real-world economics review, issue no. 89
subscribe for free

The sleights of hand of MMT

Anne Mayhew[1] [University of Tennessee, USA]

I count myself as one of those friendly critics who applaud several of the major MMT contributions to our understanding of the modern American economy. Among these contributions are the emphasis put on

- the endogeneity of money;
- the importance of using of a flow-of-funds approach in analysis of the macroeconomy;
- detailed descriptions of how the FED (Federal Reserve System) actually operates, details usually missing from texts.

And from these three emphases the central conclusion of MMT is that the availability of space for fiscal expansion is larger than commonly understood. These three emphases are used to construct a forceful rejection of the argument that financial constraints can require austerity in economies with unused non-financial resources. Although much of the analysis has been focused on the U.S. economy, the MMT attack on austerity policies as necessary also has much wider application. This I also applaud.

I am, however, a critic, because in their pursuit of policy relevance, MMT advocates too often offer apparently simple solutions to complex issues of political economy. That they do so in the cause of political relevance and journalistic attention does not absolve them of responsibility for over simplifying debate about very serious economic issues. My criticism, and I suspect that of many others, is somewhat difficult to articulate because it rests upon the failure of MMT advocates to use, or at least fully use in practice, the very foundational ideas for which I applaud them. That is, in carrying out their analysis, MMT advocates often come ever so close to denying the endogeneity of money; they use a severely truncated form of flow-of-funds analysis; they do not employ an accurate description of the relationship of the FED to the rest of government. In each of these three cases sleight of hand is used so that it is difficult to pinpoint the exact difference between foundational proposition and analysis/prescription in practice. Now you see it, now you don't is the lasting impression that I, a friendly critic, often take away from arguments about the importance and validity of MMT. I do not mean to suggest that the MMT advocates are deliberately duplicitous. Instead, I suggest that in their understandable zeal to make policy makers and the public understand how unnecessary governmental austerity most often is, the subtleties of the foundational principles are elided in the interests of journalistic simplicity.

In the pages that follow I will try to explain my understanding of these sleights of hand and discuss why they matter. There is now an enormous literature from advocates of MMT and from their critics, friendly and otherwise. In this essay I do not say anything that has not already been said by Lavoie, Palley, and others.[2] My intent is to try to explain why I as a heterodox and Institutionalist economist continue, after a long struggle with the writings of MMT advocates and their critics, to find MMT both appealing and yet lacking.

---

[1] Professor Emerita, University of Tennessee.
[2] I also thank Sherry Kasper, Chris Brown, and Eric Hake for our discussions about MMT and for their useful suggestions about the arguments of this essay.

In writing this essay I have relied heavily upon the recently published *Macroeconomics* by William Mitchell, L. Randall Wray, and Martin Watts, which I take to be the current definitive statement of MMT. In some cases, as noted in citations, I have supplemented this text with passages from recent email discussions.

Is money really endogenous in the MMT model?

There is, especially in political statements made by MMT advocates, a built-in conflict between true money endogeneity and the desire to make money provision the lever by which governments can achieve the macroeconomic goals of full employment and relative price stability. There is no doubt that Randy Wray, probably the leading spokesperson for MMT, is, and has been throughout his scholarly career, an advocate of the idea that the flow of money through economic systems is determined by the actions of multiple actors within the system rather than policy makers alone. This is an idea that has been around for a century or more and an idea that played a central role in American Institutionalist thought (Mitchell, Copeland, Dillard). And yet, this idea has been eroded in practice by the centrality in MMT writing of the idea of a special relationship between money and government. This erosion makes it appear, or perhaps makes it out to be the case, that money, and the ease with which it is available, can be determined by government. But that is inconsistent with true endogeneity.

