit higher level of unemployment. In practice, Congress dumped the problems of inflation and unemployment on the Fed.

But problems arose. The NAIRU isn't visible or measurable. It can only be seen in retrospect. And now we are pretty sure there isn't a clear relationship between inflation and unemployment, as the Fed assumed. [2] The Fed Chair, Jerome Powell, freely admitted to Rep. Alexandria Ocasio-Cortez that the Fed has been wrong about NAIRU, but defended its use on the grounds that "We need to have some sense of whether unemployment is high, low or just right." P. 53.

2. The Problem of Unemployment

It turns out that the Fed used the purported correlation between inflation and unemployment as its primary tool for controlling inflation, ignoring all other causes of inflation. When the economy heated up and unemployment dropped, workers gained market power, and their share of national income increased. That led the Fed to raise interest rates leading to a tightening of the economy and usually a recession, as the following chart shows.



Gray bars indicate recessions.

Kelton calls this a "human sacrifice", forcing some people out of the workforce when they want to work and can be productive. She thinks we are asking too much of the Fed. It can't spend money into the system; only Congress can do that. All the Fed can do is change the cost of borrowing. If unemployment is too high, the Fed can make borrowing cheaper, but it can't force anyone to borrow. Usually when unemployment is high, no one wants to borrow. I note that this was what happened after the Great Crash. The Fed cut interest rates to zero and lowered bank reserve requirements, hoping to increase money going into the economy. It didn’t work.

3. The Job Guarantee

Kelton argues that a better way to deal with unemployment is a job guarantee. Every person who wants to work should be able to get a decent job with decent pay and decent benefits. If the private sector won’t provide those jobs, the government should. [3] Kelton discusses this idea and its foundations.

It would probably be impossible for Congress to monitor the economy closely enough to manage full employment by tweaking taxes and spending. A job guarantee would act as a safety-valve and an automatic stabilizer for the economy and help solve this problem, leaving the Fed free to focus on inflation. If the private sector needs all the workers it can find them. If not, the government hires people to do jobs that need doing. There is plenty of work that needs doing, and, as Kelton pointed out elsewhere, we can always use more flowers in our parks and boulevards.

4. Preventing Inflation

So how should Congress budget knowing that the only effective constraint on spending is inflation? What would change? The way Congress currently works is that every bill that calls for expenditures gets a score from the Congressional Budget Office that assesses the impact of the expenditure on the deficit over a ten-year period. If inflation were the constraint, then the CBO would offer a score based on the probable impact of the expenditure on inflation. If the economy is, as now, operating well below its capacity for producing goods and services, the possibility of inflation would be low.

If the economy is close to capacity, either as a whole or in part related to the area of expenditures, then Congress has to make hard calls. How important is the expenditure? Can we create “fiscal space” for the expenditure with taxes? For example, in the case of the entire economy humming along, a general income tax hike would take money out of most people's hands so they would not be buying as much, leaving room for the government to buy more. If there is a bottleneck, a more focused tax or some other step might be necessary.

Conclusion

MMT recognizes that inflation is a crucial problem. It shows how it arises and how we should protect ourselves from it.

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[1] Marx said that the reserve army of labour is a necessary part of capitalism. Hmmm.

[2] This relationship is embodied in the Philips Curve. I discuss it here.

[3] Other economists favor a universal basic income. Both have the added benefit of freeing workers from abusive or irritating employers. Your family won't starve if you walk out on a bad situation.

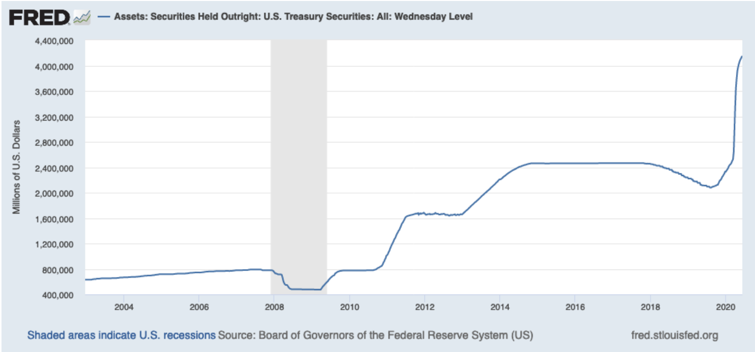
DEBUNKING THE DEFICIT MYTH

Posts in this series
The Deficit Myth By Stephanie Kelton: Introduction And Index

The first chapter of Stephanie Kelton's book *The Deficit Myth* takes up the biggest myth about federal government finances, the idea that federal budget deficits are a problem in themselves. The deficit myth is rooted in the idea that the federal government budget should work just like a household budget. A family can’t spend more than its income will support. The family has income, and may be able to borrow money, and the sum of these sets the limit on household spending. Those who propagate the deficit myth say government expenditures should be constrained by the government’s ability to tax and borrow. First the government has to find the money, either through taxes or borrowings, and only once it has found the money can it spend. The way things actually work is different.

