GMO

VIEWPOINTS

WHY DOES EVERYONE HATE MMT?

Groupthink In Economics

James Montier | March 2019

EXECUTIVE SUMMARY

Modern Monetary Theory (MMT) seems to provoke a visceral reaction amongst the 'great and the good' such as Rogoff, Krugman, and Summers. However, when reading their criticism I am often left with the impression that they haven't actually bothered reading anything on the subject of their critique. Rather, they seem to prefer to knock down straw men based on massively caricatured paraphrasing, and by using name-calling and scary (but empty) stories to make their case. These are not the actions of people interested in open and honest debate, but are more reminiscent of the actions of 'mind guards' in defense of groupthink. In my experience, MMT provides a much more accurate and insightful framework for understanding the economy than the precepts of neoclassical economics.

GIVEN THE OUTPOURING OF ARTICLES (NOT TO MENTION TWEETS, ETC.) IN THE LAST FEW WEEKS YOU WOULD BE HARD-PRESSED NOT TO HAVE HEARD THE TERM MODERN MONETARY THEORY (MMT), OFTEN ACCOMPANIED BY WORDS LIKE MADNESS, NONSENSE, MESS, GARBAGE, AND EVEN VOODOO. Such is the visceral reaction that MMT seems to produce amongst the 'mind guards' of standard economics.

As I have noted before, I was fortunate enough to have gone to university a long time ago when a pluralist approach to economics was still the norm, before neoclassical hegemony really took grip. As such, I am used to exploring differing schools of economics, but this tradition is largely extinct today. Instead economics seems to be taught as if it were a 'hard' science.

Ultimately I have come to judge economic theories by their usefulness at framing and explaining the world, not their mathematical elegance. For me an economic approach must help me understand the world, and provide me with some useful insights (preferably about my day job – investing). On those measures let me assure you that MMT thrashes neoclassical economics, hands down.

Many of the negative articles I've read about MMT use the tried and tested method of setting up a straw man purely for the purposes of knocking him down. So, to avoid confusion, I will lay out a simple and straightforward description of what MMT is, or at least what I believe the most important elements of MMT are.

1. **Money is a creature of the state.** Money is effectively an IOU. Anyone can issue money; the trouble is getting it accepted. The ability to impose taxes (or other obligations) makes a country's 'money' valuable.

2. **Understanding the monetary environment is vital.** The monetary regime under which a country operates matters. Any country that issues debt only in its own currency and has a floating currency can be thought of as being monetarily sovereign. This means it cannot be forced to default on its debt (i.e. the U.S., Japan, and the UK, but not the Eurozone or most emerging markets).

3. **An operational description of the monetary system is critical.** Understanding that loans create deposits (which in turn create reserves, aka endogenous money) is a much more realistic starting point than the mainstream view that

deposits create loans. For example, knowing that government deficit spending creates reserves and drives down interest rates is vital to understanding Japan's bond market.

4. **Functional finance, not sound finance.**[1] Fiscal policy is much more potent than monetary policy. Fiscal policy should be aimed at generating full employment while maintaining low inflation (rather than, say, achieving a balanced budget position). A Job Guarantee scheme is an example of a useful policy option to effect this outcome (acting like a buffer stock in a commodity market) in the eyes of MMT.

5. **Limits are real resource and ecological limits.** If any sector of the economy pushes it beyond the limits of capacity, then inflation will result. If a government spends too much or taxes too little, it can create inflation, but there is nothing unique about the government sector in this regard. These are the limits that matter – people, machines, factories – not 'financing' constraints.

6. **Private debt matters.** Even in a monetarily sovereign state, private debt matters. The private sector cannot print money to repay its debts. As such, it has the potential to create a systemic vulnerability. Think Minsky's financial instability hypothesis: stability begets instability.

7. **Macro accounting (Godley style) keeps us honest.** One sector's debt is another's asset. So, the government's debt is the private sector's asset. Understanding how one sector relates to another using a sectoral balance framework is very helpful, as is understanding the Kalecki profits equation, or the way reserves work in a financial system. Accounting isn't glamourous and identities shouldn't be taken as behaviours, but they can help us spot unsustainable situations.

There you have it – my attempt to succinctly describe the core of MMT. Just under 400 words… hopefully short enough to satisfy even the most attention-challenged.[2]

Now let's have a quick look at some of the things that have been said by the great and the good and see how they map against this simple summary.

I'll start with Ken Rogoff's "Modern Monetary Nonsense".[3] This piece has very little to do with MMT at all as far as I can tell. His most serious point seems to be:

> The U.S. is lucky that it can issue debt in dollars, but the printing press is not a panacea. If investors become more reluctant to hold a country's debt, they probably will not be too thrilled about holding its currency, either. If that country tries to dump a lot of it on the market, inflation will result.

A similar sentiment is offered by Larry Fink, CEO of BlackRock, who said of MMT:

> That's garbage. I'm a big believer that deficits do matter. I'm a big believer that deficits are going to be driving interest rates much higher and could drive them to an unsustainable level.[4]

Paul Krugman has adopted the same stance:

1
Functional finance is an economic theory that states that government should finance itself to meet explicit goals, such as taming the business cycle, achieving full employment, ensuring growth, and low inflation. Sound finance theory posits that fiscal policy should have a minimum range of operations and that budgets should be balanced over some period.

