# **\*\*\* Affirmative**

### Fiat Money/AT: Inflation

#### The ability to *fiat money* as a result of sovereign currency holder status means that the government *can never run out of money*. Inflation will always be checked by an *increase in taxation*, but the supposed purpose of generating revenue is *unnecessary and incorrect*.

Matthews 2/18

Dylan Matthews, Staff Writer for the Washington Post, “Modern Monetary Theory, an unconventional take on economic strategy”, <http://www.washingtonpost.com/business/modern-monetary-theory-is-an-unconventional-take-on-economic-strategy/2012/02/15/gIQAR8uPMR_print.html>, JS

Keynesian roots “Modern Monetary Theory” was [coined](http://www.google.com/url?q=http%3A%2F%2Fworthwhile.typepad.com%2Fworthwhile_canadian_initi%2F2011%2F04%2Freverse-engineering-the-mmt-model.html%3Fcid%3D6a00d83451688169e2014e87e90e9d970d%23comment-6a00d83451688169e2014e87e90e9d970d&sa=D&sntz=1&usg=AFQjCNG4zcQkIVGKsVlgj_PD-ycf-qE-9w) by Bill Mitchell, an Australian economist and prominent proponent, but its roots are much older. The term is a reference to John Maynard Keynes, the founder of modern macroeconomics. In “A Treatise on Money,” Keynes asserted that “all modern States” have had the ability to decide what is money and what is not for at least 4,000 years. This claim, that money is a “creature of the state,” is central to the theory. In a “fiat money” system like the one in place in the United States, all money is ultimately created by the government, which prints it and puts it into circulation. Consequently, the thinking goes, the government can never run out of money. It can always make more. This doesn’t mean that taxes are unnecessary. Taxes, in fact, are key to making the whole system work. The need to pay taxes compels people to use the currency printed by the government. Taxes are also sometimes necessary to prevent the economy from overheating. If consumer demand outpaces the supply of available goods, prices will jump, resulting in inflation (where prices rise even as buying power falls). In this case, taxes can tamp down spending and keep prices low. But if the theory is correct, there is no reason the amount of money the government takes in needs to match up with the amount it spends. Indeed, its followers call for massive tax cuts and deficit spending during recessions.

#### **Individual spending is mostly determined by income, but in the case where the ability to deficit spend exists, net wealth can be created – this in turn generates a cycle of spending that causes growth.**

New Economic Perspectives 11

Highly Qualified Modern Monetary Theory Blog dedicated to the Education of the Masses, MMT, SECTORAL BALANCES AND BEHAVIORneweconomicperspectives.org/2011/06/mmt-sectoral-balances-and-behavior.html, JS

Deficits -> savings and debts -> wealth. We have established in our previous blogs that the deficits of one sector must equal the surpluses of (at least) one of the other sectors. We have also established that the debts of one sector must equal the financial wealth of (at least) one of the other sectors. So far, this all follows from the principles of macro accounting. However, the economist wishes to say more than this, for like all scientists, economists are interested in causation. Economics is a social science, that is, the science of extraordinarily complex social systems in which causation is never simple because economic phenomena are subject to interdependence, hysteresis, cumulative causation, and so on. Still, we can say something about causal relationships among the flows and stocks that we have been discussing in the previous blogs. Some readers will note that the causal connections adopted here follow from Keynesian theory. ¶ a) Individual spending is mostly determined by income. Our starting point will be the private sector decision to spend. For the individual, it seems plausible to argue that income largely determines spending because one with no income is certainly going to be severely constrained when deciding to purchase goods and services. However, on reflection it is apparent that even at the individual level, the link between income and spending is loose—one can spend less than one’s income, accumulating net financial assets, or one can spend more than one’s income by issuing financial liabilities and thereby becoming indebted. Still, at the level of the individual household or firm, the direction of causation largely runs from income to spending even if the correspondence between the two flows is not perfect. There is little reason to believe that one’s own spending significantly determines one’s own income.¶ b) Deficits create financial wealth. We can also say something about the direction of causation regarding accumulation of financial wealth at the level of the individual. If a household or firm decides to spend more than its income (running a budget deficit), it can issue liabilities to finance purchases. These liabilities will be accumulated as net financial wealth by another household, firm, or government that is saving (running a budget surplus). Of course, for this net financial wealth accumulation to take place, we must have one household or firm willing to deficit spend, and another household, firm, or government willing to accumulate wealth in the form of the liabilities of that deficit spender. We can say that “it takes two to tango”. However, it is the decision to deficit spend that is the initiating cause of the creation of net financial wealth. No matter how much others might want to accumulate financial wealth, they will not be able to do so unless someone is willing to deficit spend. ¶ Still, it is true that the household or firm will not be able to deficit spend unless it can sell accumulated assets or find someone willing to hold its liabilities. We can suppose there is a propensity (or desire) to accumulate net financial wealth. This does not mean that every individual firm or household will be able to issue debt so that it can deficit spend, but it does ensure that many firms and households will find willing holders of their debt. And in the case of a sovereign government, there is a special power—the ability to tax–that virtually guarantees that households and firms will want to accumulate the government’s debt. (That is a topic we pursue later.) We conclude that while causation is complex, and while “it takes two to tango”, causation tends to run from individual deficit spending to accumulation of financial wealth, and from debt to financial wealth. Since accumulation of a stock of financial wealth results from a budget surplus, that is, from a flow of saving, we can also conclude that causation tends to run from deficit spending to saving. ¶ c) Aggregate spending creates aggregate income. At the aggregate level, taking the economy as a whole, causation is more clear-cut. A society cannot decide to have more income, but it can decide to spend more. Further, all spending must be received by someone, somewhere, as income. Finally, as discussed earlier, spending is not necessarily constrained by income because it is possible for households, firms, or government to spend more than income. Indeed, as we discussed, any of the three main sectors can run a deficit with at least one of the others running a surplus. However, it is not possible for spending at the aggregate level to be different from aggregate income since the sum of the sectoral balances must be zero. For all of these reasons, we must reverse causation between spending and income when we turn to the aggregate: while at the individual level, income causes spending, at the aggregate level, spending causes income. ¶ d) Deficits in one sector create the surpluses of another. Earlier we showed that the deficits of one sector are by identity equal to the sum of the surplus balances of the other sector(s). If we divide the economy into three sectors (domestic private sector, domestic government sector, and foreign sector), then if one sector runs a deficit at least one other must run a surplus. Just as in the case of our analysis of individual balances, it “takes two to tango” in the sense that one sector cannot run a deficit if no other sector will run a surplus. Equivalently, we can say that one sector cannot issue debt if no other sector is willing to accumulate the debt instruments. ¶ Of course, much of the debt issued within a sector will be held by others in the same sector. For example, if we look at the finances of the private domestic sector we will find that most business debt is held by domestic firms and households. In the terminology we introduced earlier, this is “inside debt” of those firms and households that run budget deficits, held as “inside wealth” by those households and firms that run budget surpluses. However, if the domestic private sector taken as a whole spends more than its income, it must issue “outside debt” held as “outside wealth” by at least one of the other two sectors (domestic government sector and foreign sector). Because the initiating cause of a budget deficit is a desire to spend more than income, the causation mostly goes from deficits to surpluses and from debt to net financial wealth. While we recognize that no sector can run a deficit unless another wants to run a surplus, this is not usually a problem because there is a propensity to net save financial assets. That is to say, there is a desire to accumulate financial wealth—which by definition is somebody’s liability.¶ Conclusion. Before moving on it is necessary to emphasize that everything in this blog (as well as Blog #2) applies to the macro accounting of any country. While examples used the dollar, all of the results apply no matter what currency is used. Our fundamental macro balance equation, ¶ Domestic Private Balance + Domestic Government Balance + Foreign Balance = 0¶ will strictly apply to the accounting of balances of any currency. Within a country there can also be flows (accumulating to stocks) in a foreign currency, and there will be a macro balance equation in that currency, too.¶ Note that nothing changes if we expand our model to include a number of different countries, each of which issues its own currency. There will be a macro balance equation for each of these countries and for each of the currencies. Individual firms or households (or, for that matter, governments) can accumulate net financial assets denominated in several different currencies; vice versa, individual firms or households (or governments) can issue net debt denominated in several different currencies. It can even become more complicated, with an individual running a deficit in one currency and a surplus in another (issuing debt in one currency and accumulating wealth in another). Still, for every country and for every currency there will be a macro balance equation.

