What if the federal deficit didn't actually matter? Modern Monetary Theory explained

Stephanie Kelton's new book, 'The Deficit Myth,' argues that the path to shared prosperity and achieving progressive goals means no longer asking how we will pay for things, and instead just creating the money to make them happen.

By Talib Visram
June 15, 2020 – *Fast Company*

In response to the economic impact of the coronavirus pandemic, Congress passed a $2.2 trillion stimulus package, transferring large amounts of cash to people in the form of both direct stimulus funds and an extra $600 on top of the unemployment checks they were due. It was an action antithetical to the typical spending policy trumpeted by Republicans and many Democrats, which treats government borrowing and spending as something to be avoided, in favor of always lowering the federal deficit and keeping the federal budget balanced.

The question that spells an end to so many policy proposals is "how will we pay for it?" But the support for the massive coronavirus stimulus—and its success in forestalling the worst possible outcome of broad shutdowns—could cause more politicians to look at a different theory of spending: Modern Monetary Theory, once an obscure branch of economic thinking that's been gaining mainstream attention. It asserts that (at the federal level, at least) we don't need to ask how to pay for things: The money has always been there for the spending, and always will be.

As one of the current champions of MMT, Stephanie Kelton, a professor of economics at Stony Brook University, former chief economist for the Democrats on the U.S. Senate Budget Committee, and economic advisor for Bernie Sanders in 2016, has taken on the daunting task of persuading Americans to think differently about how the government spends money. Her new book, *The Deficit Myth*, argues that there are some constraints that should curb government spending, the unfounded fear of a deficit—that the government should be run like a business—should not be one.

The book was supposed to come out earlier, but Kelton broke her wrist during the writing process. The resulting publication delay turned out to be serendipitous. Now, the need for spending is more potent, as the U.S. officially entered a recession on June 8, and is headed for a $4 trillion deficit by the end of the year. But MMT is also a longer-term framework for ending suffering through government programs. "There's been a lot of foregone prosperity in the name of trying to run a budget more like a household or a private business," Kelton says. "And that is costly to us as an economy, and as a society."

What is Modern Monetary Theory?

MMT relies on the basic fact that the U.S. government is a currency issuer: It has its own sovereign currency, the U.S. dollar, just like Japan has the yen, and U.K. has the pound sterling. Because the U.S. is the exclusive producer of the U.S. dollar, it can print more cash, without help, whenever it needs it. That's not the same for countries without their own sovereign currency; even economically robust Germany is a user of the shared euro. It's also not the same for U.S. state and local governments, which receive funding and have to keep balanced budgets. Or, of course for private businesses, or households.

While those entities can easily run out of money and so must strive to stay in the black, the government can afford to be in the red. In fact, MMT posits that it *should* be in the red: federal deficits can be good and necessary for the economy. That's because the government's deficit is the people's surplus. "A government surplus works like a vacuum," Kelton says. "It sucks dollars out of the economy. And a deficit works like a blower—it blows dollars onto the balance sheet, injecting dollars."

She disputes that the government surplus during the Clinton years—acclaimed at the time—was actually beneficial to country. At the time, the administration imposed a large tax increase on wealthier individuals, a payroll tax increase intended to fund Social Security, and some spending restraints. It's now well-documented that those policies ultimately drove the government back into deficit, because it funneled wealth away from taxpayers, driving household savings down, and granting us less purchasing power to keep the economy ticking along.

The prevailing system allows monetary policy, set by the Federal Reserve, to steer the economy when it gets too hot or cool by modifying the money supply, and manually tweaking interest rates to encourage or discourage borrowing and spending. MMT wants to hand the steering wheel, and the purse strings, over to fiscal policy, set by Congress, to achieve economic stability using legislative means, producing a delicate balance between spending and taxing—all the while paying little notice to the deficit.

In the MMT view, because the government issues the currency, it doesn't need to tax and borrow to afford to spend. Taxes are still necessary, Kelton says, but not to create funds for the government. "It's wrong to even call it tax revenue," she says. "Taxes are for subtraction, they're not for paying for things." MMT has firmly picked its side in the chicken-or-egg conundrum: It reorients the government's financial sequence from taxing and borrowing, then spending, to simply spending first. "That's the biggest thing to let go of," she says. "Once you get that, then you're off and running."

Republicans like the ideas behind MMT—when they're in charge

While MMT may still be on the outer edges of the mainstream, Congress has used the MMT lens to pass legislation time and time again, perhaps inadvertently or for political expediency. Congress annually spends $700 billion on defense "because they feel generous." In 2017, Congress passed the Trump tax cuts, which showed, by the continued roaring of the economy, that the size of the deficit had no negative impact. Those cuts created a government deficit, which amounted to a surplus for the people—in this case, the already wealthy.

"Every time [Democrats] control the House or the Senate or the White House, [Republicans] scream and squawk about deficits," Kelton says, and yet, the Trump administration's chief accomplishment was a measure that "will add $2 trillion to the deficit over the next 10 years." Perhaps unwittingly, they used the lens of MMT to prove that spending is fine, and took action to ensure their favored trickle-down Reaganomics could continue. The Democrats "got played, like Charlie Brown with Lucy and the football," she says. "So, how come [the Republicans] get to have all the fun?"

