Are there Spending Constraints on Governments Sovereign in their Own Currencies?
An Answer Based on Modern Money Theory

• **Analytic Framework and the Basis for What Follows**
• **But MMT is a Misnomer**
• **MMT is **Not** Theoretical**
  – It is Simply Descriptive
    • It Describes the Operational Realities of a Modern Monetary System
    • Based on Accounting Identities and Existing Fiscal and Monetary Arrangements
    • It is Economics without Assumptions!
• **The Ideas are **Not** Modern**
  – Can be Found in:
    • G.F. Knapp (1925)
    • J.M. Keynes (1930)
    • Abba P. Lerner (1941)
• **More recently identified with many of us here today**
## Contrasting Views: What is Money?

<table>
<thead>
<tr>
<th>Conventional Economics</th>
<th>Modern Money Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Nature &amp; Origin of Money</strong></td>
<td><strong>Nature &amp; Origin of Money</strong></td>
</tr>
<tr>
<td>– Barter Story</td>
<td>– Authorities Played Central Role in Emergence of Money</td>
</tr>
<tr>
<td>– Emerges Spontaneously</td>
<td>– Unit of Account</td>
</tr>
<tr>
<td>– “Stateless”</td>
<td>– Money Represents a Social Debt Relationship</td>
</tr>
<tr>
<td>– Medium of exchange</td>
<td>– Always Two-Sided</td>
</tr>
<tr>
<td>– Money is What Money Does</td>
<td></td>
</tr>
<tr>
<td><strong>Why is it Accepted?</strong></td>
<td><strong>Why is it Accepted?</strong></td>
</tr>
<tr>
<td>– Gold?</td>
<td>– Taxes Create Demand for Currency</td>
</tr>
<tr>
<td>– Legal Tender?</td>
<td>– Hierarchy or Debt Pyramid</td>
</tr>
<tr>
<td>– Fiat?</td>
<td></td>
</tr>
</tbody>
</table>
"In advanced societies the central government is in a strong position to make certain assets generally acceptable media. By its willingness to accept a designated asset in settlement of taxes and other obligations, the government makes that asset acceptable to any who have such obligations, and in turn to others who have obligations to them, and so on."

-- James Tobin, 1998
The Central Proposition

• **MMT stresses the relationship between the government’s ability to make and enforce tax laws on the one hand and its power to create or destroy money by fiat on the other**

• **Governments that retain these powers can be described as ‘sovereign’ in their own currencies**

• **Among others, the U.S., Canada, the U.K., Japan, and Australia are all sovereign in this regard**

• **So….**

  – How much can a sovereign government spend?
  – Can the U.S. afford Social Security? Medicare? Tax Cuts?
  – Is the current path sustainable?
  – Isn’t inflation going to be a serious problem?
  – Will we bankrupt our children and grandchildren?
  – What if foreigners decide not to buy our bonds?
“The government, just like every American household, has to live within its means.”

-- Ross Perot

The United States government has run “out of money.”

-- President Barack Obama
The Household Budget Constraint

- How much money can YOU spend?
  - Everything you receive (earned and unearned) after taxes
  - Plus everything you can borrow

- When it comes to buying things in the US, there is only one way to make final payment

- High-Powered Money (i.e. government money)

- At the end of the day, every purchase involves transferring government liabilities to the seller
  - EXAMPLE: Purchase a meal with a credit card. Pay your Visa bill with check drawn on your bank. Results in transfer of government liabilities (bank reserves) from your bank to Visa’s bank, and from Visa’s bank to the restaurant’s bank

- YOU are the user of the government’s currency
Is the Federal Government Like a Household?

- Is the Government’s Ability to Spend Limited by its Ability to Raise Money by Taxing or Borrowing?
- NO!
- The Government is the **issuer** of the currency
- Those of us in the private sector have to earn or borrow US dollars **before** we can make payments
- The federal government **must** spend first
- Government spending is not operationally constrained by revenues (tax payments and borrowings)
- The only relevant constraints are **self-imposed**
  - **Debt Ceiling** Rules
  - Treasury **Overdraft**
  - Direct “**Monetization**” by the Fed
How Does the Federal Government Spend?

• By Writing Checks on its Account at the Federal Reserve

• Coordination of Treasury Operations Creates the Illusion that Taxes and Bonds Help the Government “Pay For” its Purchases

• But that is Not What’s Really Going On

• The Government Neither Has nor Doesn’t Have Any Money

• It is Simply the Scorekeeper
What Happens When the Government Spends?