The first bit of sleight of hand often used in MMT arguments to get around this inconvenient reality has been an emphasis on Chartalism, which is the thesis that money originates with government. Chartalism has been offered by Wray and others as an alternative to the "barter story" that is often to be found in standard textbooks, a story in which money is initially used as an efficiency move in imaginary economies organized by market exchange. While I completely agree that the barter story is wildly inaccurate as a description of human history, it has long been a puzzle to me why Wray and others have been insistent on some form of Chartalism and insistent on searching for the origins of money at all[3] However, Chartalism remains closely associated with MMT and this makes some sense if it seen as part of a move to establish a special relationship between the state and the flow of money. Assertion of a special relationship between money and the state is crucial to the sleight of hand required to make money endogeneity and central bank control of money consistent.

In their text, Mitchell, Wray, and Watts also assert a special relationship by, in effect, equating determination of a unit of account and issuance of currency denominated in that account (p. 134). Whereas in the barter story, gold or other precious metal serves as the backing for money used in exchange, in the MMT account, after a unit of account is determined, the national government then gives *the* "backing" to the money by accepting the fiat currency in payment of taxes. Of course, it is true that acceptance of payment of tax obligations provides some "backing," but it is also true that dollars in the U.S., pounds in the U.K. and etc. are "backed" by the willingness of businesses and others to accept them as payment. To single out the power of taxation as the primary source of acceptability of our dollars or pounds or pesos in their various forms is to use a logical relationship to establish causal sequence: first taxes give value to dollars and then dollars have value in other uses. It is beyond the scope of

[3] Actually, in the new MMT text the word Chartalism does not appear in the index and in the chapter on "Economic History and the Rise of Capitalism," the authors say that "money's origins are not really known" (Mitchell, Wray, Watts, p. 39). However, in arguing the case for MMT in a recent exchange on the email list AFEEMAIL, Wray continues to refer to the "state theory of money", Chartalism, as an important part of MMT (May 4, 2019).

this essay to provide a detailed explanation of why this is not an historically accurate account of the development of the various units of account and of banking in the western world. Suffice to say that it is not good history to say that first governments established units of account, then they taxed, and then money denominated in the chosen units had value. In the U.S., in the U.K. and generally in Western history the development of units of account and the growth of monetization were more or less simultaneous processes. In Western Europe, the growth of nation states and of taxation followed.[4] In MMT it is, however, important to simplify the actual historical process so as to give primacy to government in determining the supply of money.

The importance of Chartalism in MMT arguments also has the effect of tying modern money to the idea of money as physical, storable stuff. The fact is that modern money is as non-physical as it gets. Even though this is widely recognized to be the case, treatment of money as "liquidity," as a liquid that flows through the economy serves to reinforce the idea of money as stuff. Morris Copeland, who created the moneyflows accounts that in the U.S. became the FED-published flow-of-funds accounts, argued that money in the modern world should be thought of as being like electricity. Electricity materializes only when someone turns on a switch. Until that happens electricity does not exist even though the capacity to produce it is there (Copeland 1952; Mayhew, 2010). Electricity is energy as is money in almost all of its modern forms.

By relying on Chartalism MMT advocates carry over the idea of money as stuff and simply do not go far enough in saying that it isn't until it is. The common claim that the FED injects money into the economic system simply makes no sense and MMTers should say so. *Reserves,* meaning the capacity to spend, increased but the amount of money does not increase. Money is measured by spending in our economies where agents draw on pre-existing lines of credit (including credit cards) to finance payrolls, home improvements, financial assets, or whatever.

In effect, MMT advocates, by adopting a state money story, and by using sleight of hand to convert money into a physical thing, convert MMT into a form of monetarism while still allowing its advocates to play lip service to endogeneity. It comes closer to the truth to say that in commercial (monetized) economies a diversity of monies is used, with state authorized money often having greater legitimacy in times of economic turbulence. [5] The history of

[4] Actually, in the U.S. the dollar was established as the official unit of account as part of the breakaway from English rule. The use of a unit of account known as the dollar was common before the official act in 1792 but referred to the "pieces of eight" that made up the widely circulating thaler/dollar earned by trade with Spanish colonies. Mitchell, Wray, and Watts refer to the experience of the U.S. colonies to support their contention that taxation gives value to money and in the case of the bills of credit issued by the various colonies this was true. There were competing monies circulating in the colonies and the bills were issued to pay for specific projects and retired as taxes were collected. Care needs to be taken in generalizing this American colonial experience.

