Week 2 (April 25 2022):
Context for Chapter 1, "Don't Think of a Household"

Today we discuss the central obstacle to a clear understanding of the role which federal government spending and taxation play in the political economy of the United States: the so-called "Household Budget Analogy."

The Household Budget Analogy argues that federal spending and taxation work in the same way that an individual household's budgeting of income and expenditures works, only at much greater scale. Any individual household needs to accumulate funds before it can spend. In what politicians will typically describe as a "hard-working American family," these funds can be accumulated, broadly speaking, in one of three ways:

1. They can be inherited.
2. They can be borrowed.
3. They can be earned by having household members go on the labor market and sell their ability to work for wages or salaries.

Whichever way it's done, the household has to amass currency before it can spend that currency on the goods and services it needs to survive. The currency does not come from within the family. It originates somewhere outside the family; the family is merely a *currency user*.

In a typical discussion of households we ignore inherited funds, so the question of family budgeting reduces to the question: *Can the family meet its spending targets solely from its earned income, or must the family resort to borrowing to do so?* If the family borrows to maintain its consumption targets, it incurs obligations to make interest payments to its lenders and ultimately to repay the principal on those loans. Having to take on debt places the family's long-term financial stability in question. In our society taking on debt means that the family is taking on a certain degree of social stigma as well.

Like households, businesses must also amass funds before they can spend. These funds can come from sales or perhaps from borrowing. So businesses are currency users just like households. However, when a business takes on debt it is usually less stigmatized than a household is. Business spending done with borrowed funds can usually be characterized as "investment spending" which will presumably lead to increased profits in the future.

How about state and local governments? Must they amass funds before they can spend? Yes, they must amass funds by raising revenue via taxation or fees, or by borrowing before they can spend. How they raise revenue and what restrictions exist on their borrowing are strictly limited by law. In the U.S., state and local governments don't have the ability to create currency, so they are currency users much as households and businesses are.

Households, businesses and state and local governments are all currency users. They all have to amass funds before they can spend -- funds in the form of currency which originates someplace else. Households, businesses and state and local governments all have to engage in a budgeting process which "balances" income and spending over some period of time.

How about the U.S. federal government? Does it have to amass funds before it can spend? Is the U.S. federal government a currency user like households, businesses and state and local governments? Does the federal government face the same budgetary constraints that households, businesses and state and local governments do?

The answer to each of these questions is: *No*. And here we come to the central insight of Modern Money Theory: The U.S. federal government is not like a household. It does not have to amass funds before it can spend. It creates the currency in the very act of spending it. It is a *currency issuer*, not a currency user.

There are a number of implications of this which will at first seem very startling to you. Then, as you start to understand MMT, these implications will appear as common sense. Let's just mention one of them now.

If the federal government does not need to amass funds before it can spend, then it doesn't need to tax or borrow before it spends. That means that taxation and federal debt sales must have purposes other than "financing" the federal government or "finding the money" which the government spends. To cite just one of those purposes right now: If the currency is created in the process of spending dollars into the economy, then the currency is destroyed when those dollars are withdrawn from the economy via taxation or borrowing.

If you're encountering these ideas for the first time, they will seem startling, or at least counterintuitive. They certainly contradict the conventional wisdom. Recall the first of the three phrases I mentioned in last week's introductory remarks: "what *does* happen". MMT argues that the way the economy actually works is very different from the way described in orthodox economics textbooks or in conventional wisdom -- and that's particularly true for the way federal government budgeting and spending work.

Let's now turn to our discussion questions for Chapter 1 of Stephanie Kelton's *The Deficit Myth*, the chapter titled, *Don't Think of a Household.*