AMI's evaluation of "Modern Monetary Theory" (MMT)

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March 21, 2012

Modern Monetary Theory (MMT) is a theory developed by a group of economists over the past 25 years or so. In the current crisis it has been receiving some wider attention from the prevailing economic community and politicians looking for a new direction.

The American Monetary Institute (AMI) is sometimes asked about MMT and whether it fits in with monetary reform. We assess anything to do with monetary matters carefully.

At the outset AMI enjoys a good, cordial relationship with some of the leading MMT economists, and we certainly wish to build on this relationship. But one thing we can't compromise on is facts. MMT, like much of modern economic thinking, builds upon some erroneous assumptions and a definition of money that is not neutral and works to the detriment of the 99%. In addition MMT has its own specific problems between its claims and the facts which have bearing on the validity of MMT.

Economists too often get the facts wrong

MMT shows a lack of respect for empirical facts. This is a problem with economists' theories in general, and we find that MMT is no exception. **As the monetary historian Alexander del Mar observed over a century ago (and it still holds true today):**

> **"As a rule, political economists ... do not take the trouble to study the history of money; it is much easier to imagine it and to deduce the principles of this imaginary knowledge."[1]**

To their credit, MMT economists like Professor L. Randall Wray admit to using imaginary history, for example:

> "This ... summation of the 'origins' of money, much of it relying on speculation" is used in "a stylized, hypothetical example of the way in which an economy can be monetized."[2]

But by using this imaginary method, important historical facts get missed. For instance, in an overview of the Continental currency of the Revolutionary War, Professor Wray jumps to the MMT theory-fitting conclusion that "Without a sufficient tax liability, the notes depreciated quickly."[3]

No mention is made of the massive counterfeiting done by the British. This played the main part in the ultimate depreciation of the currency, as Benjamin Franklin tells us in an article he wrote in 1786, reflecting on his first-hand experience of that time:

> "Paper money was in those times our universal currency. But, it being the instrument with which we combated our enemies, they resolved to deprive us of its use by depreciating it; and the most effectual means they could contrive was to counterfeit it. The artists they employed performed so well, that immense quantities of these counterfeits, which issued from the British government in New York, were circulated among the inhabitants of all the States, before the fraud was detected. This operated

> considerably in depreciating the whole mass, first, by the vast additional quantity, and next by the uncertainty in distinguishing the true from the false; and the depreciation was a loss to all and the ruin of many. It is true our enemies gained a vast deal of our property by the operation; but it did not go into the hands of our particular creditors; so their demands still subsisted, and we were still abused *for not paying our debts!*"[4]

For its part, the Continental Congress maintained an excellent record: $200 million notes were authorized, and about $200 million were put in circulation at any one time (and about $48 million damaged notes were replaced).[5]

This example highlights the poor methodology which is at the root of MMT's problems: it's extremely bad practice of selectively taking pieces of history out of context and then using them as a prop to give their pre-conceived ideas the appearance of legitimacy, when they are in fact baseless.

Not that MMT is alone in doing this, the mainstream high school textbook, Economics: Principles in Action (published by Pearson, 2007, p. 248) written by Arthur O'Sullivan and Steven M. Sheffrin, perpetuates this same misunderstanding of the American Revolution. What is happening here is that these stories put in people's minds that government is incapable of handling monetary affairs, specifically, the supply of money. History shows that ancient governments, the American colonies and the United States government were quite capable of running their monetary systems in a healthy and fairer way than today's system.

MMT misuses terms

MMT stretches and twists the meaning of words beyond normal usage; for example, Wray says:

> "We say that fiat money is a government liability. For what is the government liable? To accept its money in payment of taxes."[6]

Normally people think of a liability as being something owed and due. Money need not be something owed and due, ***it's what we use to pay something owed and due***. To call money a liability ignores the nature and properties of money. It removes the concept of money and substitutes a concept of debt in its place.

MMT mis-defines money as debt

Poor methodology and misuse of terms leads MMT to mis-define money as debt; e.g., Wray says: "*Fiat money* will be defined as ... nothing more than a debt."[7]

But money and debt are two different things, that is why we have different words for them. We pay our debts *with* money.

