Levy Economics Institute of Bard College

One–Pager | No.69

February 21, 2022

Time to Celebrate Modern Money Theory?

YEVA NERSISYAN and L. RANDALL WRAY

A piece in the *New York Times* evaluates whether Modern Money Theory (MMT) can declare victory after its policies were supposedly implemented during the pandemic. The article suggests yes, but for the high inflation it sparked. Some economists took exception and were even offended that the paper of record devoted space to MMT. Our view? The policy response largely validated MMT's claims even though it was not MMT's policy.

1. MMT claims sovereign government spends without "pay-fors," i.e., without raising taxes dollar for dollar. It pays for things by changing numbers in bank accounts. During the pandemic, Congress spent $5 trillion without pay-fors. Treasury instructed the Federal Reserve to make payments on its behalf. Treasury did not need to collect any taxes before this could happen. *Score one for MMT.*
2. MMT claims sovereign governments cannot be forced to default. There is no magic debt-to-GDP ratio beyond which the sky is going to fall. Contrast this to mainstream economists who believe there will be a day of reckoning. Carmen Reinhart and Kenneth Rogoff famously claimed that a debt-to-GDP ratio of 90 percent is the limit beyond which all heck breaks loose. The US debt-to-GDP ratio increased from 108 percent in 2020Q1 to 122 percent in 2021Q3 (reaching an all-time high of 135 percent in 2020Q2)—and total debt now stands at $30 trillion. The result: no defaults, no runs out of Treasury debt, no attack by bond vigilantes. *Score two for MMT.*
3. MMT claims government debt increases do not directly raise interest rates. Instead, rates go up only when the Fed raises them. Contrast this to mainstream economics, which claims that interest rates will go up as the Treasury competes with private borrowers for limited loanable funds. Ten-year Treasury yields dropped below 1 percent in the summer of 2020 and have consistently stayed below 2 percent, inching up recently only because the Fed announced coming rate hikes in 2022. *Score three for MMT.*
4. MMT claims that too much spending can generate inflation, not insolvency. Even if we assumed current inflation is due to too much government spending, this would vindicate MMT, not discredit it! Most economists agree that excessive spending can cause inflation, of course. But they do not think of inflation as the only consequence of excessive spending—they emphasize problems posed by deficits, debt ratios, and the unsustainability of interest rates rising above growth rates.

   Still, the labor market is about 4.6 million jobs below its prepandemic level. The inflation we are seeing is not the result of exceeding our potential. In other words, it is not what J. M. Keynes called "true inflation" but rather results from bottlenecks that push prices higher even before full employment—exacerbated by industry consolidation boosted by the crisis, which concentrates pricing power. *Score four for MMT.*
5. Post-pandemic policy was not MMT. MMT promoted spending targeted to job creation and a direct response to the pandemic—not what amounted to a large-scale universal basic income guarantee, with stimulus payments sent even to high-income households that had not lost incomes.

Funnily enough, detractors claim the pandemic relief represented a real-world MMT experiment, and at the same time argue policymakers do not take MMT seriously. They cannot have it both ways. If MMT cannot influence policymakers, how can MMT be held responsible for the inflation?

It turns out that both of these claims are false. The House Budget Committee Chair, Rep. John Yarmuth, explicitly embraces MMT. He fully recognized that the danger is not insolvency, but possible inflation. While this did not carry over to influencing the types of policies chosen or the targets of all this fiscal firepower—as noted, MMT advocates called for different policy measures—the chair of the House Budget Committee surely played a role pushing spending proposals without pay-fors.

No one knew at the time how long the pandemic would continue, nor how deep the economy would fall. While there were worries about supply chains, it is clear that few recognized how severe the disruption would be—including Jerome Powell at the Fed, who exhibited uncommon restraint—expecting economic recovery would grow supply and relieve price pressures. There is now some evidence that this view was overly optimistic. Maybe we all got it wrong?

Larry Summers was one of the few who might have gotten this one right. Over his career, he has gotten an awful lot wrong, as he admits: "I've been right this year, but there have been plenty of years when I've been wrong." Perhaps his inflation warnings were not taken seriously precisely because of his previous mistake significantly underestimating the amount of stimulus the economy actually needed during the Great Recession. In this case, while we think he has the causation wrong, he did warn us. *Summers wins one?*

YEVA NERSISYAN is an associate professor of economics at Franklin and Marshall College. Senior Scholar L. RANDALL WRAY is a professor of economics at Bard College.