#### **Modern monetary theory works – the fiat money system means the government can never make too much money and can always use taxes as a means to control inflation. 100 % employment is possible, and programs to create those jobs are key.**

Coutinho 5/25 –

"How to Apply a Modern Monetary Theory Solution to an Economic Downturn" - Robert Coutinho is a disabled pharmaceutical chemist living in Massachusetts. He has been learning about life, the universe, and everything since he was born in 1963. He has had little else to do since his disability began in 1997.themoderatevoice.com/148003/how-to-apply-a-modern-monetary-theory-solution-to-an-economic-downturn-guest-voice/

A while back I wrote about Modern Monetary Theory. I have been digesting just how such information could be used to help our society. Although the originators of the theory probably have more complete suggestions, I wanted to share with you what could be done with our economic system. Please keep in mind that the following might (very likely would) require Constitutional Amendment or a Third Republic (which is likely to occur soon, but that’s another whole ball of wax).¶ Using the fiat currency reality of MMT, we know that the issuing government can, at will, create and destroy money. The most common method for creating it is by spending it into existence on goods and services (or giving it to people who are incapable of providing goods and services). The most common (possibly the only) method of destroying it is by taxes. The purpose of government spending should be to buy the goods and services it needs. ¶ That is it. ¶ The purpose of government taxes is to prevent out-of-control inflation. That is it. In addition to taxes, the government (from here on in I will be referring to the government as that which issues the fiat currency, please keep in mind that US states and EZ countries such as Greece are NOT issuers of fiat currency) can use lender-of-last-resort prices to help set the inflation rate. Whether we are talking about the Federal Reserve or the Treasury Department is actually, from a macroeconomic perspective, irrelevant.¶ Thus: (not all suggestions are mine, go here to read from one of its originators: <http://moslereconomics.com/wp-content/powerpoints/7DIF.pdf> )¶ The government can (and should) offer anyone (of legal age and not 100% disabled, of course) a job at minimum wage with benefits. This should be limited only by the person’s eligibility to work in the United States (illegal immigrants can be excluded if you want). The minimum wage would, then, as a virtual guarantee, really be the minimum wage. The reason is that few, if any, people would work for less money. Thus, if they could automatically get a government job, they would take that instead of one offering less money (perhaps some would rather work for a different boss or something, but that’s small potatoes in the macro economy). This would, for the first time, establish a real minimum wage in the country. ¶ Any business that could not offer the same wages and benefits would simply be priced out of the market by the government. The jobs being offered should include a certain amount of time to allow these transient workers to look for employment in the private sector (through job training, searching, etc.) What the government did with these people would vary over time, but could include nearly anything that would be safe (thus, one would not put such workers as prison guards, but might have them file papers or conduct data entry).¶ The government would no longer link expenditures to taxes. Since taxes are for the purpose of curbing inflation (the reality, not the myth), there is little to no sense in pretending that taxes must equal expenditures. After a transition period, the Treasury Department (includes the Federal Reserve, as mentioned above) would start setting an inflation rate. We need the transition period because we now have lots of people working who were unemployed before. ¶ How do we set the inflation rate? Taxes and Overnight Lending Rates. How do we currently control inflation? To be perfectly honest, although not always through deliberate planning of such, we control inflation through taxes and the Overnight Lending Rates. The Fed rate is done with planning towards inflation. The taxes are not currently done that way.¶ Some of the arguments against such a policy would be epithets such as “Socialism” or “Communism” or “Government take-over of [fill in the blank]”. Let me ask you this, “Would such a system be harmful to society? If so, how?” How is it useful for us to have twenty percent of our eligible workforce either unemployed or under-employed? In addition, as was often done during the Great Depression, the government could outsource the transient labor to local officials (states, local communities, etc.) They would probably need to put into place safeguards against cheating of all kinds. They would also need to establish a minimum level of benefits for workers.¶ All of these things are the types of things our elected officials should be capable of doing! Why else would we elect them?¶ The only real problem with “creating” money to pay government expenditures is the possibility of inflation (or even hyperinflation). Thus, we need to have a flexible tax policy to deal with the items that cause such inflation. Again, after the transition period, we would have Treasury look at the real inflation rate. This would include food and energy prices (where it currently excludes them). Due to the volatility of such prices, one could use a running three-year average for these items. This would prevent one month of increase (or decrease) from disproportionately affecting the value. Next, Treasury would highlight for congress and the president which items appeared to be fueling inflation above the “acceptable” level. ¶ Thus, we would look at why such inflation was occurring and could easily slow things down (if needed) through taxes. Remember, taxes take money out of the system. That is one of their only purposes (at least when the money is a fiat, non-exchangeable currency). The other purpose is to set value (since one needs the sovereign currency to pay one’s taxes), so all other values become related to the tax base.¶ Politically this could be a major problem for our elected officials. They would be under enormous pressure to allow more inflation in certain areas (whichever ones the lobbyists wanted). This would have to be prevented. Whether such prevention occurred through banning lobbyists or through threatening politicians with tar-and-feathering (or some other method), such prevention would be mandatory to a viable running of such a system. In addition, there might be enormous pressure from workers to get the minimum wage raised, however, such an action would, virtually by definition, cause either an increase in the GDP (through increased purchasing power fueling expansion) or job loss (due to workers’ pay requirements shutting down companies). ¶ Either way, the effect would be noticeable and could be remedied if the more undesirable outcome (unemployment) occurred. It would not be too hard to convince previously-employed people that the minimum wage got too high. They would feel it in their pocket books (as the fewer goods being produced would lead, at least initially, to inflation).