If money is defined as a debt, it artificially places an unnecessary burden of debt on the whole of society. It turns the positive real net worth of all we produce into a financial negative instead of positive. In effect, it artificially places financial claims on all of our achievements and progress, thus denying us full benefit and enjoyment of all we create.

While most money in the U.S. mis-designed system is really debt, put into circulation by banks when they make loans, it is a huge error to then define the "nature" of money as debt. That mistake would render it impossible to redesign the system in a just and sustainable way.

The AMI considers the concept and definition of money as the most critical factor in determining whether a society's money system functions in a just and sustainable way. How money is defined determines who controls the money system, and whoever controls the money system will dominate the whole society. For instance:

- If money is defined as wealth (e.g., commodities like gold and silver by weight), as Adam Smith did, then the wealthy will control not only their own wealth, but the money system and thus the whole society as well.
- If money is defined as credit or debt, as MMT and most economists now do, those who dominate credit (the banks) will control society's monetary mechanism – and we know from experience they will misuse it to create bubbles, until the whole system crashes.
- If money is defined as an abstract legal power of society, as the Constitution does, then the money system is placed under our constitutional system of checks and balances to work justly and sustainably for the whole society, not for only a privileged part of it.

The AMI uses the following concept of money:

Money's essence (apart from whatever is used to signify it) is an abstract social power, embodied in law, as an unconditional means of payment.

Some particulars about MMT

Now we'll look at some of what MMT claims and compare it with the facts. Then we'll look at where MMT got its ideas from, what that means, and suggest how MMT can fix these errors.

MMT makes these specific claims about the present monetary system:

1. government creates money when it spends, and can create as much as society wants;
2. taxes aren't used for government spending, and are "literally burned" instead;
3. government bonds aren't used for government spending either, but to help the Fed;
4. right now, government can create money for full employment and price stability.

MMT confuses its theory for facts

We'll take some quotes from MMT literature related to these claims and show that there are serious problems with them. We then take some of MMT's own contradictory quotes which seem to admit this.

1. Does government create money when it spends (as much as we want)? - No

Wray says "Government expenditure will generate coins, notes or bank reserves"[8] and "Government spending is constrained only by ... the public's desire for money."[9]

In fact, according to official sources, the creation and issuance of coins, notes and bank reserves is unrelated to government expenditure. All coins and notes are issued to the public through banks, and all bank reserves are originally created by the Fed for banks.[10] Government expenditure merely transfers (previous) bank reserves back to banks.[11]

Therefore, government spending *is* constrained by present monetary arrangements, not by the public's desire for money.

MMT bases this erroneous claim on the assertion that, as Wray says: "Treasury spends before and without regard to either previous receipt of taxes or prior bond sales."[12]

In fact, Treasury must receive taxes or the proceeds of bond (or other debt) sales into its general (checking) account at the New York Fed before payments can be made from it, as the law prohibits the Fed from making loans or overdrafts to Treasury.[13] The Fed has to debit Treasury's account to credit banks' accounts, otherwise its books wouldn't balance.

Therefore, Treasury cannot spend without regard to how much is in its account.

2. Is our tax money "literally burned" instead of being spent again? - No

Wray says "tax receipts cannot be spent"[14] as "the money is literally burned, or simply wiped off the liability side of the central bank's balance sheet."[15]

In fact, Treasury publishes daily statements of its accounts showing that tax funds are transferred to its account at the Fed, and the Fed publishes weekly statements showing these amounts as liabilities on its balance sheet; they are not wiped off.[11] As for burning money, that is a federal crime.[16] Currency re-enters circulation until damaged or worn.[17]

MMT bases its erroneous claims on the belief that, as Wray says: "Taxes are used to drain excessive disposable income."[18]

In reality we're in a deep recession (or depression) right now, most people certainly don't have any excessive disposable income, and yet most people are still being taxed.