The CARES Act was, in Kelton's view, a taste of the possibilities of considerable government spending to help those most vulnerable, without the need for a "pay-for." In such an instance, when Congress gives the okay for spending, it quite simply instructs the Federal Reserve, the nation's bank, to create money. Because it can. "It's not taxpayer money," former Fed chairman Ben Bernanke admitted, "We simply use the computer to mark up the size of the account." It's just "digital dollars," Kelton says, avoiding the term "printing money," which she's been careful to push back against in the past, because of its dark echoes of Weimer Germany and Venezuela, and the association with hyperinflation.

How do you know when you've spent too much?

MMT stresses that inflation, not the deficit, should be the major constraint on spending. Inflation occurs during a thriving economy, when people have more purchasing power and, thus, there is a higher demand for goods. The increase in prices brought on by higher demand sends the value of currency plummeting. The Federal Reserve is currently tasked with carefully controlling the rate of inflation, generally keeping it stable at about 2%, by constantly tugging at the interest rate.

But, in order to do that, the bank uses the NAIRU, or the Non-Accelerating Inflation Rate of Unemployment, a specific—but arbitrary—rate of unemployment that the Federal Reserve believes must be sustained to offset inflationary risks. It deems that inflation would rise if unemployment dipped during a strong economy, so in accordance with standard monetary policy, it increases interest rates to decrease borrowing and spending—and employment.

The targeted number is a crapshoot, and when pressed by Representative Alexandria Ocasio-Cortez during a congressional hearing, Federal Reserve chairman Jerome Powell recently admitted he had kept the number too high, at around 6%, which means 2 million people remain unemployed during a perceived "good economy." That leads Kelton to call NAIRU "a 50-year-old doctrine that relies on human suffering to fight inflation." MMT economists believe it's possible to keep the maximum number of people employed and still keep the economy stable, using prudent fiscal policy.

Jobs for all

Kelton has a proposal for avoiding that human suffering: keeping inflation low even while everyone has a job, via a "federal job guarantee," whereby anyone unemployed who wants to work would be given a job by the government. Ideally, these jobs would be based in the "care economy" that would contribute to improving communities for the public good. The jobs would be federally funded, but locally administered, because a small locality in northeastern Oklahoma, say, knows its community's needs best. Positions could stretch from construction and conservation to the arts, based on the individual's skills and interests.

The U.S. came close to this during the New Deal era, when the Works Progress Administration employed 8.5 million people, stopping just short of guaranteeing full employment. More recently, Argentina's Jefes de Hogar program, inspired directly by MMT economists, created 2 million public jobs in 2002.

Those jobs would directly put income into the hands of the people. They'd be remunerated with a competitive wage (Kelton suggests $15 per hour) and benefits package, which would not only help people live dignified lives, but also drive up wages, and the quality of jobs, in the private sector. "Why would you take Amazon's $8.50 an hour, in subpar working conditions," she says, "if you could have 15 bucks an hour and healthcare and paid sick leave?"

Imagine this program during our current recession: It would put the 40 million unemployed to work for public services, creating a smoother economy, a strong baseline wage, and a more experienced pool of people from which to hire, all of which Kelton says supply stability against inflation, without the need for monetary action. What's more, this spending would be automatically stabilized, meaning fiscal tweaks would happen without the need for more legislation every time there was a new economic crisis. The deficit would naturally expand during a recession, as the government paid out more wages to hire people who had lost their private sector jobs, then shrink as people recover and move back into the private sector.

Putting people into public work also produces physical resources, which Kelton says should be the new framing when considering ambitious programs. When appraising the Green New Deal—or Medicare For All—the question shouldn't be "how will you pay for it?" but, "do we have the doctors and nurses?" or "do we have the infrastructure?" Similarly, for education: "Do we have the faculty and facilities?" Taxing would be necessary, to ward off inflation or deflation, and would be implemented at a precise, calculated figure. Taxing would *not* be for the purpose of scraping up the dollars, because the dollars are already there.

Communicating a new narrative

When the "pay-for" question is posed at a presidential debate, or on *60 Minutes*, it's understandable that progressive candidates proposing Medicare For All and such programs can appear effectively cornered. For Bernie Sanders to run in a crowded field and announce, "We can do this with only offsetting 50% of the spending" wouldn't click with the customary thinking. "You don't want to be that guy," Kelton says, "when nobody has paved the way and nobody's going to help you." It's easier to say: Tax the rich.

In order for propositions to be taken seriously, MMT has to move from the theoretical to the mainstream. Kelton is optimistic that, after a pandemic and years of gridlock, people are curious, and she's seen a "ratcheting up of serious interest" from media and policymakers. As the CARES Act showed, flickers of MMT are already happening, if inadvertently.

More recently, Rep. Ocasio-Cortez has expressed openness to MMT, and Kelton says she works with many progressive candidates running for Congress—she specifically mentions Nabilah Islam, who just missed a chance at a runoff election in Georgia's 7th district by a percentage point, and Kara Eastman, who will face off in November's congressional election in Nebraska's 2nd district. "Look what the Tea Party did with just 20-some people,"she says. "You could be a disruptive force for good with a handful."

If the federal deficit is a myth, Kelton says there are still deficits that matter: shortfalls that the U.S. has ignored in jobs, healthcare, education, climate, democracy, all of which she believes MMT can address, and finally create opportunity after decades of scarcity. What's so frustrating is that the tools—the digital dollars—are already present and ready to be dispersed.

"It bothers me so much," she says, knowing that feeding a hungry child, fixing a crumbling bridge, making material improvements in our short time we have here on this planet, is being restricted artificially by fear of the number that falls out of the budget box at the end of the fiscal year."