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Modern Monetary Theory: Everyone's Talking About MMT, But What Is It, And Will It Work?

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Maybe you've never heard of Modern Monetary Theory. But no doubt, as the 2020 election nears, you will. It's the latest contentious buzzword to hit Washington, D.C.

The idea, despite its name, is not new or "modern." But it has set off a heated political and economic debate, with Fed Chairman Jerome Powell telling Congress last week that Modern Monetary Policy is "just wrong."

Does Modern Monetary Theory, or MMT, represent a brave new future of ever-expanding government spending to meet Americans' vital needs? Or is it a dangerous idea that could lead to runaway inflation, financial disaster and, ultimately, collapse?

The theory, in a nutshell, says that because the U.S. can borrow in its own currency, it can simply print more money when it needs to pay off its debts. All the Fed has to do is keep interest rates low. Simple. It's an increasingly popular idea among left-leaning economists.

Fed Chairman Powell: MMT Is 'Just Wrong'

Not surprisingly, however, when Fed Chairman Powell testified before Congress on Tuesday, he pulled no punches on Modern Monetary Theory.

"The idea that deficits don't matter for countries that can borrow in their own currency I think is just wrong," Powell said, describing one of MMT's main pillars. "And to the extent that people are talking about using the Fed — our role is not to provide support for particular policies. Decisions about spending, and controlling spending and paying for it, are really for you (Congress.)"

Mainstream economists — even on the left — don't like the MMT idea.

For one thing, it violates a widely-held tenet of conventional monetary theory: That the quantity of money matters, especially for inflation. MMT maintains if inflation becomes a problem, just raise taxes. And print money to pay your bills.

Critics also note that MMT would support politicians issuing massive amounts of new debt backed by the printing press. Spending and debt would soar, crowding out private investment by sucking up private savings.

In response, leading proponents argue that those who oppose MMT don't really get how it works.

"The MMT framework rejects this, since government deficits are shown to be a source (not a use!) of private savings," writes Stephanie Kelton, a professor at Stony Brook and former economic advisor to Sen. Bernie Sanders' 2016 presidential campaign, in a recent Bloomberg piece. "Some careful studies show that crowding-out can occur, but that it tends to happen in countries where the government is not a currency issuer with its own central bank."

MMT Used To Justify Federal Spending

This is more than just another dorm-room debate with no consequences.

Democratic Party proposals like the Green New Deal, Medicare for All, and guaranteed incomes and jobs, will cost enormous sums. By at least one estimate, the 10-year tab for the progressive Democratic agenda now emerging from Congress could total $93 trillion. Only MMT, proponents say, could pay for it all.

This idea, in particular, angers MMT's foes.

"It is intellectually fraudulent, though I suspect Stephanie (Kelton) is a true believer," economist Dan Mitchell, co-founder of the free-market Center for Freedom and Prosperity, told IBD. "In any event, it is the fiscal/monetary equivalent of a perpetual motion machine. Sort of turbocharged Keynesianism."

Other economists note Modern Monetary Theory is a decades-old idea that's been debated, and discarded, by mainstream economists. MMT has only recently re-emerged as a way to justify more spending.

"The theory does ... lend itself to use, if not to abuse, by big spending proponents," said George Selgin, director of the Cato Institute's Center for Monetary and Financial Alternatives. "They like to harp on its observation that governments' right to create money gives them practically unlimited spending capacity. That claim is true, if not banal. But it's also misleading: Governments may be able to spend without limit; but outside of recessions they can't do so to any great extent without having to make their citizens ultimately foot the bill, either by paying higher taxes or by having to endure inflation.

"When politicians promise something for nothing, people should be wary," he added. "There's nothing to MMT that should make them any less so."

MMT: Inflation Threat?

Even Paul Krugman, himself a liberal-left economist, finds MMT lacking. "When people expect inflation, they become reluctant to hold cash, which drives prices up and means that the government has to print more money to extract a given amount of real resources, which means higher inflation, etc.," he wrote last month. "Do the math, and it becomes clear that any attempt to extract too much from seigniorage (printing money) — more than a few percent of GDP, probably — leads to an infinite upward spiral in inflation. In effect, the currency is destroyed."

The Congressional Budget Office now predicts $1 trillion annual federal deficits during the next decade. And the Treasury reports that total U.S. national debt now exceeds $22 trillion.

So a lot hangs on the key question posed by Modern Monetary Theory: Do federal deficits and debts matter at all? Supporters of MMT say not if the Fed holds rates below the growth of both GDP and debt. That would stabilize the debt-to-GDP ratio, and hold down inflation.

But others argue the inflation risks of MMT are huge. The Fed since 1990 has kept inflation at about 2% by targeting it. Its political independence gave it room to do so. Examples abound elsewhere of central banks running the printing presses to please politicians, resulting in hyperinflation and economic collapse — Venezuela, Zimbabwe and Argentina, for example.