2
For those interested in reading more on MMT I would suggest L. Randall Wray's excellent Modern Money Theory: A Primer on Macroeconomics for Sovereign Monetary Systems, Springer, 2nd edition (2015).

3
https://www.project-syndicate.org

(Stephanie) Kelton seems to claim that expansionary fiscal policy…policy that pushes the IS curve out, will lead to lower, not higher interest rates. Why?

It seems as if she's saying that deficits necessarily lead to an increase in the monetary base, that expansionary fiscal policy is automatically expansionary monetary policy. But that is so obviously untrue – think of the loose fiscal/tight money combination in the 1980s – that I hope she means something different. Yet I can't figure out what that different thing might be.[5]

An understanding of how the monetary and fiscal system actually works reveals this to be, to borrow Rogoff's term, nonsense.[6] In fact, when a government spends it simply tells the central bank to credit the government's account with funds (created by keystrokes). Similarly, when a government taxes, these funds eventually end up as a credit to the government in its central bank account.

Ergo, when a government runs a fiscal deficit, it creates more money than it receives (by definition). This money is then used to purchase goods and services, so the central bank transfers money from the government's account to the reserve account of the bank with which the sellers of goods and services happen to hold their accounts. This creates excess reserves at the bank. No bank willingly sits on excess reserves, and so money is lent out in the interbank market. This has the effect of lowering the interest rate towards zero (or to the level that the central bank pays on reserves).

Bonds are issued to 'mop up' these reserves and help the central bank hit its target. Because the Fed pays interest on reserves, there is actually no need to issue bonds to help achieve its target at all these days (albeit this a new state of affairs given the Fed has only paid interest on reserves since 2008).[7]

Larry Summers takes up the mantle here:

Contrary to the claims of modern monetary theorists, it is not true that governments can simply create new money to pay all liabilities coming due and avoid default. As the experience of any number of emerging markets demonstrates, past a certain point, this approach leads to hyperinflation.

Frankly, Summers makes some embarrassing errors in his analysis and one might reasonably conclude that he hasn't actually bothered to read anything that MMT economists have actually written. The first half of his statement is just flat out wrong for a monetarily sovereign nation such as the U.S. The second half tries to use nations that don't fit the criteria as a scare story for those that do. As noted above, most emerging market countries are not monetarily sovereign. They generally issue debt in multiple currencies and often have fixed exchange rate regimes, thus violating the conditions outlined above. These markets therefore offer no evidence of any relevance to the U.S. Hyperinflations, which I have addressed previously at length,[8] are generally characterized by three traits: 1) large supply shock; 2) big debts in a foreign currency; and 3) distributive conflict. The really odd thing is that Summers once knew all this.[9] Back in 2014 he noted,

We have a currency we print ourselves, and that fundamentally changes the nature of the macroeconomic dynamics in our country and all analogies between the United States and Greece are, in my judgment, deeply confused.

4
https://www.bloomberg.com
5
https://www.nytimes.com
6
For a much more robust treatment on this topic see James Montier (January 2016), "Market Macro Myths: Debts, Deficits, and Delusions", a GMO white paper available at www.gmo.com.
7
https://libertystreeteconomics.newyorkfed.org
8
See James Montier (February 2013), "Hyperinflations, Hysteria, and False Memories", a GMO white paper available at www.gmo.com.

Sadly, the behaviour of the great and the good is far from exemplary in terms of economic debate. Terms like mess, foolish, fringe, nonsense, and voodoo alongside fear-mongering mentions of hyperinflations may make for an exciting story but they do little to advance the debate. In fact, the use of these words and the generally dismissive (but thoroughly unsubstantiated) nature of these articles appear to be typical of the output of those suffering from groupthink.

The term 'groupthink' was coined by Irving Janis in 1972. In his original work, Janis cited the Vietnam War and the Bay of Pigs invasion as prime examples of the groupthink mentality. However, modern examples are all too prevalent.

Groupthink is often characterised by:

- A tendency to examine too few alternatives;
- A lack of critical assessment of each other's ideas;
- A high degree of selectivity in information gathering;
- A lack of contingency planning;
- Poor decisions are often rationalised;
- The group has an illusion of invulnerability and shared morality;
- True feelings and beliefs are suppressed;
- An illusion of unanimity is maintained;
- Mind guards (essentially information sentinels) may be appointed to protect the group from negative information.

The failure in some cases to even bother to read – let alone understand – the elements of MMT coupled with name-calling suggests that the great and the good are acting more like mind guards (defending a broken orthodoxy) rather than academics evaluating an idea on its merits. A truly sad state of affairs.

James Montier
Mr. Montier is a member of GMO's Asset Allocation team. Prior to joining GMO in 2009, he was co-head of Global Strategy at Societe Generale. Mr. Montier is the author of several books including "Behavioural Investing: A Practitioner's Guide to Applying Behavioural Finance"; "Value Investing: Tools and Techniques for Intelligent Investment"; and "The Little Book of Behavioural Investing." Mr. Montier is a visiting fellow at the University of Durham and a fellow of the Royal Society of Arts. He holds a B.A. in Economics from Portsmouth University and an M.Sc. in Economics from Warwick University.

9
Larry Summer: We Print Our Own Money
(https://www.youtube.com)