In the real world, it goes like this. Congress votes to direct an expenditure and authorize payment. An agency carries out that direction. The Treasury instructs the Fed to pay a vendor. The Fed makes the payment by crediting the bank account of the vendor. That’s all that happens. It turns out that the real myth is that the Treasury had to find the money before the Fed would credit the vendor. That’s because the federal government holds the monopoly on creating money. U.S. Constitution Art. 1, §§8, 10. In practice this power is given to the Treasury, which mints coins, and to the Fed, which creates dollars. [1]

It also turns out that for the most part, the Treasury does cover the expenditure by taxing or borrowing, but because the government is an issuer of dollars, it isn’t necessary. [2] In the last few months, the Treasury has been selling securities and the Fed has been buying about 70% of them. Here’s a chart from FRED showing Fed holdings Fed holdings of treasury securities. The Fed may or may not sell those securities to third parties. If it doesn’t, they will be held to maturity and remitted as a dividend to the Treasury.



The recognition that spending comes first, and finding the money comes second is one of the fundamental ideas of MMT. Kelton describes her meeting with Warren Mosler who introduced her to these ideas; the stories are amusing and instructive. I particularly like this part:

> [Mosler] began by referring to the US dollar as “a simple public monopoly.” Since the US government is the sole source of dollars, it was silly to think of Uncle Sam as needing to get dollars from the rest of us. Obviously, the issuer of the dollar can have all the dollars it could possibly want. “The government doesn’t want dollars,” Mosler explained. “It wants something else.”
>
> “What does it want?” I asked.
>
> “It wants to provision itself,” he replied. “The tax isn’t there to raise money. It’s there to get people working and producing things for the government.” Pp. 24-5.

Put a slightly different way, people accept the government’s money in exchange for goods and services because the government’s money is the only way to pay taxes imposed by the government. Kelton says she found this hard to accept. She spent a long time researching and thinking about it, and eventually wrote her first published peer-reviewed paper on the nature of money. [3]

The monopoly status makes governments the issuers of money, and everyone else is a user. That fundamental difference means that governments have different financial constraints than households, and that it certainly isn't constrained by its ability to tax and borrow. Kelton offers several interesting and helpful analogies that can help people grasp the Copernican Revolution that this insight entails.

Once we understand that government doesn't require tax receipts or borrowings to finance its operations, the immediate question become why bother taxing and borrowing at all. Kelton offers four reasons for taxation.

1. Taxation insures that people will accept the government's money in exchange for goods and services purchased by the government.
2. Taxes can be used to protect against inflation by reducing the amount of money people have to spend.
3. Taxes are a great tool for reducing wealth inequality.
4. Taxes can be used to encourage or deter behaviors society wants to control. [4]

She explains borrowing this way: government offers people a different kind of money, a kind that bears interest. She says people can exchange their non-interest-bearing dollars for interest bearing dollars if they wish to. "… US Treasuries are just interest-bearing dollars." P. 36. Let's call the non-interest-bearing dollars "green dollars", and the interest-bearing ones "yellow dollars".

> When the government spends more than it taxes away from us, we say that the government has run a fiscal deficit. That deficit increases the supply of green dollars. For more than a hundred years, the government has chosen to sell US Treasuries in an amount equal to its deficit spending. So, if the government spends $5 trillion but only taxes $4 trillion away, it will sell $1 trillion worth of US Treasuries. What we call government borrowing is nothing more than Uncle Sam allowing people to transform green dollars into interest-

> bearing yellow dollars. P. 36-7.

It might seem that there are no constraints, but that is not so. Congress has created some legislative constraints on its behavior, including PAYGO, the Byrd Rule, and the debt ceiling, but these can be waived, and always are if a majority of Congress really want to do something. They also serve as a useful way of lying to progressives demanding public spending on not-rich people, like Medicare For All. We have to pay for it under our PAYGO rules, they say, while waiving PAYGO for military spending (my language is harsher than Kelton's).

The real constraints are the availability of productive resources and inflation. The correct question is not "where can we find the money", but "will this expenditure cause unacceptable levels of inflation" and "do we have the real resources we need to do this" and "is this something we really want to do. As Kelton puts it, if we have the votes, we have the money.

In my next post, I will examine some of these points in more detail. Please feel free to ask questions or request elaboration in the comments.

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[1] Art. 1, §8 authorizes the federal government to create money; §10 prohibits the states from issuing money. That leaves open, for now, the possibility that private entities can issue money. Banks and from time to time other private entities play a role in the creation of money, but I do not see a discussion of this in the book.

For those interested, here's a discussion of the MMT view from Bill Mitchell. I may take this up in a later post. In the meantime, note that every creation of money by a bank loan is matched by a related asset. Thus, bank creation of money does not increase total financial wealth. In MMT theory this is called horizontal money. It is contrasted with vertical money representing the excess of government expenditures over total tax receipts, which does increase financial wealth. Here's a discussion of this point.

[2] There are, of course, constraints on government spending, especially inflation and resource availability. We'll get to that in a later post.

[3] Kelton cites the paper in a footnote: *The Role Of The State And The Hierarchy Of Money*.

[4] Compare this list to the list prepared by Beardsley Ruml, President of the New York Fed, in 1946.

THE DEFICIT MYTH BY STEPHANIE KELTON: INTRODUCTION AND INDEX

Posts in this series.

The last two chapters of Stephanie Kelton's *The Deficit Myth*