Modern Monetary Theory & Economic Education | With Stephanie Kelton – Part 1

This transcript may not be 100% accurate due to audio quality or other factors.

acTVism:

Thank you for joining us today, Let's begin with economic education. How important is economic literacy for lay people and how can we improve it?

Stephanie Kelton (SK):

How important is economic literacy for lay people and how can we improve it? I think it wouldn't be as important that lay people understand economic theory and much about economics at all really if they got better policy, and their politicians and those who made policy better understood. Because then things would work better and the rest of us wouldn't have to worry so much about what the underlying economic theory behind their policy decisions is. Because, in so many places around the world, the policy is not very good. Policy makers aren't giving us the kind of policies that are producing robust economies where workers are getting ahead, where labor markets are tight, where wages are increasing, where prosperity is broadly shared. For those reasons I think it's more important for the average person to try to gain some understanding, to educate themselves so that they can become part of the process to move policy in a better direction.

How do we get there? I think what you're doing is a big part of it. You know, I talk a lot, not just in the US but around the world, and I know that many economists are out there doing the kinds of things that I'm doing, which is engaging with ordinary citizens and talking with them in various platform, settings, conferences, gatherings, with the activist community. We're doing our part to try to reach out and to be partners with the community, so I think that's just one way that we can work together to try to improve economic understanding.

acTVism:

What is Modern Monetary Theory?

SK:

I think of Modern Monetary Theory as a brand name. It's a shorthand way of referring to a body of research that a number of economists, myself included, started developing around 20 years ago. Somewhere along the way the work that we were doing got referred to as Modern

Monetary Theory or Modern Money Theory, and then later just shorthand MMT. It's a big project, right? But if I have to boil it down into a little one-sentence takeaway for your listeners Modern Monetary Theory is a school of thought in economics that starts with the simple recognition that, in most countries, the currency itself is a simple public monopoly. Which is to say, that the currency is issued by the state and because the state is in control of its currency, is the issuer of the currency: it can never run out of money; it can never be forced into default; it isn't like a household or a private business. It doesn't face the same constraints that households and businesses face, and therefore it can do things it can operate its budget in a way that's different from the way that households have to play the game. So that in a nutshell what MMT is about.

acTVism:

What is “sovereign money”?

SK:

When we, in the MMT school, when we talk about a country that operates with its own sovereign currency we're talking about a country like the US, like Japan, like the UK, like Canada; a country that spends, taxes and borrows in a currency that it, and only it, can create. So we're talking about a country that uses a “money thing” – in the US we have the dollar and the US dollar isn't tethered to gold. The government doesn't promise to convert dollars into another country's currency or into any finite thing like gold or silver or anything like that. So it's a fiat currency and it's not convertible. And because the US government is the sole authority, the only entity on Earth with the legal authority to issue the dollar, we say that the dollar is a sovereign currency. Now Australia has a sovereign currency, the UK has a sovereign currency, Japan has a sovereign currency, so those are examples of countries that have a non-convertible fiat currency under their own control, and that gives them a degree of policy space. They can do things, operate their budgets in a way that countries that lack a sovereign currency like, for example, those that belong to the Economic and Monetary Union, those that use the euro, simply don't have that degree of policy space.

acTVism:

What kind of monetary system does the Eurozone have and what are its limitations?

SK:

So in the Eurozone, the monetary system looks very different. Right? And some people have even compared the monetary system that is in place in the Eurozone now to a gold standard. So if you go back to the Financial Times, for example, and you look at past articles written by people like Martin Wolf, you can find the comparison being made between the monetary system that you have in the Eurozone and the old gold standard system that was in place, let's say 75 years ago, or 175 years ago. So why would someone make those comparisons? The euro is in convertible into gold. So why would anybody compare it to a gold standard or a fixed exchange rate type of system? And the reason is, because in the design and setup of the

euro, what was done under the Maastricht Treaty, is that all of these countries that joined the currency union gave up their sovereign currencies and adopted a currency that they cannot issue. So, Italy, Spain, Portugal, Greece, Ireland – the so-called awful name, the so-called PIGS – and everyone else who adopted this currency is in the same boat in the sense – that each of these countries is now constrained in a way that they weren't when they operated with their own sovereign currency. What does that mean? It means that, in order to spend, these countries have to actually go out and get the currency, they have to come up with the euros from somewhere. And that means, either through raising taxes and collecting euro, or by borrowing the euro. You say, well why would that be any different than in the US? The US also borrows dollars when it deficit spends.