¶ I have not lain out everything here, but it gives you, the reader, some idea of what is really possible. That our politicians appear to be completely oblivious to the reality of how money is created (and destroyed), what taxes actually do, how the accounts at the Federal Reserve actually work, and what the implications of the Chinese, Japanese, German and other foreign entities holding Treasury Certificates really is (hint: we don’t need them to buy the bonds, they do it because they don’t plan on spending the money any time soon and would like to earn whatever nominal interest they can get) all lead to a great deal of unnecessary suffering, waste, loss of opportunity, and, ultimately, political nonsense.¶ We do not need to balance the budget in order to prevent our children from having to pay our debts. Our children will consume the goods and services they produce, just as we consume the goods and services that we produce. We should not be cutting educational funding. ¶ Educational funding is likely the only source that will allow us to retire with some semblance of financial security. ¶ In other words, our children need to be innovative enough to produce more with less, just as we have done, as did our parents. Without innovation, this can not happen. Thus, the worst of all possible political plans is to cut educational funding (where do such politicians expect to get innovation?) ¶ One last point: for all the Baby-Boomers out there who are worried about retirement funding: is it the amount of money that you need or how much that money can obtain for you that really counts. Financially, those shooting for retirement are (more or less) competing against each other and (to some extent) the younger generations for the goods and services that will be produced in the future (that is, when the BB generation is retired). If there are more goods and services per person available, then the cost for said items will likely be less. If there are fewer goods and services available per person then retirement is “gonna be a bitch!” Either way, the Social Security payments can be met by the government; the only problem will be how much those payments will buy.¶ It is not Insolvency that faces us in the future, it is Inflation, and that is the real lesson of MMT.

### **Deficits Good**

#### **Surplus is bad and deficits are good – when taxation outweighs spending, the private sector has *net less capital* and *less theoretical jobs can be created –* this is reverse causal.**

Wray 11

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One’s financial asset is another’s financial liability. It is a fundamental principle of accounting that for every financial asset there is an equal and offsetting financial liability. The checking deposit is a household’s financial asset, offset by the bank’s liability (or IOU). A government or corporate bond is a household asset, but represents a liability of the issuer (either the government or the corporation). The household has some liabilities, too, including student loans, a home mortgage, or a car loan. These are held as assets by the creditor, which could be a bank or any of a number of types of financial institutions including pension funds, hedge funds, or insurance companies. A household’s net financial wealth is equal to the sum of all its financial assets (equal to its financial wealth) less the sum of its financial liabilities (all of the money-denominated IOUs it issued). If that is positive, it has positive net financial wealth.¶ Inside wealth vs outside wealth. It is often useful to distinguish among types of sectors in the economy. The most basic distinction is between the public sector (including all levels of government) and the private sector (including households and firms). If we were to take all of the privately-issued financial assets and liabilities, it is a matter of logic that the sum of financial assets must equal the sum of financial liabilities. In other words, net financial wealth would have to be zero if we consider only private sector IOUs. This is sometimes called “inside wealth” because it is “inside” the private sector. In order for the private sector to accumulate net financial wealth, it must be in the form of “outside wealth”, that is, financial claims on another sector. Given our basic division between the public sector and the private sector, the outside financial wealth takes the form of government IOUs. The private sector holds government currency (including coins and paper currency) as well as the full range of government bonds (short term bills, longer maturity bonds) as net financial assets, a portion of its positive net wealth.¶ A note on nonfinancial wealth (real assets). One’s financial asset is necessarily offset by another’s financial liability. In the aggregate, net financial wealth must equal zero. However, real assets represent one’s wealth that is not offset by another’s liability, hence, at the aggregate level net wealth equals the value of real (nonfinancial) assets. To be clear, you might have purchased an automobile by going into debt. Your financial liability (your car loan) is offset by the financial asset held by the auto loan company. Since those net to zero, what remains is the value of the real asset—the car. In most of the discussion that follows we will be concerned with financial assets and liabilities, but will keep in the back of our minds that the value of real assets provides net wealth at both the individual level and at the aggregate level. Once we subtract all financial liabilities from total assets (real and financial) we are left with nonfinancial (real) assets, or aggregate net worth.¶ Net private financial wealth equals public debt. Flows (of income or spending) accumulate to stocks. The private sector accumulation of net financial assets over the course of a year is made possible only because its spending is less than its income over that same period. In other words, it has been saving, enabling it to accumulate a stock of wealth in the form of financial assets. In our simple example with only a public sector and a private sector, these financial assets are government liabilities—government currency and government bonds. These government IOUs, in turn, can be accumulated only when the government spends more than it receives in the form of tax revenue. This is a government deficit, which is the flow of government spending less the flow of government tax revenue measured in the money of account over a given period (usually, a year). This deficit accumulates to a stock of government debt—equal to the private sector’s accumulation of financial wealth over the same period. A complete explanation of the process of government spending and taxing will be provided in the weeks and months to come. What is necessary to understand at this point is that the net financial assets held by the private sector are exactly equal to the net financial liabilities issued by the government in our two-sector example. If the government always runs a balanced budget, with its spending always equal to its tax revenue, the private sector’s net financial wealth will be zero. If the government runs continuous budget surpluses (spending is less than tax receipts), the private sector’s net financial wealth must be negative. In other words, the private sector will be indebted to the public sector.¶ We can formulate a resulting “dilemma”: in our two sector model it is impossible for both the public sector and the private sector to run surpluses. And if the public sector were to run surpluses, by identity the private sector would have to run deficits. If the public sector were to run sufficient surpluses to retire all its outstanding debt, by identity the private sector would run equivalent deficits, running down its net financial wealth until it reached zero.