3. Is government borrowing presently unnecessary? - No

Wray says "bond sales ... cannot finance or fund deficit spending,"[19] but are done "to prevent ... a zero per cent bid for reserves, ... allowing the [Fed] to hit its target."[20]

As above, data published by Treasury and the Fed show the proceeds of bond (and other debt) sales go in and out of Treasury's account/s at the Fed; they *are* used.[11] And today the effective bid rate for reserves is at the Fed's target rate of near-zero,[21] yet Treasury is still selling more bonds.[22]

Yet MMT believes that, as Wray says: "Once domestic households and banks are content with their holdings of government bonds and ... reserves, then government need not ... sell any more bonds."[23]

Today holdings of government debt and bank reserves are much higher than ever before, but Treasury is still selling more bonds.[22] Aren't we "content" with government debt yet?

4. Is government presently able to create money to create full employment? - No

Wray says "Treasury's ability to issue fiat money"[24] means "full employment with price stability ... can be achieved, now."[25]

Treasury does not 'have the ability to issue fiat money at present,' banks do, so government is not in a position to create and spend money into the economy to achieve full employment and price stability right now.

MMT lacks any real evidence

We haven't found any real, officially-confirmed, evidence to support what MMT claims. All the official sources we've checked (and we have!) indicate that the facts are contrary to what MMT claims; *under the monetary arrangements that prevail at present*.

Of course, Congress can change these arrangements, and fortunately we have legislation introduced into this Congress which restructures our money system so Treasury can create the money supply (as MMT thinks is happening) to enable full employment and price stability to be achieved and sustained.

MMT doubts its own validity

To their credit, MMT economists like Wray question their own assumptions:

> "What if we have erred in our understanding of money, and in our analysis of government budgets? In this case, we must take [federal program] costs seriously."[26]

In this case, we must ask: What is MMT really doing? We ask because MMT literature sometimes admits something factual, but then reverts straight back to saying things that are completely contradictory to the facts just admitted; e.g., Wray says:

> "It is true that the Treasury transfers funds from the private banks to its account at the Fed when it wishes to 'spend'," but in the very next paragraph says: "Treasury cannot withdraw taxes from the economy before spending."[27]

As we've seen above, Treasury's account is debited when it spends, so it must get funds from the economy (since the Fed can't lend it funds). The funds transfer back and forth between Treasury and the economy; so it's pointless saying which direction occurs first.

What else - some other problems with MMT:

5. Combining the Treasury and Fed together as though they're both "the government":

In fact, the operational arms of the Fed, the 12 Fed banks, are stock-owned by member banks. It should be clear by now that the Fed exists to help banks, not society.[28]

6. Saying money has value because of taxes, that's why people want it, and government decides its value: [29]

In reality, money has value because of what it can buy, we want it for many things, e.g., to buy food (paying taxes is much lower on the list), and sellers usually decide its "value" as such. What enables that value to be created in the first place is people living together in a supportive legal and social structure creating values for living, such as education, science, medicine, technology, the arts, etc.

7. Ignoring the continuous transfer of wealth from poor to rich due to government debt:

A big part of our taxes go to pay interest on debt, held disproportionately by the top 1%.

8. Ignoring banks' ability to counteract government's effect on the economy at any time:

Banks can shrink the economy by shrinking the money supply (e.g., Great Depression) or expand it with bubbles (e.g., housing) regardless of government deficits or surpluses.

9. Ignoring the continuous theft from society due to private money creation:

Society creates all economic value; private money acts as a private tax on that value.

10. Accepting systematic injustice:

Loaning money into circulation widens wealth and income disparities, as those with the most get the most loans and those with the least get the least; e.g., Wray says: "Clearly, large segments of the population are 'quantity rationed' ... quantity rationing can even be irrational - perhaps discriminatory -" but then says: "We will not dwell on such issues."[30]

At AMI we do dwell on such issues, because not doing so is a morally bankrupt position.

MMT goes back and forth in its logic

MMT backtracks on the timing of government spending and tax transfers; e.g., Wray says: "Treasury transfers funds ... to its account at the Fed simultaneously as it spends."[31] That's a lot different from "Treasury spends before and without regard to ... receipt of taxes"[10] (as quoted above). So MMT admits that Treasury does need funds to spend.

