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Modern Monetary Theory Is Not The Answer

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When I studied economics at Rutgers College and then at Columbia University's Graduate School of Business, it was a serious, some might even say boring, subject. The most important macroeconomic debates at the time centered on whether monetary or fiscal policy was the better tool for managing an economy. There were disagreements among the top thinkers to be sure, but everyone agreed on the fundamental principles. That's not necessarily the case anymore. Certainly not when Modern Monetary Theory (MMT) comes into play.

The proponents of MMT, such as Bernie Sanders' economic advisor Stephanie Kelton, say that self-imposed limits on fiscal spending in the US are holding back economic growth and frustratingly limiting sorely-needed inflation. They advise that the government should therefore just print another $500 BN of new money to pay for things. However, MMT proponents fail to acknowledge that this path is a slippery slope and the same one that's caused many other economies to topple when investors lose confidence. In their rush to come up with a new and better theory for managing today's "modern" economy, they omit consideration of whether old statistical measures (like CPI) should also be revamped. If they had, they would have to concede that a more modern measure of prices for managing an economy should incorporate the measurement of asset bubbles. This is because big asset bubbles have preceded many modern recessions, even though CPI appeared tame at the time.

Whatever one's position regarding MMT, we can all agree that these last 12 months have been an extreme period in terms of monetary policy. After four rounds of quantitative easing ("QE"), in 2018 the Fed started tightening, and proceeded to lift rates four times. However, after the equity market sold off and a Trump tweetstorm ensued, the Fed mysteriously reversed course with three rate cuts in 2019. In addition, late last year it began repo operations, which some observers say amounts to a fifth round of QE. It's obvious to see that expansionary fiscal policy (tax cuts & deregulation), combined with aggressive monetary printing well past the end of our last recession has created a number of concerning asset bubbles.

As I've noted previously in this space, numerous asset bubbles are expanding and the bursting of any one of them could prove catastrophic. The US is in the middle of its longest economic expansion in history, but we have no idea how and when it will end. However, the bursting of historic asset bubbles – from the tulip mania in the 1600s, the tech bubble of the late 20th century, and the housing bubble this century – has rarely been benign. Economic growth usually contracts after big asset bubbles burst, and the systemic reverberations from larger ones are greater, as we saw in the aftermath of the Great Financial Crisis.

In order to reign in deficit spending and control the appetites of politicians, Congress therefore prudently passed budget laws which limit the amount the US government can spend without offsetting revenue or a commensurate reduction in spending elsewhere. However, MMT takes the view that these laws are old fashioned and inhibit growth. The notion is that, because inflation as measured by CPI has remained benign, what we really ought to do is just change the law and aggressively spend an extra $500 BN or so to ignite some real inflation

MMT proponents loudly proclaim that newly printed money can be used to fund economy-boosting projects, like rebuilding sorely needed infrastructure. That sounds great in theory, but there's no guarantee that such spending will in fact stimulate growth; in fact, when the government's involved there's always a tendency to focus on political pet projects that may not stimulate overall GNP. At the same time, what is not being said by the MMT camp is that once you open the monetary spigot it's very difficult for politicians to close it again. The onset of what appears to be QE 5 is the latest worrying example of this human tendency.

Another point that hasn't been discussed much is that cheap money policy is a real transfer of wealth. There's no getting around the fact that the more money the government borrows, the more it devalues our currency. That creates more inflation, even if it's not immediately apparent in CPI figures. However, regular money printing strips away buying power from savers and retirees and transfers that wealth over to borrowers and younger people. Of course, that concept may align well with Sanders' political platform but it isn't forthright in terms of what's actually occurring.

Fed Chairman Powell recently voiced some concern about these issues in his testimony before Congress when he warned that trillion-dollar deficits are unsustainable. The federal government's debt has grown by an estimated $3 trillion under the Trump administration and its latest budget would add another $5 trillion over 10 years. However, the current Federal debt is only a portion of our government's total obligations. If underfunded pensions, Medicare and Social Security liabilities are included, Federal liabilities rise to $100 trillion or more! If our government just keeps printing money, one day it will become impossible to repay all that's been borrowed. It has already proven very challenging to stop QE cold turkey. Although Powell is publicly optimistic about the health of the US economy, economies have always been cyclical (in the olden days and in modern times), and when the next recession hits we may not have the necessary tools left to support a quick recovery.

I do not want to be an economic Cassandra, but MMT goes against every major economic principle – supply & demand, limited resources, rational behavior, incentives, etc. With this in mind, MMT proponents would be wise to come clean about the real risks of their proposals. Printing another half trillion dollars to stimulate growth may sound great at first glance, but how will it impact all those citizens who relied on the government to balance its books? Will they lose confidence in our currency and thus start looking for alternatives (like cryptocurrency), and might this already be happening? Moving the goal posts midway through the game definitely makes getting a touchdown easier for one side, but what player (on either team) will truly want to compete in this newly-rigged game over the long haul?

My final question to MMT proponents is how have historic economies that printed lots of money fared over the long term, and how might a review of asset bubbles that preceded systemic collapses give us additional tools to monitor today's real inflationary risks? I would submit that all these important economic questions are simply being ignored by MMT proponents. With that in mind, we would all be well-advised to get back to balancing our collective checkbook, while keeping a close eye on the massive asset bubbles that ultra-loose monetary policy has already bestowed upon us. Doing so will help us reduce the risk of future systemic collapses over the course of a full and inevitable economic cycle.