• Treasury Issues a $100 million Check to Halliburton
  • The Fed Marks down the Treasury’s balance  -$100,000,000

• Halliburton Deposits the Check into its Account at BoA
  • BoA marks up Halliburton’s balance  + $100,000,000
  • The Fed marks up the size of Bank of America’s reserve account at the Fed  + $100,000,000

• What are the EFFECTS of the Treasury’s Spending:
  – The Monetary Base increases by $100,000,000
  – The “Money Supply” (M1) increases by $100,000,000

• LESSON: Government Spending creates new money (M1) and leads to an increase bank reserves (HPM)
What Happens When the Government Collects Taxes?

• You write a $5,000 check to the IRS on your account at Wells Fargo
  – Wells Fargo marks down the balance in your account -$5,000

• The IRS deposits the check into the Treasury’s account at the Federal Reserve
  – The Fed marks up the balance in the Treasury’s account +$5,000
  – The Fed marks down the balance in Wells Fargo’s Reserve Account -$5,000

• What are the Effects of Paying Taxes?
  – The monetary base decreases by $5,000
  – The money supply decreases by $5,000

• LESSON: Paying taxes destroys money (M1) and leads to a decrease in bank reserves (HPM)
What If You Pay Your Taxes with Cash?

The government will destroy the money by throwing it in a shredder.
Then Why Bother Collecting Taxes?

- When we pay our taxes (by cash or check), we are merely **returning** the government’s own **liabilities**
- It does not “**get**” anything that it can use to make future purchases
- **So why** does it **bother** taxing us?

**Two Reasons:**

- **To Maintain Demand for Government Currency**
  - Taxes give value to government money
  - They get us all working and producing things in order to earn US dollars
  - **This allows the government to buy things with its otherwise worthless paper**

- **To Regulate Aggregate Demand**
  - Too much spending power causes inflation
  - Too little spending power causes unemployment and recessions
What About Bond Sales?

• Doesn’t the government have to “borrow” to cover any shortfall (deficit)?

• And isn’t there some limit – a “tipping point” – to the amount of money it can safely borrow?

• What if the interest payments become too large?

• What if foreigners (China) decide to stop buying US government securities?
What are Government Bonds?

• Nothing more than a savings account at the Fed

• You part with dollars today and receive your dollars plus interest at a future date

• When the government sells bonds, funds are moved from checking accounts (used to purchase the bonds) into “savings accounts” (called Treasury securities)

• As bonds mature, the ‘debt’ is paid as the Fed shifts the dollar balances from the savings accounts at the Fed (Treasury securities) back into the checking accounts at the Fed (reserve accounts)
The World US Dollar Saving Account
The Issue of Solvency Risk

Stephanie Kelton Associate Professor University of Missouri-Kansas City
Can the Government Run Out of Money?

• The US Government Cannot Run out of Money any more than the Washington Nationals’ baseball stadium can run out of points!

• As Bernanke explained to Scott Pelley on ‘60 Minutes’ in 2009:

• (PELLEY): Is that tax money that the Fed is spending?

• (BERNANKE): It’s not tax money. The banks have—accounts with the Fed, much the same way that you have an account in a commercial bank. So, to lend to a bank, we simply use the computer to mark up the size of the account that they have with the Fed.
“[A] government cannot become insolvent with respect to obligations in its own currency. A **fiat money system**, like the ones we have today, can produce such claims **without limit**.

-- Alan Greenspan, 1997
Then Why are the PIIGS in Trouble?

• If governments can simply create money, then why can’t Greece get a loan?

• All 16 members of the EMU gave up their sovereign currencies in order to use the stateless currency known as the euro

• This means that default risk (i.e. solvency) is a legitimate issue

• Every one of these governments could default on their debts if they are unable to raise enough money by taxing or borrowing from those who already have euros
## They are All *Users* of the Currency