MMT even admits that banks control our money supply; e.g., Wray says: "the supply of bank money depends on the supply of loans which is not under the control of the government."[32]

We need bank money before anyone can get cash, buy government bonds, or pay taxes. Thus banks have total control over our money supply: nobody (including government) can get any money <u>unless a bank decides</u> to make a loan or purchase.

MMT fails to realize that this vast power is in private hands, <u>not</u> in the hands of society through government. We're supposed to be living in a democracy, not a plutocracy.

MMT also admits the Fed exists to serve the needs of banks, not society; e.g., Wray says: "the [Fed] cannot ... refuse to provide reserves ... needed by the ... private banking system ... **as all banking systems operate with a fractional reserve system**, banks ... are automatically loaned reserves."[33] (emphasis added)

All of this gives a very different impression of the main assertions of MMT.

Where MMT got its mistaken ideas from: The 'Smoking Gun' and fatal error

MMT got its mis-definition of money from two articles written by "A. Mitchell Innes" (actually A. Mitchell-Innes), a top British diplomat to America at the time the Fed was being established. Innes only ever wrote two articles on money (the second was only to drive home the first), and in effect they created a "backstory" for the new Fed system.[34] Innes is the rotten apple. Following Innes has led MMT down a hole.

Through the Looking-Glass, and What MMT Found There . . .

Through a maze of inaccuracies and inconsistencies, Innes created a "theory" which says:

"It is the issue of money which is the burden and the taxation which is the blessing."[35]

Take a moment to test this theory against your own experience. Have you ever felt this? This is backward thinking. Innes tricked serious people by removing the concept of money and replacing it with debt.[36]

Substituting debt for money inverts the idea of money. It turns good into bad; and has a domino effect: inverting everything else to give a totally inverted view of the real world.

The inherent problem with MMT: it keeps the present problems in place

Under present arrangements, all money is issued with debt (but it doesn't have to be). Issuing money with debt places an unnecessary interest burden on our money supply and makes it susceptible to collapse and susceptible to private, often corrupt, interests. These are existential threats to our economy and society that MMT fails to address.

It's okay, there *is* a way out: HR 2990

It doesn't have to be like this. We need a simple system which every normal person can understand. There is already a bill in Congress which gives us a simple system which isn't prone to endless bubbles and crashes. This bill is HR 2990 and it's main goals are full employment and price stability, which are the main goals of MMT too. HR 2990 explicitly takes the money power back into Congress, where it belongs, which is where MMT says it belongs too.

HR 2990 enables government to spend money without taxing or borrowing, i.e, the functional approach MMT espouses. HR 2990 requires non-inflationary results and provides funds to improve our infrastructure and education at all levels.

HR 2990 is the missing link that makes what MMT says happens really happen, by treating money as money, not debt.

MMT needs HR 2990 for the things they say they want to become a reality. MMT can then be about calling for more money instead of more debt - a more reasonable position, and a much easier sell politically.

Conclusion

MMT economists are commended for at least looking at money creation, when almost all other economists don't even consider it, but they look at it in such an inaccurate way that MMT is rendered useless in any practical sense.

This is because MMT has embedded within it a mis-definition of money as debt, meaning the harder we work as a society, the more in debt we get, meaning we have to work even harder, use more resources, get into more debt, and so on, i.e., it's a self-defeating system.

Thus MMT fails to address the source of economic instability and the driver of the social and environmental degradation we see all around us. It proposes putting an ambulance at the bottom of the cliff whenever there's a crash, instead of preventing them happening.

This error comes from the mis-definition of money as debt. The mis-definition of money as debt is incompatible with the Chartal (legal) nature of money that MMT espouses, and history shows us that it is also incompatible with MMT's stated goals of full employment and price stability. Therefore, MMT has to treat money as money: a necessary medium of exchange - without associated debt - if it wants our money system to reflect reality.