[5] Bell (2001) surveys some aspects of monetary history and of the history of thought about money to argue that state authorized money must necessarily be the most important of monies because of the primacy of the use of money to pay taxes. My statement that state authorized money often has greater legitimacy in times of economic turbulence differs from Bell's conclusion in that I do not think or assume that the ability to pay taxes with a particular form is the determinant of legitimacy. In fact, I have often thought it amusing to consider that the most statish of all state monies in the U.S. – the Federal Reserve Notes that constitute our cash – cannot be used to pay taxes. Internal Revenue forms say quite explicitly that cash should not be sent in payment of tax obligation. This is one indication that there is, in MMT literature, an underlying confusion between establishment of unit of account and the legal standing of different contractual forms and the legal enforceability of various kinds of contracts that bedevils discussion of just what it is that constitutes "state money." But analysis of that confusion goes well beyond the scope of this paper.

Central Banking is in many ways a history of state efforts to control diversity and to alleviate the panic that results when there are runs from less to more legitimate forms of money/credit.

Truncating the flow-of-funds analysis

MMT uses a sectoral balances framework, which, with some manipulation, can be made consistent with either the national accounts that are standard in textbooks or with a flow of funds approach. Mitchell, Wray, and Watts credit Lawrence Ritter in the U.S. and the Cambridge Economic Policy Group in the U.K. with development of this approach. An earlier version developed by Morris Copeland with the guidance of Wesley C. Mitchell, founder of the NBER, formed the basis of the flow-of-funds accounts that are now issued quarterly by the Federal Reserve (Copeland, 1952). To understand the importance of a true moneyflows analysis and the difference between such analysis and the truncated sectoral balances approach of MMT, it is useful to review a little history.

What Copeland, did was to trace the flow of funds, where funds are defined as whatever form of credit/money is used, to complete transactions. (Note that completion of transactions defines money in this analysis.) Payers and recipients of funds are grouped into sectors: households, businesses, governments, foreigners. In Copeland's moneyflow analysis there was no imputation as there is in national income accounting. The funds had to move from one economic unit to another to be counted. Nor were non-paid but "accrued" sums included. Funds, again including both "money" and "credit" had to actually change hands to be counted.

While it was true in this Copeland model that what was paid always equaled what was received, it was also true that the analysis gave a good sense of the ability of the different sectors to take financial actions in the future. In other words, Copeland's moneyflow analysis was a way of foretelling the future rather than a simple snapshot of the present. The portfolio of a sector is treated as a major determinant of the ability of that sector to borrow and spend more or of a need for retrenchment. Here is the way Copeland explained it. At any time, the different sectors may be bulls (expanding spending), bears (retrenching), or sheep (just going along for the ride),

> "…according to the way they exercise discretion over their ordinary expenditures, and a fourth class as influencing the moneyflows of other transactors (discretion modifiers). The first three classes are nonoverlapping; together they account for all transactions… *The composition and relative importance of these three classes of transactors change from one period to another.* The fourth class of transactors overlaps the other three. Bull, bears or sheep may influence the money flows of other transactors. The Federal government and the banking sector are important discretion modifiers" (Copeland, 1952, pp. xxix-xxx; italics added).

What this means is that the household sector as well as the business sector could attempt to borrow more and if the banking sector is willing, become bulls. Particularly in an economy in which it has become commonplace for households to have credit cards and lines of credit, and as was true up until 2008, easy access to second mortgages, households can become quite bullish, or, as in this summer of 2019, worrisomely bearish.

I am sure that MMTers would agree, but their truncated form of sectoral flow analysis does not lend itself to emphasis on this point. MMT sectoral analysis, based as it is upon the amalgamation of national income accounting practices with a flow of funds analysis, becomes a statement about what must be true at any given level of income at which a statistical snapshot is taken: GDP = C + I + G + NX = C + S + Tnet + NX.[6] Mitchell, Wray and Watts write that:

> "Importantly, transactions within the private domestic sector do not alter the net financial position of that sector overall. … The only way the private domestic sector can increase its net financial assets overall is through transactions with the government or external sector, for example, by acquiring a government bond (or foreign corporate bond). These two points are key MMT insights" (p.95).

