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MMT's key claim is true but simplistic

Articles and presentations about Modern Monetary Thinking (MMT) are often annoyingly one sided. This isn't too surprising given the policy recommendations by MMT's proponents are a substantial departure from what was mainstream economics a few decades ago, but it is still disappointing in that it exposes the frequent intellectual dishonesty of people arguing strongly for or against it. It also degrades the external observer's view of economics as a field of endeavour, making it harder for sound economic advice to be trusted. We've seen the same problem this year with Covid-19; experts present opposing views with both claiming their arguments are settled science. Unsurprisingly, much of the general public loses faith in experts when this occurs.

There are many parts to MMT to argue about, but it helps to start with the primary claim of MMT. That is, governments can print money to pay for goods and services and therefore taxation policies can be considered separately from spending policies. The first part of this claim is of course true, governments can indeed print money to pay for financial assets (QE), welfare programs, infrastructure, salaries for public servants and a myriad of other things governments spend money on. However, there clearly is a limitation as unlimited money printing creates hyperinflation.

Proponents of MMT put forward that Japan has demonstrated that printing money is a viable option, and that inflation will take far longer to increase when the virtual printing presses are being used. Opponents of MMT argue that Venezuela and Zimbabwe are current examples of the outcome of excessive money printing. The two sides are talking past each other, hardly acknowledging the key points the other has made and rarely seeking to rebut them.

What neither side seems to want to acknowledge is that inflation is far more complex than we had previously thought. Milton Freidman's statement that "inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output" is an incomplete answer. We have seen substantial expansion of the money supply in the last decade without seeing substantial consumer price inflation, but we undoubtedly have seen asset price inflation.

The apparent lack of consumer price inflation can be partly explained by the supply of labour, international trade dynamics and the mechanics of calculating consumer price inflation (e.g. technology is deflationary but this doesn't capture that people typically trade-up rather than buying the same quality of technology over time) amongst many potential answers. Yet this discussion itself ignores the root question; why do we need inflation to be around 2%? Consumers love price declines, accept stable prices but get upset at price rises. Why are consumers wrong on this and governments/central banks right? (There is strong evidence and acceptance in mainstream economics that substantial price increases are bad, but close to no evidence that stable or decreasing prices are a problem.)

Proponents of MMT cannot ignore the historical and current examples of hyperinflation, or expect to be taken seriously when they argue that they have sufficient knowledge and control of inflation to stop printing money before excessive inflation takes hold. Similarly, what the opponents of MMT cannot confidently argue is that money printing will result in a spike in (consumer price) inflation in the short or medium term. The honest answer is that inflation will rise in the long term if there is substantial money printing, but we cannot predict when or by how much. If the government gives every citizen $1, it will have no impact on inflation. If the government gives everyone $1 million, we will get hyperinflation. The spectrum in the middle is far harder to predict.

The better response to is acknowledge that MMT is effectively being implemented now with many countries printing money and running substantial deficits at the same time. This isn't just a temporary Covid-19 phase, few national governments in developed economies have any plans to return to surpluses in the medium term. Some are arguing

MMT only occurs when the central bank prints money and hands it directly to the government, which mostly isn't the case. However, when the central bank sells (primary) bonds and then buys those exact bonds or equivalents back (secondary) days later it is basically the same thing. Governments and central banks might claim they aren't participating in MMT but on this one the emperor has no clothes.

Once the fact that MMT is being implemented is acknowledged, the better argument against its implementation is that there are negative consequences, which are neither immediate nor blatantly evident to the untrained observer. MMT allows governments to accumulate debts, spend wastefully, reduce interest rates to artificially low levels, and ignore taxation and productivity reforms. All of these act as a handbrake on future economic growth. The increased spending advocated by MMT proponents accompanied by low interest rates pulls demand forward, which means that in the short term they can appear to be achieving positive outcomes. In this way, MMT masks the underlying problems and is akin to staying drunk to avoid a hangover.

Those opposing MMT should be honest in saying that governments can print money to pay for things, at least in the medium term. However, those arguing for MMT style spending need to acknowledge that just because you can do something that provides positive short term impacts doesn't mean it is an optimal long term policy. Japan has shown that even with enormous fiscal and monetary stimulus, avoiding fundamental economic reforms results in sub-par economic growth for decades.

Footnote: MMT is often categorised as a school of thought only supported by left wing economists seeking to justify increased government spending. Whilst this observation is generally accurate, MMT can also be used as an argument that tax cuts are affordable. Democrat and Republican politicians with a few exceptions have no problem running deficits when their side is in power. The difference is their view on how to divide the spoils. Economists of all persuasions should take an apolitical stance, pointing to the basic economic principles and historical examples that show the negative consequences of long term budget deficits and money printing.

Written by Jonathan Rochford for Narrow Road Capital on 26 December 2020. Comments and criticisms are welcomed and can be sent to info@narrowroadcapital.com

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