Treating money as money is a pre-requisite for any realistic and sustainable solution. Only then can we enjoy the benefits of technology without endless toil and resource use. When economics is founded on reality, not theory, we'll all be better off.

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* MMT forms part of a sub-branch of economic theories called “Neo-Chartalism” which itself forms part of a branch of economic theories called “Post-Keynesian” (after the late economist John Maynard Keynes).

Notes:

[1] del Mar, 1895, p. 101; Zarlenga, 2003, p. 4
[2] Wray, 1998, p. 54 (paragraphs 1 and 2)
[3] Wray, 1998, p. 62
[4] Franklin, 1819, p. 488; Sparks, 1840, p. 504; Franklin, 1987, p. 1127; Zarlenga, 2002, p. 380-81
[5] Zarlenga, 2002, p. 381-82, and p. 388, note 37
[6] Wray, 1998, p. 95, note 6; Wray, 2003, p. 15, note ix (using slightly different words/terms)
[7] Wray, 1998, p.12
[8] Wray, 1998, p. 80; Wray, 2003, p. 6
[9] Wray, 1998, p. 87

[10] US Mint, 2011 Annual Report, p. 9 (http://www.usmint.gov/downloads/about/annual_report/2011AnnualReport.pdf); Federal Reserve Bank of New York, June 2008 (http://www.newyorkfed.org/aboutthefed/fedpoint/fed01.html); Federal Reserve System, July 20, 2011 (http://www.federalreserve.gov/paymentsystems/coin_about.htm); Federal Reserve System, 2005, pp. 27-50 (http://www.federalreserve.gov/pf/pdf/pf_complete.pdf); Coleman, 2002 (http://www.federalreserve.gov/pubs/bulletin/2002/0202lead.pdf); Bech, 2008 (http://www.newyorkfed.org/research/epr/08v14n2/0809bech.pdf)
[11] US Treasury, Daily Treasury Statement, March 19, 2012 (https://www.fms.treas.gov/fmsweb/viewDTSFiles?dir=w&fname=12031900.pdf); Federal Reserve System, Federal Reserve Statistical Release H.4.1, March 15, 2012 (http://www.federalreserve.gov/releases/h41/20120315/)
[12] Wray, 1998, p. 78; Wray, 2003, p. 5
[13] Federal Reserve Act, Section 14, Subsection (b) (http://www.federalreserve.gov/aboutthefed/section14.htm) [12 USC 355]
[14] Wray, 1998, p. 78
[15] Wray, 1998, p. 111
[16] 18 USC 333
[17] Federal Reserve Bank of New York, October 2011 (http://www.newyorkfed.org/aboutthefed/fedpoint/fed11.html)
[18] Wray, 2003, p. 9
[19] Wray, 1998, p. 85; Wray, 2003, p. 7
[20] Wray, 1998, p. 86
[21] Federal Reserve System, Federal Reserve Statistical Release H.15, March 19, 2012 (http://www.federalreserve.gov/releases/h15/20120319/)
[22] US Treasury, Treasury Direct, Historical Auction Query, March 1-19, 2012 (http://www.treasurydirect.gov/RI/OFAuctions).

[23] Wray, 1998, p. 87
[24] Wray, 1998, p. 119
[25] Wray, 1998, p. 124
[26] Wray, 1998, p. 180 (5 pages from the end of the book)
[27] Wray, 1998, p. 78 ((new) paragraphs 1 and 2); Wray, 2003, p. 5 ((new) paragraphs 2 and 3)
[28] Zarlenga, 2006 (http://www.monetary.org/is-the-federal-reserve-system-a-governmental-or-a-privately-controlled-organization/2008/02)
[29] For an academic critique on these points, readers are referred to Febrero (see References).
[30] Wray, 1998, p. 110
[31] Wray, 1998, p. 116
[32] Wray, 1998, p. 110
[33] Wray, 1998, p. 105
[34] Wray, 2004, p. 11-13
[35] Innes, 1914, p. 160
[36] Zarlenga, 2010 (http://www.monetary.org/critique-of-innes/2012/06)