In the MMT text, Mitchell, Wray and Watts give almost no attention to the important role of consumer agency and, while they do talk of fluctuations in business investment expenditures and causes of those fluctuations, those too take a backseat to the role of government expenditures.

The implication of the statement that, "transactions within the private domestic sector do not alter the net financial position of that sector overall" is that households and businesses will adjust to what government does. There may be shifts in net flows as between the household and business sectors but it is **G**overnment that will determine the level of national income.

Partly from a failure to recognize the important difference between a thorough flow-of-funds analysis and the National Income and Product Accounts, but also from an understandable desire to show what the government sector **can** do, government is put in the driver's seat. Mitchell, Wray, and Watts are careful to say that the flow of funds approach is" based on accounting principles rather than being a behavioral (theoretical) framework for understanding…" (p. 96). But throughout the text and in much of the other writing of MMT advocates, their sectoral flows analysis becomes, even if by default, the behavioral framework that is available. The reasonable conclusion is that Government will be the sector that will determine the level of national income, the level of employment, and how rapidly the overall price level will rise or fall. The private sector plays a secondary role in this analysis. Sleight of hand is involved in using an apparently sound analysis to downplay the importance of non-governmental sectors.

MMT analysis of the government sector

Having created a framework in which government is the sector of the economy that can and does determine the level of GDP, analysis of that sector should assume great importance for MMT. Without doubt, proponents of MMT have contributed greatly with their careful descriptions of the actual processes whereby the FED carries out the transactions that are

[6] Truncation of Copeland's moneyflow analysis and downplaying of its importance began long before the current version of MMT was created. It began when the Federal Reserve Board absorbed Copeland's moneyflows project and began to make his flows consistent with the income and product accounts that had become the primary source of macroeconomic information for policy makers and in textbooks. For a brief summary of this process see Taylor 1991. And, for a discussion of the difference between the Godley and Lavoie flow analysis upon which MMT is based and that of Copeland, see Chapter 2 of Godley and Lavoie (2007).

central to FED involvement in the U.S. economy. These are the “monetary arrangements” that are at the center of MMT analysis according to Mitchell, Wray, and Watts (p. 13).

However, and in spite of these useful descriptions, the MMT treatment of the government sector is seriously inadequate. The first, and most serious, reason for this has to do with the almost total absence of any discussion of the actual processes whereby federal government decisions to spend or to tax are made. That is, there is an almost total lack of attention to fiscal policy formation and to the political context in which such policy is formed.

In an AFEEMAIL exchange that I had with Wray (May 4, 2019), he responded to my statement that I was puzzled by the lack of attention given to fiscal policy by writing:

> “We DO NOT (caps in original) emphasize monetary policy (as normally defined) and indeed argue not only is it fairly impotent but that we do not even generally know if the FED is stepping on the gas or the brake. Our emphasis is and always has been on fiscal policy. I simply cannot understand where you got this idea [that MMT ignores fiscal policy] from. Our answer is “spend more”. Why do you see that as monetary policy?” (AFEEMail, May 4, 2019).

It is true that Wray, Kelton, and other MMT advocates have proposed a Job Guarantee program and more recently a Green New Deal, both designed to attack directly the problem of unemployment while also achieving other worthwhile goals. But, to date, most of the MMT analysis has focused on the affordability of such programs rather than on the complexities of getting such programs through the Congress that holds the power of the purse and especially upon the complexities of getting such programs adopted in the federalist system of the U.S. I realize that analysis of the difficulties of getting expansionary spending programs adopted in the U.S., and in many other countries as well, requires venturing into the realm of political economy but this is not usually an area deemed beyond the scope of Institutional and heterodox analysis.