#### **MMT predicted all financial crises since Clinton /// Federal deficits key – states and locals don’t solve.**

New Economic Perspectives 11

Highly Qualified Modern Monetary Theory Blog dedicated to the Education of the Masses, Recent USA Sectoral Balances: Goldilocks, the Global Crash, and the Perfect Fiscal Storm

, <http://neweconomicperspectives.org/2011/06/recent-usa-sectoral-balances-goldilocks.html>, JS

Back in 2002 I wrote a paper announcing that forces were aligned to produce the perfect fiscal storm. (I note that in recent days a few analysts—including Nouriel Roubini—have picked up that terminology.) What I was talking about was a budget crisis at the state and local government levels. I had recognized that the economy of the time was in a bubble, driven by what I perceived to be unsustainable deficit spending by the private sector—which had been spending more than its income since 1996. As we now know, I called it too soon—the private sector continued to spend more than its income until 2006. The economy then crashed—a casualty of the excesses. What I had not understood a decade ago was just how depraved Wall Street had become. It kept the debt bubble going through all sorts of lender fraud; we are now living with the aftermath. ¶ Still, it is worthwhile to return to the so-called “Goldilocks” period (mid to late 1990s, said to be “just right”, with growth sufficiently strong to keep unemployment low, but not so swift that it caused inflation) to see why economists and policymakers still get it wrong. As I noted in that earlier paper, ¶ It is ironic that on June 29, 1999 the Wall Street Journal ran two long articles, one boasting that government surpluses would wipe out the national debt and add to national saving—and the other scratching its head wondering why private saving had gone negative. The caption to a graph showing personal saving and government deficits/surpluses proclaimed “As the government saves, people spend”. (The Wall Street Journal front page is reproduced below.) Almost no one at the time (or since!) recognized the necessary relation between these two that is implied by aggregate balance sheets. Since the economic slowdown that began at the end of 2000, the government balance sheet has reversed toward a deficit that reached 3.5% of GDP last quarter, while the private sector’s financial balance improved to a deficit of 1% of GDP. So long as the balance of payments deficit remains in the four-to-five percent of GDP range, a private sector surplus cannot be achieved until the federal budget’s deficit rises beyond 5% of GDP (as we’ll see in a moment, state and local government will continue to run aggregate surpluses, increasing the size of the necessary federal deficit). [I]n recession the private sector normally runs a surplus of at least 3% of GDP; given our trade deficit, this implies the federal budget deficit will rise to 7% or more if a deep recession is in store. At that point, the Wall Street Journal will no doubt chastise: “As the people save, the government spends”, calling for a tighter fiscal stance to increase national saving!¶ Turning to the international sphere, it should be noted that US Goldilocks growth was not unique in its character. [P]ublic sector balances in most of the OECD nations tightened considerably in the past decade–at least in part due to attempts to tighten budgets in line with the Washington Consensus (and for Euroland, in line with the dictates of Maastricht criteria). (Japan, of course, stands out as the glaring exception—it ran large budget surpluses at the end of the 1980s before collapsing into a prolonged recession that wiped out government revenue and resulted in a government deficit of nearly 9% of GDP.) Tighter public balances implied deterioration of private sector balances. Except for the case of nations that could run trade surpluses, the tighter fiscal stances around the world necessarily implied more fragile private sector balances. Indeed, Canada, the UK and Australia all achieved private sector deficits at some point near the beginning of the new millennium. (Source: L. Randall Wray, “The Perfect Fiscal Storm” 2002, available at <http://www.epicoalition.org/docs/perfect_fiscal_storm.htm>)

#### **Our current deficit is not enough – *historical models are wrong* – periods of great economic prosperity represented a 5% deficit – tax revenue and state funding strategies do not solve – only exploiting our ability to print money does.**

New Economic Perspectives 11

Highly Qualified Modern Monetary Theory Blog dedicated to the Education of the Masses, Recent USA Sectoral Balances: Goldilocks, the Global Crash, and the Perfect Fiscal Storm

, <http://neweconomicperspectives.org/2011/06/recent-usa-sectoral-balances-goldilocks.html>, JS

