Modern Monetary Theory

(See Mankiw 2019, Cochrane 2020)

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Introduction

- There has been a new brand of monetary policy that has gained traction (or attention) over last five years
- Advocated by main economic advisor of Bernie Sanders and also endorsed by Alexandra Ocasio-Cortez
- "Modern Monetary Policy"
- Here we'll discuss what it is (as best we can)
- Some big caveats

MMT Concerns: Overview

- The big issue with MMT is that even people who try to study it have a hard time figuring out what it is(!)
- My own view, which you are free to dismiss, is it's a giant shell game
- There aren't great sources on this, so we can't go into great mathematical depth
- But we'll read *blog* posts (sorry)

What is the Idea of Modern Monetary Theory

- It starts from the observation that the government is able to issue its own money.
- In the words of three of its main advocates: "The most important conclusion reached by MMT is that the issuer of a currency faces no financial constraints. Put simply, a country that issues its own currency can never run out and can never become insolvent in its own currency. It can make all payments as they come due"
- This means that:
  - It can buy whatever it wants (that is priced in its money)
  - It can pay off any nominal bonds it wants (by printing money)
  - Its only limitation is inflation, which it can control with taxation
- All of this is true! If people are willing to accept dollars, you can just print whatever you need to pay for it!
- What's downside?

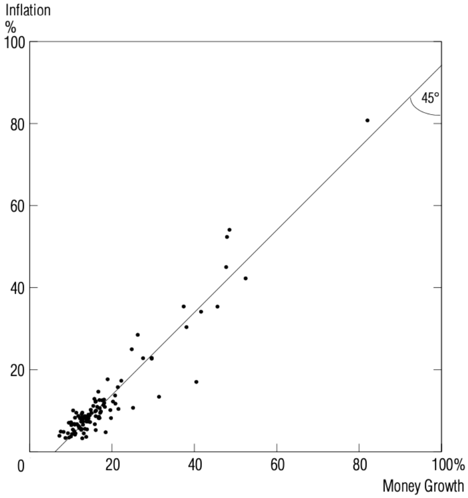
MMT-II

- From an interview with Stephanie Kelton: “MMT starts with a really simple observation and that is that the U.S. dollar is a simple public monopoly. In other words, the United States currency comes from the United States government. It can?t come from anywhere else. And therefore, it can never run out of money. It cannot face a solvency problem, bills coming due that it can’t afford to pay. It never has to worry about finding the money in order to be able to spend. It doesn’t need to go and raise taxes or borrow money before it is able to spend.”
- We shouldn’t care about the deficit, we should care about the inflation risk
- If economy not at full capacity, then M increases, Y increases, and no effect of inflation on P ($MV = PY$)

Downside of Printing Money

- One concern might be that printing money to pay your bills will cause inflation
- The major MMT advocates note that ?no simple proportionate relationship exists between rises in the money supply and rises in the general price level.?
- This is absolutely false.

Simple Proportionate Relationship



Source: International Monetary Fund

Evidence from $\approx$ 90 countries over thirty years. Same in modern times, Latin America, etc.

Simple Proportionate Relationship

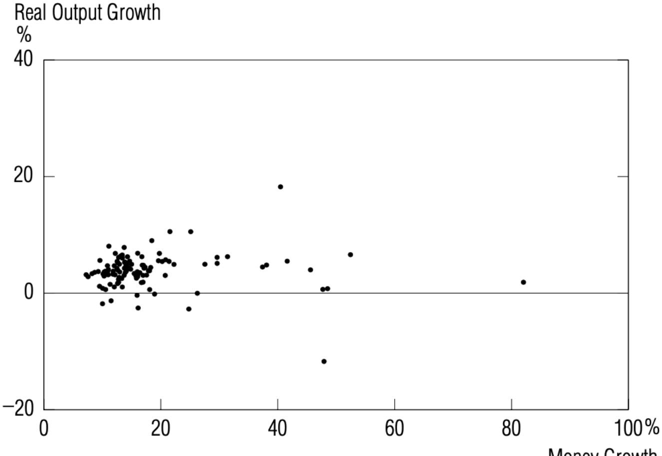
- Every hyperinflation I've ever seen was caused by the government printing money
- Every stop to a hyperinflation involved the central bank no longer agreeing to fund the government (or being unable to due to dollarization)
- There's clearly a nearly one-to-one relationship
- As Mankiw reports, the correlation is 0.79

MMT-III

- Same interview with Stephanie Kelton: "The government can simply spend the money into the economy and when it does, the rest of us end up receiving that spending as part of our income."
- Idea: when government spends money (their deficit) then households gain money (our surplus)
- That's good! We're richer!
- Easier when think about real resources–government uses real resources today to build bridge and print money ($1)
- Now more money in the economy
- If production increases by 1, no effect
- Is this the case?

Money and Real Output Growth:
No Correlation in the Full Sample . . .

Average Annual Rates of Growth in M2
and in Nominal Gross Domestic Product, Deflated by Consumer Prices
During 1960–90 in 110 Countries



How to stop inflation: MMT

- While they appear to be wrong, why, according to MMT, does inflation occur?
- They argue it occurs when workers and capitalists are fighting over their shares of the pie
- To control inflation, we need government wage and price controls
- But will inflation occur?

Other claims on inflation

- Claim: "capitalist economies are rarely at full employment. Since economies typically operate with spare productive capacity and often with high rates of unemployment, it is hard to maintain the view that there is no scope for firms to expand real output when there is an increase in nominal aggregate demand"
- Idea here is that you won't get inflation unless the economy is at capacity, and the economy is rarely at capacity
- Why? If the government prints money, and it employs a new person who was't working before to consume something that wasn't working before, potentially just made idle resources work but shouldn't raise prices b/c no competition
- Also, why not just raise taxes to take money out of the economy?
  - Then we're back where we started!

Shell Game

- We can just print money for what we want!
- But that will cause inflation
- No it won't, because economy isn't at capacity
- But what if it does?
- We can raise taxes as necessary to control
- But taxes immediately necessary! Essentially all long-run inflation caused by money growth

Other Criticisms

- MMT is really a guru-based system
- No real formal models that everyone can write down and analyze the consequences of
- Just have to ask the proponents and have them change their positions depending on the question
- I believe it's correct to describe it as starting from true statements, then obfuscating the relationship between money growth and inflation to argue there are big free lunches

So what is recoverable from MMT?

- Fiscal Theory of the Price Level! (next class)