In the U.S. the Congress-imposed federal debt ceiling has been used repeatedly to argue against additional Federal spending and has put ability to pay at the rhetorical center of policy formation in Washington D.C. The adoption of austerity measures as necessary in several western European countries in recent years has further increased the importance of the MMT message that ability to pay is not the serious constraint that many have argued. Nevertheless, if MMT is simply about the ways in which monetary arrangements can accommodate fiscal policy, this needs to be made clearer. If it is really about fiscal policy the fuller analysis of the conflicts that have rendered Congress unable to take forceful fiscal action is needed. It seems reasonably clear that fear of breaching the debt ceiling in the U.S. is as much an excuse as cause of Congressional failure to address structural unemployment and other chronic issues. Focus on the excuse is an inadvertent sleight of hand that results in lack of attention to the real problems.

But, set that complaint aside and consider instead some of the other peculiarities of the MMT argument that raise doubts in my mind about the adequacy of their analysis. The first of these has to do with alleged special characteristics of the government sector. Government is said to be unlike actors in other sectors because it does not need to tax in order to spend. This is true but is it not also true of other actors in the economy? Consumers spend by using credit cards and pay down their balances when they get paid at the end of the pay period. Business firms buy goods on credit in anticipation of selling those goods and repaying their debts.

I would agree that the Federal government (and for that matter State governments) have a longer leash than most consumers and many (though apparently not all if Amazon and Uber are a good guide) business firms but the claim that the government sector is totally different in being able to spend without prior receipt of revenue seems exaggerated. Advocates of MMT argue that the source of the longer leash possessed by national governments derives from the fact that a sovereign nation cannot run out of its own currency. This is logically true.

But the institutional reality is that sovereign governments borrow to spend an amount that exceeds tax revenues for the accounting period. Of course, this is human-created convention but that does not make it less important for the same is true of all of the other organizational patterns, rules, and laws by which we live our lives. And in the real world in which we live, the borrowing power of the state depends on the willingness of portfolio controllers to absorb government debt issues. The MMT argument is that the gilt-edged status of government issues is explained primarily by the powers of monetary sovereignty. The debt issues of monetary sovereigns are, for all intents and purposes, default-proof, because the sovereign is always in a position to create the stuff in which its debts are payable. The MMT argument seems to be that portfolio controllers understand this, which provides a running insurance policy against a speculative run on government debt issues.

It seems reasonable to think that confidence in the U.S. dollar now and in recent decades depends more on the fact that the U.S. government has legal taxing power on a $20 trillion economy. This is undoubtedly reinforced by the evolution of the FED's role as market maker, or buyer of last resort, in secondary markets for government issues. That is, portfolio controllers can normally count on the FED to guarantee the liquidity of government issues and maintain their spot prices in some narrow range.

But it is important to remember that MMT analysis has developed in the U.S. of a particular time. Because the U.S. dollar has been the international reserve currency since the end of WWII, the U.S. has had a great deal of policy space. Add this to the size and relative stability of the U.S. economy over this period and it does appear that there is no real limit to government indebtedness. However, there is no reason to believe that the dollar will continue to be the reserve currency forever. There may well be a long and messy period when the dollar is replaced by another currency or other currencies. This is what happened during the interwar years as the dollar replaced the British pound. In such a period the policy space will shrink and the ratio of Federal government spending to Federal taxation may assume an importance that it does not currently have. It is for this reason that I am uneasy by the tone of MMT advocates who seem to be arguing that there simply can never be a reason to worry about the size of sovereign debt in a sovereign nation. MMT analysis makes me, as an Institutionalist who finds overwhelming evidence of continuing change and evolution in economies, very uncomfortable because of a failure to consider the historic specificity that gives rise to their confidence that the debt issues of sovereign nations are default proof.