This chart shows the “mirror image”: a government deficit from 1980 through to the Goldilocks years is the mirror image of the domestic private sector’s surplus plus our current account deficit (shown as a positive number because it reflects a positive capital account balance—the rest of the world runs a positive financial balance against us). (Note: the chart confirms what we learned from Blog #2: the sum of deficits and surpluses across the three sectors must equal zero.) During the Clinton years as the government budget moved to surplus, it was the private sector’s deficit that was the mirror image to the budget surplus plus the current account deficit. ¶ This mirror image is what the Wall Street Journal had failed to recognize—and what almost no one except those following the Modern Money approach as well as the Levy Economic Institute’s researchers who used Wynne Godley’s sectoral balance approach understand. After the financial collapse, the domestic private sector moved sharply to a large surplus (which is what it normally does in recession), the current account deficit fell (as consumers bought fewer imports), and the budget deficit grew mostly because tax revenue collapsed as domestic sales and employment fell. ¶ Unfortunately, just as policymakers learned the wrong lessons from the Clinton administration budget surpluses—thinking that the federal budget surpluses were great while they actually were just the flip side to the private sector’s deficit spending—they are now learning the wrong lessons from the global crash after 2007. They’ve managed to convince themselves that it is all caused by government sector profligacy. This, in turn has led to calls for spending cuts (and, more rarely, tax increases) to reduce budget deficits in many countries around the world (notably, in the US and UK). ¶ The reality is different: Wall Street’s excesses led to too much private sector debt that crashed the economy and reduced government tax revenues. This caused a tremendous increase of federal government deficits. {As a sovereign currency-issuer, the federal government faces no solvency constraints (readers will have to take that claim at face value for now—it is the topic for upcoming MMP blogs).} However, the downturn hurt state and local government revenue. Hence, they responded by cutting spending, laying-off workers, and searching for revenue. ¶ The fiscal storm that killed state budgets is the same fiscal storm that created the federal budget deficits shown in the chart above. An economy cannot lose about 8% of GDP (due to spending cuts by households, firms and local and state governments) and over 8 million jobs without negatively impacting government budgets. Tax revenue has collapsed at an historic pace. Federal, state, and local government deficits will not fall until robust recovery returns—ending the perfect fiscal storm.¶ Robust recovery will reduce the overall government sector’s budget deficit as the private sector reduces its budget surplus. It is probable that our current account deficit will grow a bit when we recover. If you want to take a guess at what our “mirror image” in the graph above will look like after economic recovery, I would guess that we will return close to our long-run average: a private sector surplus of 2% of GDP, a current account deficit of 3% of GDP and a government deficit of 5% of GDP. In our simple equation it will look like this:¶ Private Balance (+2) + Government Balance (-5) + Foreign Balance (+3) = 0. ¶ And so we are back to the concept of zero!

#### **Budget surplus forces recession – empirics.**

Matthews 2/18

Dylan Matthews, Staff Writer for the Washington Post, “Modern Monetary Theory, an unconventional take on economic strategy”, <http://www.washingtonpost.com/business/modern-monetary-theory-is-an-unconventional-take-on-economic-strategy/2012/02/15/gIQAR8uPMR_print.html>, JS

“I said economists used to understand that the running of a surplus was fiscal (economic) drag,” he said, “and with 250 economists, they giggled.”¶ Galbraith says the 2001 recession — which followed a few years of surpluses — proves he was right.¶ A decade later, as the soaring federal budget deficit has sharpened political and economic differences in Washington, Galbraith is mostly concerned about the dangers of keeping it too small. He’s a key figure in a core debate among economists about whether deficits are important and in what way. The issue has divided the nation’s best-known economists and inspired pockets of passion in academic circles. Any embrace by policymakers of one view or the other could affect everything from employment to the price of goods to the tax code.¶ In contrast to “deficit hawks” who want spending cuts and revenue increases now in order to temper the deficit, and “deficit doves” who want to hold off on austerity measures until the economy has recovered, Galbraith is a [deficit owl](http://www.google.com/url?q=http%3A%2F%2Fwww.newdeal20.org%2F2011%2F07%2F11%2Fhawk-nation-a-guide-to-the-catastrophic-debt-ceiling-debate-51211%2F&sa=D&sntz=1&usg=AFQjCNHgaYF89YcfAq9tdeb7oiaPvrzJiw). Owls certainly don’t think we need to balance the budget soon. Indeed, they don’t concede we need to balance it at all. Owls see government spending that leads to deficits as integral to economic growth, even in good times.¶ The term isn’t Galbraith’s. It was [coined](http://www.google.com/url?q=http%3A%2F%2Fneweconomicperspectives.blogspot.com%2F2010%2F07%2Fdeficit-doves-meet-deficit-owls.html) by Stephanie Kelton, a professor at the University of Missouri at Kansas City, who with Galbraith is part of a small group of economists who have concluded that everyone — members of Congress, think tank denizens, the entire mainstream of the economics profession — has misunderstood how the government interacts with the economy. If their theory — dubbed “Modern Monetary Theory” or MMT — is right, then everything we thought we knew about the budget, taxes and the Federal Reserve is wrong.

# \*\*\* Negative

### Hyper-Inflation

#### Modern monetary theory is wrong – deficit spending causes *hyperinflation* which cannot be curbed by increasing taxation.

