Week 4 (April 22 2024): Introductory Remarks

Welcome to the fourth session of the Henry George School's spring 2024 course on Modern Money Theory. This week we pick up our pace and cover two chapters in Stephanie Kelton's *The Deficit Myth* rather than just one. Those chapters are Chapter 3, "The National Debt (That Isn't)", and Chapter 4, "Their Red Ink Is Our Black Ink."

Here the material starts to get wonkier. Unemployment is an issue that cuts across a wide swath of the population; inflation even moreso, as we are currently learning (or re-learning). But a problem like that of the alleged burden of the national debt is one that mainly gets discussed in what I'll call "elite discourse": business circles and in Washington, D.C. That means that you as students are going to have to dig in a bit deeper to understand the material.

Recall the three phrases I asked you to keep in mind back in Week 1:

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

Chapters 3 and 4 are primarily concerned with what does happen. That is, they're concerned with the way government spending, taxation and financing actually work. When we view the government through the MMT lens, we see that things work very differently from the way they are described in economics textbooks, in the media, and in national politics.

The MMT Theory of the State

To frame Stephanie Kelton's discussion in chapters 3 and 4, I'd like to start off with a brief look at what I call the "MMT theory of the state." I'll have three propositions.

1. **The state mobilizes resources in pursuit of the public purpose.**

   Here we use the term "the state" in the way that political scientists use it: government in the most general sense: the entity that makes, enforces and adjudicates law. (If we want to refer to "states of the United States," we will get specific.) How that "public purpose" is defined and who gets to do that defining – those are topics for a separate discussion.

2. **The state generally prefers to mobilize those resources in a stable manner which is perceived as lawful.**

   States could simply plunder resources from the populations they govern, but that system wouldn't be very stable. States could mobilize those resources via slave labor, but, with the exception of prison labor, that's viewed as retrograde.

   If the state only needed a limited range of resources, it could impose a tax to be paid in those resources – a *tax in kind*, such as in cattle. But that would quickly fail to scale.

3. **A state can mobilize resources by (i) issuing currency for the purchase of resources and (ii) simultaneously imposing a tax obligation in that currency.**

   The tax obligation creates an incentive for the population to acquire the currency in

> which the tax must be paid. That currency can be obtained by producing goods and services that can be sold to the state in return for that currency. That implies that the state must issue the currency and make it available to the population via state spending before the population can pay taxes with it. For monetarily sovereign, currency-issuing governments, spending precedes taxation, not the other way around.
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> This further implies that taxation serves purposes other than amassing funds prior to spending. In Week 2 we saw that Kelton identifies at least four purposes of taxation, one of which purposes is to ensure that some production of goods and services in the non-government sector is available for the state's provisioning of itself.

What About "Borrowing"?

Now you might well ask, "*Does a monetarily sovereign government need to borrow before it spends? If not, why does it borrow at all?*"

The answer Modern Money Theory provides is: No, a monetarily sovereign, currency-issuing government does not need to amass funds via borrowing before it can spend. Hence, what we commonly call government "borrowing" must have purposes *other than* amassing funds prior to spending.

At the end of Chapter 4, Kelton identifies one of the reasons for that "borrowing" (an activity which would be better described as *sales of debt instruments*). That purpose is to drain reserves from the banking system and to prevent an infusion of reserves from driving interest rates below the Federal Reserve's target level.

Now, that is a wonkish mouthful; I am not going to attempt a detailed explanation right now.

What About Those Buckets?

When we study political economy, we have to develop a facility for thinking and talking about the economy in short-hand fashion. This is as true in Modern Money Theory as in any other approach to macroeconomics. In Chapter 4 Kelton introduces what we'll call a two-sector model of the economy: an economy with a government sector which is a currency issuer, and a non-government sector which is a currency user. She then depicts the flows of currency between these sectors as flows of water between two buckets.

When you reach this part of *The Deficit Myth*, I strongly advise you to get a few pieces of paper and pen or pencil and draw those buckets yourself. Teach yourself this stock-flow modeling of the economy and get it into your muscle memory. Those of you who have grandchildren: Have your grandchildren get out their crayons and have them draw these buckets as well. Use that as an opportunity to discuss the economy with them. I assure you that in drawing these buckets they will pick up what MMT is saying about the economy much better than the average member of the U.S. Congress does.

Let's now turn to our discussion questions for chapters 3 and 4.