The difference is, that when the government in the United States borrows dollars, there's no default risk. Financial markets understand that the government is borrowing in a currency that it creates, and therefore the possibility of ending up with bills that you can't pay, bonds maturing and the US government can't find a way to pay the bills, is impossible. Whereas, in the Eurozone, if you're borrowing in euro and you're let's say Greece or Spain or Italy, or even France or Germany, there could be a possibility that bonds are maturing, the government is obligated to make payments in euro, and it doesn't have the euro to do that. And financial markets understand that the risks are different. And so what happens is, financial markets expect a premium. They want a little something extra in order to assure them, in order to provide greater assurances that they're being compensated for the extra risk they're taking in lending to these countries, and so economists call that a risk premium. In other words, the countries that are borrowing in currencies that they don't control have to pay a higher price, generally speaking, than countries that are borrowing in a currency that they control.

acTVism:

Why should a country deficit spend?

SK:

Well the answer is, it depends on what's happening in its economy. So if you see an economy that has high levels of unemployment, that's an indication, we would say, of a deficit that is too small, because unemployment is just evidence of people who are walking around looking for paid work. That's what unemployment is. So if you have high levels of unemployment it means you have lots of people who are walking around looking for paid work. And if the policy goal is to reduce or eliminate the unemployment then we prefer a fiscal response to this as opposed to a monetary response, which would come from the central bank. So what we like to say in MMT is, unemployment is evidence of people looking for paid work, the way to resolve the problem of unemployment is either to cut taxes – which increases people's income, which should then lead to additional spending so unemployment goes down – or just directly increased spending by government, hire people and reduce unemployment directly.

So why should governments run deficits? You would do that if you have unemployment in the economy and you're trying to address the unemployment problem. Does that mean that every government must always keep its budget in deficit? The answer is, No. Some countries have a trade surplus that does the heavy lifting, that demand from the rest of the world is so

strong that it's creating enough employment in the domestic economy, that the government can run either a very small budget deficit or maybe even have its budget move into surplus and still have a pretty healthy economy. So it's not a question with a universal one size fits all answer.

acTVism:

What are the limits on government spending?

SK:

If you have a country that operates with its own sovereign currency, like the US or the UK, and by definition what we're saying is that the government can always afford to buy whatever is for sale in its own currency, then the natural question is to say, what are the limits? Surely you can't just have a government go around spending willy nilly and expect no consequences from that. And that is, of course, correct. The limits to government spending are on the real side of the economy not on the financial side. The risk isn't that the government will run out of money. The risk would be that the government would spend too much into an economy that's already operating too close to full employment. So, if there aren't extra resources available, lying around, unused labor, capital, raw materials. If you want to do infrastructure, you want to build high speed rail, fix bridges and roads, and that sort of thing. And you come up with a big ambitious plan to do that. You say the government is going to spend hundreds of billions or even trillions of dollars in order to fix crumbling infrastructure, modernize the infrastructure. The risk would be that you start implementing that infrastructure investment program in an economy where you don't have construction workers, you don't have engineers, you don't have architects. You don't have steel and concrete and machines to move things around. If the economy is already using up all of those things, the government can't come in and take them and put them to work without creating an inflation problem. So the risks are always on the real side of the economy. The government is resource-constrained not finance-constrained.

acTVism:

What causes a currency to go down (devalue)?

SK:

Lots of things can cause the value of a country's currency to fluctuate because, of course, it's a function of global supply and demand at any point in time, so currency values are always moving around. What you tend not to see are countries that are running very healthy macroeconomic policies where there's high levels of economic growth, high levels of employment, broadly shared prosperity. A good economy tends not to be associated with a weak currency.

So you wouldn't expect the risk of running policy according to, let's say, MMT principles to result in a weaker currency. What's interesting is that so many countries seem to be confused about what they want in their currency. Do you want a strong currency? Sometimes the US will talk up strong dollar policy. OK. And yet, at the same time, our leaders here will often

complain about China keeping the value of its currency artificially low. I wonder what is it you want? Do you want the dollar to weaken against the Chinese currency or do you want a strong US dollar?

And what happens with these concerns about the value of the currency is usually a preoccupation with a country's trade balance. So if you're really interested in orienting your own economic policy and your own economy around producing goods and services that go to the rest of the world, then you tend to be preoccupied with the value of your currency. Because you say I want my currency to be competitive so that the rest of the world will want all my stuff, so that our people can work and produce and we can supply to the rest of the world. So countries that depend on demand for their goods and services from other countries to generate the employment they're looking for usually like the idea of having their currency get weaker. But if you were running your own domestic policy oriented to achieve full employment in your economy you wouldn't have to worry so much about whether other countries are going to create demand for your products and create employment, and then you wouldn't be so preoccupied with the value of your currency. You'd want to run your economic policy to create full employment at home, domestically, produce as much as it's possible to produce, using all the resources that are available, and in a sense, ideally keep as much of it as you can at home and allow it to be consumed domestically to raise standards of living.

END