Finally, I also worry about something that is a little harder to articulate. Even in the currently tattered U.S. democracy there is a pervasive sense that the government should be accountable to its citizens and should be subject to most of the same laws and constraints that apply to ordinary citizens. To say that government debt, however the funds raised through that indebtedness may be spent, is not a threat is inconsistent with this most basic and pervasive sense. Most of us, even students in introductory classes in economics, know that it is not a good idea for households to accumulate substantial debt to pay for lavish vacation trips even though it may be quite sensible to borrow to buy a house or pay for education. So too do we all recognize that business firms should incur debt if there are good opportunities for investment for future production, but would be unwise to borrow for frivolous expenditures. So, it is with government expenditures and the taxes that we use to balance the accounts in our accounting dominated society. Citizens want and should want to know how the accounts of government add up at the end of each accounting period and should want to know how that money is being used. To the extent that MMT downplays the importance of such accounting when it is used to limit government, they muddy rather than clarify important public discussion of how best to use the powers of government. I do not accuse MMT advocates of saying that money spent for tax relief or redundant defensive weaponry is money well spent. But by focusing almost exclusively on "monetary arrangements" there is also sleight of hand that distracts us from the really crucial issues of the day. It is no compliment to say that this is the same sleight of hand used by deficit hawks who shout that we cannot afford to spend more.

Conclusion

The creators and advocates of MMT are to be applauded for their ability to do what many of us who have spent long hours teaching economics have been unable to do: attract considerable allegiance to the idea that here is room in most modern industrial economies for government-led programs that enhance general welfare. They have persuaded some political leaders and devoted followers that the decade of the 1930s was not unique in providing an opportunity for a public New Deal. For this I applaud them loudly.

My applause for the analytical underpinnings that they use to support these views is decidedly more muted. From my decidedly heterodox and Institutionalist perspective, I see an urgent need for more emphasis on true endogeneity, which means more emphasis on the limited powers that the FED has to determine the performance of the macroeconomy. I also see an urgent need to improve the way in which we teach and talk about the economy so that the nature of modern money/credit is accurately treated. And, I wish for recognition of the historical specificity of the conditions that allow the MMTers to speak of the very large fiscal space for the U.S. government if only they would use it. If the MMTers could add these things I would convert from friendly critic to strong advocate.

References

Bell, Stephanie (2001) "The Role of the state and the hierarchy of money." *Cambridge Journal of Economics* 25 (2), pp. 149-163.

Copeland, Morris (1952) *A Study of Moneyflows in the United States.* Publications of the National Bureau of Economic Research No. 54. New York: National Bureau of Economic Research.

Dillard, Dudley (1987) "Money as an Institution of Capitalism." *Journal of Economic Issues* 21(4), pp. 1263-1647.

Godley, Wynne and Lavoie, Marc (2007) *Monetary Economics: An Integrated Approach to Credit, Money, Income, Production and Wealth.* New York: Palgrave Macmillan.

Lavoie, Marc (2014) "The Monetary and Fiscal Nexus of Neo-Chartalism: A Friendly Critique." *Journal of Economic Issues* 47 (1), pp. 1-32.

Mayhew, Anne (2010) "Copeland on Money as Electricity." *Real-World Economics Review* 53, pp. 52-55.

Mitchell, William, Wray, L. Randall, and Watts, Martin (2019) *Macroeconomics*. London: Red Globe Press.

Mitchell, Wesley C. (1952) Introduction. *A Study of Moneyflows in the United States.* Publications of the National Bureau of Economic Research No. 54. New York: National Bureau of Economic Research.

Palley, Thomas (2019) "What's Wrong with Modern Money Theory (MMT): A Critical Primer." FMM Working Paper. Forum for Macroeconomics and Macroeconomic Policies.

Taylor, S.P. (1996) "From Moneyflows Accounts to Flow-of-Funds Accounts." In Dawson, John C. (Ed) *Flow of Funds Analysis: A Handbook for Practitioners*. Armonk, NY: M.E. Sharpe.

Author contact: amayhew@utk.edu

SUGGESTED CITATION:
Mayhew, Anne (2019) "The sleights of hand of MMT." *real-world economics review*, issue no. 89, 1 October, pp. 129-137, http://www.paecon.net/PAEReview/issue89/Mayhew89.pdf