Matthews 2/18

Dylan Matthews, Staff Writer for the Washington Post, “Modern Monetary Theory, an unconventional take on economic strategy”, <http://www.washingtonpost.com/business/modern-monetary-theory-is-an-unconventional-take-on-economic-strategy/2012/02/15/gIQAR8uPMR_print.html>, JS

A divisive theory ¶ The idea that deficit spending can help to bring an economy out of recession is an old one. It was a key point in Keynes’s “The General Theory of Employment, Interest and Money.” It was the chief rationale for the 2009 stimulus package, and many self-identified Keynesians, such as former White House adviser [Christina Romer](http://www.google.com/url?q=http%3A%2F%2Fwww.nytimes.com%2F2011%2F04%2F10%2Fbusiness%2F10view.html&sa=D&sntz=1&usg=AFQjCNFeJ_YLs3T-vDQWSJD2ip9HqR8TKw) and economist [Paul Krugman](http://www.google.com/url?q=http%3A%2F%2Fkrugman.blogs.nytimes.com%2F2011%2F07%2F08%2Ffalling-wages%2F&sa=D&sntz=1&usg=AFQjCNGzQ5Ep8V1OoBDHxdSVClDKu2vZUA), have argued that more is in order. There are, of course, detractors.¶ A key split among Keynesians dates to the 1930s. One set of economists, including the Nobel laureates John Hicks and Paul Samuelson, sought to incorporate Keynes’s insights into classical economics. Hicks built a mathematical model summarizing Keynes’s theory, and Samuelson sought to wed Keynesian macroeconomics (which studies the behavior of the economy as a whole) to conventional microeconomics (which looks at how people and businesses allocate resources). This set the stage for most macroeconomic theory since. Even today, “New Keynesians,” such as Greg Mankiw, a Harvard economist who served as chief economic adviser to George W. Bush, and Romer’s husband, David, are seeking ways to ground Keynesian macroeconomic theory in the micro-level behavior of businesses and consumers.¶ Modern Monetary theorists hold fast to the tradition established by “post-Keynesians” such as Joan Robinson, Nicholas Kaldor and Hyman Minsky, who insisted Samuelson’s theory failed because its models acted as if, in Galbraith’s words, “the banking sector doesn’t exist.”¶ The connections are personal as well. Wray’s doctoral dissertation was advised by Minsky, and Galbraith studied with Robinson and Kaldor at the University of Cambridge. He argues that the theory is part of an “alternative tradition, which runs through Keynes and my father and Minsky.”¶ And while Modern Monetary Theory’s proponents take Keynes as their starting point and advocate aggressive deficit spending during recessions, they’re not that type of Keynesians. Even mainstream economists who argue for more deficit spending are reluctant to accept the central tenets of Modern Monetary Theory. Take Krugman, who regularly engages economists across the spectrum in spirited debate. He [has argued](http://www.google.com/url?q=http%3A%2F%2Fkrugman.blogs.nytimes.com%2F2011%2F03%2F25%2Fdeficits-and-the-printing-press-somewhat-wonkish&sa=D&sntz=1&usg=AFQjCNEq9QJ8VpOmzwELO87Idv3llI6_4Q) that pursuing large budget deficits during boom times can lead to hyperinflation. Mankiw concedes the theory’s point that the government can never run out of money but doesn’t think this means what its proponents think it does.¶ Technically it’s true, he says, that the government could print streams of money and never default. The risk is that it could trigger a very high rate of inflation. This would “bankrupt much of the banking system,” he says. “Default, painful as it would be, might be a better option.”¶ Mankiw’s critique goes to the heart of the debate about Modern Monetary Theory — and about how, when and even whether to eliminate our current deficits.¶ When the government deficit spends, it issues bonds to be bought on the open market. If its debt load grows too large, mainstream economists say, bond purchasers will demand higher interest rates, and the government will have to pay more in interest payments, which in turn adds to the debt load.¶ To get out of this cycle, the Fed — which manages the nation’s money supply and credit and sits at the center of its financial system — could buy the bonds at lower rates, bypassing the private market. The Fed is prohibited from buying bonds directly from the Treasury — a legal rather than economic constraint. But the Fed would buy the bonds with money it prints, which means the money supply would increase. With it, inflation would rise, and so would the prospects of hyperinflation.¶ “You can’t just fund any level of government that you want from spending money, because you’ll get runaway inflation and eventually the rate of inflation will increase faster than the rate that you’re extracting resources from the economy,” says Karl Smith, an economist at the University of North Carolina. “This is the classic hyperinflation problem that happened in Zimbabwe and the Weimar Republic.”¶ The risk of inflation keeps most mainstream economists and policymakers on the same page about deficits: In the medium term — all else being equal — it’s critical to keep them small.¶ Economists in the Modern Monetary camp concede that deficits can sometimes lead to inflation. But they argue that this can only happen when the economy is at full employment — when all who are able and willing to work are employed and no resources (labor, capital, etc.) are idle. No modern example of this problem comes to mind, Galbraith says.¶ “The last time we had what could be plausibly called a demand-driven, serious inflation problem was probably World War I,” Galbraith says. “It’s been a long time since this hypothetical possibility has actually been observed, and it was observed only under conditions that will never be repeated.”

### No Political Will

#### **No political will and no belief in fiat currency. /// Link to hyperinflation.**

Spiegel 1/18

My name is Mark B. Spiegel and I'm the Managing Member of Stanphyl Capital Management LLC. I can be reached at: mark (at) stanphylcap (dot) com. Why "Modern Monetary Theory" is Unworkable in the Real Worldseekingalpha.com/instablog/195387-logical-thought/253560-why-modern-monetary-theory-is-unworkable-in-the-real-world

In a time of excessively high inflation-- when Americans' purchasing power is being severely eroded-- how many elected politicians will vote to raise voters' taxes enough to stifle that inflation? The answer is: none (at least, none who want to get reelected). Instead, those politicians-- giddy with the vote-buying power of the printing press-- are liable to keep printing and spending the nation into true hyperinflation, by which time MMT would probably require a near-100% tax rate in order to get prices back under control. THAT'S why we need the fiscal discipline of treating the Federal budget as if it \*is\* a household budget, despite the theoretical differences between the two. Furthermore, MMT-ers seem to completely ignore the psychological foundation underpinning a fiat currency. Specifically, the dollar will only be accepted as a way to transact for goods and services if those who accept it believe that they in turn will be able to spend it for a like amount of goods and services themselves. However, if folks begin to believe that the preservation of the future buying power of that currency resides solely with the whims of elected politicians, they're going to demand a substantial "inflation risk premium" before accepting that currency, thereby sparking a self-fulfilling inflationary spiral. Thus, MMT-- like many academic theories-- is unworkable in the real world, and thus should be labled as such in economic textbooks and journals before it's able to cause irreversible damage to the American economy.