<table>
<thead>
<tr>
<th></th>
<th>Greece</th>
<th>Spain</th>
<th>France</th>
<th>Italy</th>
<th>California</th>
<th>Illinois</th>
<th>New York</th>
<th>New Jersey</th>
<th>Texas</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Population</strong></td>
<td>A2</td>
<td>Aaa</td>
<td>Aaa</td>
<td>Aa2</td>
<td>Baa1</td>
<td>A2</td>
<td>Aa3</td>
<td>Aa3</td>
<td>Aa1</td>
</tr>
<tr>
<td></td>
<td>11.1 Mln</td>
<td>45.6 Mln</td>
<td>62.5 Mln</td>
<td>58.1 Mln</td>
<td>36.9 Mln</td>
<td>12.9 Mln</td>
<td>19.5 Mln</td>
<td>8.7 Mln</td>
<td>24.8 Mln</td>
</tr>
<tr>
<td><strong>Nominal GDP</strong></td>
<td>$342.3 Bln</td>
<td>$1,463 Bln</td>
<td>$2,634 Bln</td>
<td>$2,090 Bln</td>
<td>$1,850 Bln</td>
<td>$633.7 Bln</td>
<td>$1,144.5 Bln</td>
<td>$475 Bln</td>
<td>$1,224 Bln</td>
</tr>
<tr>
<td><strong>GDP per Capita</strong></td>
<td>$30,219</td>
<td>$31,016</td>
<td>$42,091</td>
<td>$34,954</td>
<td>$42,696</td>
<td>$49,124</td>
<td>$58,692</td>
<td>$50,919</td>
<td>$38,575</td>
</tr>
<tr>
<td><strong>Gov. Debt</strong></td>
<td>$377.5 Bln</td>
<td>$931.1 Bln</td>
<td>$2,000 Bln</td>
<td>$2,333 Bln</td>
<td>$89.0 Bln</td>
<td>$24.2 Bln</td>
<td>$56.9 Bln</td>
<td>$31.0 Bln</td>
<td>$12.6 Bln</td>
</tr>
<tr>
<td><strong>Debt/GDP</strong></td>
<td>108.00%</td>
<td>62.30%</td>
<td>76.70%</td>
<td>112.30%</td>
<td>4.81%</td>
<td>3.82%</td>
<td>4.97%</td>
<td>6.53%</td>
<td>1.03%</td>
</tr>
<tr>
<td><strong>Debt/Revs</strong></td>
<td>273%</td>
<td>167%</td>
<td>162%</td>
<td>240%</td>
<td>101%</td>
<td>89.3%</td>
<td>72.9%</td>
<td>108.4%</td>
<td>13.85%</td>
</tr>
<tr>
<td><strong>Debt/Capita</strong></td>
<td>$33,407</td>
<td>$19,795</td>
<td>$31,949</td>
<td>$40,103</td>
<td>$2,412</td>
<td>$1,876</td>
<td>$2,918</td>
<td>$3,563</td>
<td>$508</td>
</tr>
<tr>
<td><strong>Deficit</strong></td>
<td>$21.4 Bln</td>
<td>$174.8 Bln</td>
<td>$133.6 Bln</td>
<td>$115.8 Bln</td>
<td>$18.9 Bln</td>
<td>$17.8 Bln</td>
<td>$11.4 Bln</td>
<td>$12.2 Bln</td>
<td>$0.00</td>
</tr>
<tr>
<td><strong>Deficit/GDP</strong></td>
<td>6.40%</td>
<td>12.27%</td>
<td>7.03%</td>
<td>5.50%</td>
<td>1.08%</td>
<td>2.81%</td>
<td>1.00%</td>
<td>2.57%</td>
<td>0.00%</td>
</tr>
<tr>
<td><strong>Unemployment</strong></td>
<td>9.70%</td>
<td>20.50%</td>
<td>9.50%</td>
<td>9.10%</td>
<td>13.20%</td>
<td>12.20%</td>
<td>9.40%</td>
<td>9.70%</td>
<td>7.50%</td>
</tr>
</tbody>
</table>
Governments in the Eurozone

Greece Does NOT control Euro
Similar Problems Arise with ‘Convertible’ Currencies

• The euro is a fiat currency, but it is not sovereign
  – Governments that use it cannot create it at will
  – This makes Euroland governments users of the currency and exposes them to default risk

• There were also crises in Mexico (1995), Southeast Asia (1997) and Russia (1998)

• In each of these cases, governments had their own currencies, but they pledged to convert them, at a fixed price, into another nation’s currency

• As a result, they became users of their own currencies

• I know of no currency crisis or debt default on obligations issued in a non-convertible, sovereign currency
The US Can Control its Currency ... and its Economic Destiny

There is no REVENUE constraint for government’s that control the money that sits at the top of the hierarchy.
Does that Mean the Government Should Spend without Limit?

**NO!**

- As the economy recovers, spending will need to be regulated to prevent inflation.
- But it is time to stop letting our monetary system limit our range of policy options.
- It is causing unnecessary human suffering.
- It is time for us to recognize the advantages of a modern monetary system.