Week 3 (May 02 2022): Context for Chapter 2, "Think of Inflation"

Today in Week 3 of our close reading of Stephanie Kelton's *The Deficit Myth*, we come to Chapter 2, entitled "Think of Inflation."

Caveats

I would like to acknowledge at the outset that you are likely to find this chapter challenging, for two reasons.

First, Chapter 2 is long. The range of concepts in it is large. In this chapter we encounter many terms and concepts found in conventional macroeconomics. We are all at least half-familiar with these concepts because they are taken for granted as forming the "conventional wisdom" of political and economic discussion in the mainstream media and in national politics. Modern Money Theory, however, is critical of many of these mainstream concepts. If we're learning MMT, that means we have to learn the conventional concept, learn why MMT thinks the conventional concept is wrong, and then learn the counterposed MMT concept. That's extra work for both teachers and students.

The second reason why you may find this chapter challenging is that Stephanie Kelton was presumably writing this chapter in 2019, before the COVID-19 pandemic, before the impact of the pandemic on production supply chains became evident, and before the inflationary period that began in the spring of 2021. So she was writing in a period when consumer prices were not rising sharply and when inflation was more of a theoretical issue rather than a problem coming into view over the horizon.

This means that her analysis may feel somewhat inadequate today. In particular, she begins the chapter by stating that in reality, "For evidence of overspending, look to inflation." (41) That runs the risk of suggesting that inflation must be due *primarily* to "overspending" of some kind. It tends to dismiss the possibility that inflation might be due primarily to supply-side problems and only secondarily to excessive monetary demand in some sectors of the economy.

MMT Advocates' Focus on Unemployment

That being said, there is a tremendous amount of value in Chapter 2. We should bear in mind that from the time around 1995 when Modern Money Theory began to emerge up to the start of the pandemic, the principal political-economic issue MMT advocates were concerned with was persistently high *unemployment* -- and the waste of human resources that that unemployment represented. Unemployment rose dramatically following the start of the Great Financial Crisis in 2007 and remained persistently high for years afterwards. The recovery time for employment following the the Great Recession was much longer than for all previous recessions since the Great Depression of the 1930s. This massive waste of human resources was the principal socio-economic problem of concern to MMTers in the period between 2007 and 2020.

MMT Advocates' Response: Federal Job Guarantee

Now, MMTers were not the only people concerned with unemployment. But only MMTers had an innovative policy idea designed to respond to persistently high unemployment. That policy is the federal Job Guarantee -- or "JG," for short. Taking advantage of its position as the monopoly supplier of the currency, the federal government would offer a job to any unemployed person who wants one at a fixed, Job-Guarantee wage roughly equivalent to the minimum wage plus Medicare-for-All type health benefits. This would basically solve the problem of involuntary unemployment. It would provide a pool of labor organized at the state and local level to work on projects the private sector is not addressing. And the Job Guarantee wage would serve as the anchor of the price structure. The Job Guarantee program would be a countercyclical program of the kind economists call an *automatic stabilizer*. In times of recession, laid-off workers could enter the Job Guarantee pool and maintain their employment history. As times get better, private sector employers can hire workers out of the Job Guarantee pool by offering wages higher than the JG wage.

Remember those three phrases I mentioned in Week 1 of this course?

- What *does* happen
- What *can* happen
- What *should* happen

The Job Guarantee is the prime example of the second phrase in that group: What *can* happen?

The Job Guarantee is a policy which is fully imaginable within the overall framework of our current economic system.

The period between the Great Financial Crisis and the beginning of the COVID-19 pandemic was a period of massive underutilization, not just of human resources, but of real productive resources like raw materials, machinery and equipment as well. Persistently underutilized resources meant that there was little upward pressure on the prices of those resources. So as long as those non-human productive resources were available for purchase in the country's currency, they could be purchased at relatively stable prices.

MMTers cautioned, however, that if those real productive resources came into short supply, or if there were excessive monetary demand for those resources -- whether coming from consumers, investors or government spending -- then the economy could hit an "inflation barrier" at which point prices would rise.

So for a quarter century MMTers were primarily concerned with underutilization of productive resources -- particularly the waste of human resources represented by unemployment and underemployment. There was one situation, however, in which they turned their attention to a possible shortage of productive resources.

How to Pay for the Green New Deal

In May 2019 Yeva Nersisyan and Randy Wray published a Levy Institute working paper, *How to Pay for the Green New Deal*. In this paper, Nersisyan and Wray argue that:

1. Climate change constitutes an existential threat to human life on this planet.
2. The crisis posed by climate change can be addressed by the kind of Green New Deal program which Sen. Markey and Rep. Ocasio-Cortez introduced into Congress in 2019.
3. The Green New Deal is both technologically and financially feasible.

Nersisyan and Wray acknowledge that a Green New Deal would involve a massive, ten-year-long restructuring of the U.S. economy. During this period the Federal government will have to take steps to guarantee that resources for the fight against climate change take priority over resources for other production and consumer goods lest competition for those resources lead to inflation.

Nersisyan and Wray believe that this is a challenge which the United States can meet for the simple reason that we met a challenge like this once before, in World War II. The broad outlines of how to finance the Green New Deal derive in large part from the ideas developed by British economist John Maynard Keynes in his 1940 pamphlet, *How to Pay for the War*.

When the COVID-19 crises (medical and economic) hit us in March 2020, much talk of the Green New Deal receded, though the question of how to deal with mass unemployment did not. The U.S. experienced a recession which was both very sharp and very short. By early 2021 it became apparent that while demand for consumer goods had resurged, the world's capacity to produce those consumer goods had contracted sharply and unevenly, leading to the supply chain crises we've all heard about and to a much sharper rate of increase in consumer prices than the U.S. has experienced since the early 1980s.

Not surprisingly, inflation has become the most discussed economic topic in the media. If you had followed Stephanie Kelton's Substack blog in recent months, you'd have seen that she's talking much more about inflation now than she was back in 2019. Let's start by getting a taste of what Stephanie Kelton has to say about this in *The Deficit Myth*.