#### **Even if the plan solves the entirety of the unemployment crisis – there is no political will to adopt a policy of MMT, especially in election year.**

Baker 2/25 –

Quick Thoughts on Modern Monetary TheoryPrintWritten by Dean BakerSaturday, 25 February 2012 13:47 [www.cepr.net/index.php/blogs/cepr-blog/quick-thoughts-on-modern-monetary-theory](http://www.cepr.net/index.php/blogs/cepr-blog/quick-thoughts-on-modern-monetary-theory)

Pitfalls of Going Solo: Problems of Relying Exclusively on the Government Channel¶ There is no dispute between MMTers and more traditional Keynesians like myself that increased spending and tax cuts can be an effective way to boost demand in a downturn. The question is whether this should be the exclusive route. I have argued above that we should also look to alternative channels to boost demand and work sharing to lower unemployment. Part of the reason is that I see no good reason not to push these alternative channels, however I also do see problems with relying exclusively on the government channel.¶ One of the problems is the potential for creating large structural imbalances that could be difficult to correct, as noted in the case of large trade deficits. But there are other reasons why exclusive reliance on the government channel may not be the best route.¶ First, if we go the spending route, there is a risk that some of the spending will be wasteful. This is both an economic concern and a political one. From an economic standpoint, we should always want our spending to be done in the most useful possible way. In the context where the alternative is just wasting resources by having workers and capital sit idle, then paying workers to dig holes and fill them up again would be an improvement, but we should hope to do better. Rushing huge amounts of spending into ill-conceived projects is not likely to be the best use of funds.¶ This also raises the obvious political issue that bungled projects make great stories for the political opponents of economic stimulus. We will be hearing much about Solyndra in the months and years ahead. It is worth taking political risks when there are clear policy gains from going a specific route, but if it is not necessary, why do it?¶ Alternatively, we can go the tax cut route. There is little doubt that if we have big enough tax cuts that we will eventually prompt enough consumption to bring the economy back to something resembling full employment. However, this does raise the risk that at some point when housing has recovered, the additional consumption from the tax cut will lead to a real problem of excess demand leading to inflation. I know the MMT answer is then to raise taxes, but I am not confident that this can always be done so easily.¶ Politicians are not generally eager to raise taxes. If we create a situation in which we are counting on big tax increases to prevent inflation, then we run a real risk that inflation could become a big problem, especially if we have been very loose with our monetary policy.¶ As a practical matter, I know that inflationary concerns in the U.S. economy have been vastly overblown. Only twice in the last half century (the late 60s and the 70s) is there a plausible case for inflation having been a problem and in both cases there were highly unusual extenuating circumstances (the Vietnam War and the surge in oil prices following the Iranian Revolution). Nonetheless, we have also never had a prolonged period of large budget deficits. There can be little doubt that we can run large enough budget deficits to cause inflation, especially if monetary policy is accommodating.¶ When we get to the world where we are raising taxes then we have to be concrete in terms of whose taxes get raised and by how much. This obviously raises many difficult political questions, including the extent to which we would substitute cutbacks in government spending. Suddenly we are in the world of tradeoffs between taxes and spending in which Washington is endlessly mired. I have spent as much time as anyone yelling about the need to boost demand and to restore full employment, but assuming we do at some point accomplish this goal, I don’t see how MMT gets us around the world of budget constraints that the honchos in Washington think we are in now.¶ I’ll conclude with a final point about my own reluctance to formally embrace MMT (which I don’t see as different from Keynes). I have long realized that in Washington policy debates who says something is far more important than what is being said.¶ We see evidence of this all the time. Witness the incredible sycophantism that surrounded Alan Greenspan before the collapse of the housing bubble. Note that the list of people engaged in Greenspan worship included not just Washington politicians and the top economic reporters at the Washington Post, Wall Street Journal and elsewhere, but even many of the world’s most prominent economists. The 2005 Jackson Hole meeting of central bankers was devoted to a Greenspan retrospective where they debated whether he was the [greatest central banker of all time](http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&sqi=2&ved=0CCIQFjAA&url=http://www.princeton.edu/ceps/workingpapers/114blinderreis.pdf&ei=IxtJT8idO9Ks0AHR_fn5DQ&usg=AFQjCNF4Zua_huzNFAPqUteCJyIgw8IKcQ&sig2=dmUEisS8mFrWGXiZWRHURA" \t "_blank). In short, people who certainly should be able to think for themselves generally don’t.¶ I recall an extreme version of this back in the debate over privatizing Social Security. I made what should have been a fairly simple point: it was impossible to get 7 percent real returns in a stock market with a price to earnings ratio well over 20 and a projected real growth rate of 2.0 percent**. This was simple arithmetic, but all the big names in economics, including the non-partisan professionals at the Congressional Budget Office and the Social Security administration continued to write 7.0 percent real returns into their projections.**

### MMT Wrong

#### MMT Theory fails to explain inflation and deficit theory sufficiently – deficit hawks are superior in methodology – interest rates explain everything.

Mitchell 1/2

Rodger Malcolm Mitchell, A reminder about why Modern Monetary Theory (MMT) is wrong about inflation Monday, Jan 2 2012rodgermmitchell.wordpress.com/2012/01/02/a-reminder-about-why-modern-monetary-theory-mmt-is-wrong-about-inflation/

It is human nature, when addressing any problem, to look first at the simplest, most direct solution:¶ Employment too low? Hire people (the ELR solution). Inflation? Cut the deficit (the debt-hawk solution). Income gap? Tax the rich (the Democrat solution). Economic growth? Trade protectionism. (The populist solution) ¶ Climbing straight over the peak of a mountain may be the simplest, most direct route, but not necessarily the best way to get to the other side. That simplest, the most direct solution can actually be counter-productive. In the previous post, I described why, though ELR is the (seemingly) simplest, most direct solution for unemployment (simply hire ‘em), it may not be the best solution. This is one area where MS differs from what is called MMT. ¶ That all is discussed in the previous post and this is a prelude to what I really wanted to remind you about, in an attempt to draw a distinction between MMT and MS.¶ ======================¶ The other area of difference is the prevention and cure of inflation. Perhaps the most fundamental equation in all of economics is: Value (or Price) = Demand/Supply. Increase the Supply of money or decrease the Demand for money, and the Value of money goes down, i.e. you get inflation.¶ For adherents of MMT, inflation is a matter of money supply. Thus, inflation is to be prevented and cured by regulating the creation and destruction of dollars. MMT suggests that federal taxes be increased when excessive (above a target rate) inflation appears. In fact, according to MMT, that is a fundamental purpose of taxes – providing value to fiat money.¶ I agree and disagree. There is no question that removing dollars from the U.S. economy would help prevent/cure inflation, by giving greater value to the remaining dollars. Scarcity increases value. But, I have strong concerns about this approach.¶ While, in theory, tax increases can prevent inflation, in actual practice, tax changes would be inefficient and damaging. They are far too slow (When will they be collected?), far too political (Which taxes?) and not incremental (How much?). ¶ Although the federal government has managed to control inflation, federal taxes have not been the controlling device. Interest rates have. That is, while MMT hypotheses have focused on supply, the Fed, in the real world, has focused on demand – successfully.

#### There is no depression psychology to explain hoarding because it does not exist – MMT relies on false assumptions that prove it false.

Corrigan 2/27

goldnews.bullionvault.com/mmt\_wrong\_02272012Why Modern Monetary Theory Is Wrong - 27 February 201

One of the classic examples of faux reasoning disported by this soi disant school of innovative thinkers is one which leaps from the tautological observation that a flow-of-funds reckoning of an economy conveniently, if rudely, carved up into vast, faceless blocs labeled, 'Public' and 'Private' — must see a net private surplus offset by a net public deficit (ignoring the external 'sector' for the moment) and hence, that the overspending state is doing all its subjects a favor by living beyond the means honestly voted to it, otherwise their aggregate desire to acquire net new 'assets' could never be fulfilled!¶ On this reckoning, the Greeks, far from being the most fiscally benighted and sorely afflicted of peoples, should rejoice in the effulgence of their status as beacons of true MMT enlightenment and prosperity!¶ Suffice it to say that we can put this canard — one equivalent to saying that we benefit from paying protection money to the Mob if only the Capo holds the monthly dinner party for his lieutenants in our pizza parlor — firmly to rest after carrying out only the most trivial of disaggregations.¶ Absent the predations of the Provider State, individuals may well, on balance, engage in saving (with a view to better providing for their future needs) by acquiring claims on entrepreneurial endeavors, these latter being happy to put the funds so raised — and, by extension, the resources so spared — to a hopefully profitable, productive use.¶ Under these circumstances, the consolidated balance sheet of the private sector will certainly still show a zero balance but the twin aggregates which comprise this will show an expanding count of genuine capital accumulation, even without some insistent spendthrift in office to 'remedy' the associated joint lack by throwing a good war, or an equally useless Olympics!¶ Moreover, they also bruit about the ludicrous idea that such grossly confiscatory measures as are entailed by government spending and borrowing are easily justified because they ensure that an otherwise elusive medium of exchange is called into existence.¶ Are we really asked to believe that, short of this paternalistic blessing conferred upon us by our selfless Platonic Guardians, it would be utterly beyond the wit of Acting Men to devise some alternative means of lubricating their frequent, voluntary, and so value-enhancing transactions?¶ As part of this insidious idea that no government can be too big, no deficit too wide — saving only that Leviathan has not foolishly ceded control of the printing press to some party beyond the reach of his coercion — the MMTers also insist that the gargantuan program of monetization being undertaken as part of the global bank rescue attempt has not and, moreover, cannot, under any circumstances, lead to 'inflation' (by which they conventionally mean sustained price rises in goods and services, of course).¶ Well, let us here quote the words of an early 20th century thinker on such matters, Harry Gunnison Brown, in the slightly different—but still relevant—context of denying that there can ever be such a phantasmagorical creature as a 'liquidity trap'.¶ ...it has been argued... [that] it is impossible for banking policy — or any purely monetary policy devoted to increasing the circulating medium — to bring business back near to normal in any reasonable period, once depression has become acute. For, it is contended, the increased money will in any case merely be hoarded. Depression psychology will prevent borrowing from banks for business expansion, however large... reserves become through favorable Federal Reserve policy. ¶ Depression psychology will prevent any person or persons from whom the Federal Reserve banks purchase securities, from either investing or spending the money so received! And if the federal government directly supplements Federal Reserve policy, printing billions of Dollars of new money which it then pays out to buy back or redeem federal government bonds, this new money will also be hoarded, every Dollar of it, and so will have no effect toward increasing the demand for goods and restoring employment!¶ In this view it would appear that if each person in the country, during a period of depression, were put into possession of more money than before whether twice as many Dollars or 100 times as many or 10,000 times as many-there would nevertheless be no appreciable increase in spending, no increased demand for goods and no stimulus to business and employment! Instead, production would remain low or even sink lower, spending would remain low or even become less, prices of goods would remain low or fall even lower. All this, of course, is preposterous nonsense but it is to such a conclusion that those economists must inevitably be driven who do not admit that monetary policy can possibly promote recovery from depression.¶ Now it may well be the case that what Brown is here exploding is the nonsense associated with the ineffable Paul Krugman and his fellow-travelers, but the MMTers seem to be even more precariously balanced, straddling as they are, the Great Deflationary Abyss — within one foot planted firmly in a land where live those who believe that money can be effective in reigniting a temporarily slackened desire to spend, but with the other dangling in mid-air, well short of the opposite bank where reside those who take this to the logical conclusion that too much money can likewise easily lead to far too much spending, vaulting us readily from the frying pan (or the freezer cabinet, as may be the more suitable image) and into the fire of inflation.