10 Questions WITH NOTEWORTHY PEOPLE

Stephanie Kelton on Getting Past Our Oversimplified Understanding of Money

by Mary K. Corbin

WHO: Stephanie Kelton, Ph.D.

WHAT: Chair of the Department of Economics at the University of Missouri-Kansas City, research scholar at the Levy Economics Institute, and director of graduate student research at the Center for Full Employment and Price Stability. She is creator and editor of the blog New Economic Perspectives.

WHAT'S ON HER MIND: "As long as the government has promised to make payments in the form of U.S. dollars, it can always make those payments.... There is no solvency problem; there is no financial problem with Social Security. There is, on the other hand, a very serious problem in terms of the way that we understand our monetary system."

PODCAST: Check out our podcast with Kelton at www.FPAnet.org/Journal/Home/PodcastPage.

Stephanie Kelton, Ph.D., has a passion for economics and policy-oriented research, advanced degrees from Cambridge and the New School, and a history as a research fellow at the Levy Institute and the Center for Full Employment and Price Stability. She teaches at the University of Missouri at Kansas City.

If you attended last spring's FPA Retreat or this fall's FPA Experience conference, or know someone who did, you probably heard about the ideas of Kelton and modern money theorists. Her presentations got people talking, in person and online. Some felt that her ideas were game changers with the potential for us to revolutionize our understanding of money and fiscal policy. Others disagreed, passionately, and were left with questions. Kelton recently sat down with the *Journal* to answer some of those questions and some of our own.

1. *You've helped promote the idea that money's origins were not as a medium of barter and exchange but as a medium to demonstrate a social debt relationship. Can you explain why that's important?*

Well, they're not my ideas by any stretch. The research and the literature on this is huge. Most of it is done by people in sociology and anthropology—historians are very good at this. But economists tell this simple story: once upon a time, man conducted his affairs on the basis of barter. As an academic, as a research scholar, it's just embarrassing to have textbooks written with that sort of a story, and to expect your students to believe it. So what I and my colleagues are interested in is telling a more historically accurate story about the origin and nature of money. The reason it's important is that if you tell a simplified story where people start off by bartering, money is always a physical thing, and because it's a physical thing, it is, by definition, finite.

In the modern era, we know that money is created not by going out and finding physical things, but by entering into credit relations, entering into contracts that are based on credit, and money is created essentially out of thin air. If you walk into a bank and ask for a loan, the loan officer doesn't get up and go check the vault to see if they can make a loan today. The loan officer listens to why you want the money, looks at your credit history, your employment history, your assets, decides whether you're a good credit risk. If they conclude they can make a profit by lending to you, they credit your bank account with some amount they keystroke into existence, and that becomes the bank's liability, and it becomes your asset. The bank says, "I acquired this loan, and this is now my asset. I'm going to earn interest on this." It's modern money.

It becomes really important when we get to discussions about what the government can do, because so many programs are neglected, under-funded, and people will say, "We want good schools," or "We want safe roads and bridges," and very often, politicians will say, "We'd like those things too, but we can't afford it." Allowing people to push back against a public official who says, "We'd love to help, but we're all tapped out," is very empowering for the population. That's why we feel it's important to demonstrate that money is not an object, it's not finite, it's not limited. We're not constrained in our ability to do the things we should be doing because there isn't enough.

2. *Do you have an example to help illustrate the difference between a household budget and a government's in a way that people can really wrap their heads around?*

We use this language all the time in our scholarship, and we emphasize that there's a fundamental difference between the household, which can't issue the currency, and the federal government, which can.

Why do municipalities occasionally go bankrupt? Because they're users of the currency, and there can come a point where it's impossible for them to service their debt because they can't get enough dollars to make the payments. Households can go broke, right? Businesses file Chapter 11—they can't get enough of the currency to make good on their liabilities. That doesn't happen with currency issuers. As long as the debts are denominated in their own currency, they can always pay. Maybe it's not intuitive, but it's certainly something that people like Alan Greenspan and Ben Bernanke have publicly declared—there is no way that we can ever be forced to miss a payment, as long as the payments are due in our own currency.

3. *Can you talk a little bit about users of currency; why do users of a particular currency use it for domestic spending?*

Let's take the case of Europe, because it's such a nice example. Before January 1, 1999, nobody used the euro. All the countries had their own individual currencies. The currency that is predominately used is the currency that the government requires in payment of taxes, fees, and fines, and so forth. The government decides the unit in which those debts will be denominated, those tax liabilities will be recorded, and most of the time the government also gives itself the exclusive right to issue the currency that's denominated in that unit.

So when all of these countries got together, the governments agreed; the people didn't agree. This was a mandate, a decision that came from the state. And the people accepted it. Why? Because the government required that this was how payments would be made. Anybody employed by the governments in these nations was going to be paid in the new currency. Anybody selling goods and services was going to be collecting taxes payable in euros. So suddenly everybody had to work with the euro. And that determines what is going to circulate most widely as a medium of exchange within that country's borders.

4. *What are the policy recommendations of modern money theory?*

Well, it depends on the theorist. I mean, MMT is more than an approach. It's a framework for understanding how modern monetary economies work. And it's just an analytical framework. It doesn't necessarily carry with it a concrete set of predetermined policy recommendations. But we recognize that, because governments that issue their own currency are not revenue constrained, the question then becomes, where do you want the government? What do you want them involved in? What do you want them purchasing?

My personal position is to allow the private sector to come as close as it can to achieving full employment. That's the goal for any macro economist. You want to see an economy that operates at its potential. In a market economy, a capitalist economy, you want the private sector to do as much of the heavy lifting as possible. What you'll discover, though, is that in every market economy in the world, the private sector comes up short. It never achieves full employment and sustained production at that level. It might get there on occasion, usually during war, but it doesn't operate at full employment.

So because that carries cost, both economic and social, we think there is a role for government to play. If the economy is not at full employment, there's not enough total demand. Increase spending up to the point that your economy operates at full employment.

You may do that if your politics and your preferences are for tax cuts. Or you might say, "We have a $2.3 trillion infrastructure problem. We need to spend on infrastructure, therefore we need to hire people, put them to work rebuilding roads and bridges and so forth." That is consistent with MMT, whether the spending comes through tax cuts or directly in the form of hiring and spending to rebuild things.

I've agitated, since the start of the great financial crisis, for the government to do three things. It should have cut payroll taxes to zero immediately when we were losing 500,000, 600,000 jobs a month. We should have recognized that state and local governments were hemorrhaging and they needed a huge round of aid from the federal government, the issuer of the currency, distributing funds to the users of the currency, so they could stop laying off public sector employees and adding to the job losses and the economic contraction. And we should have instituted an employment program based on something like the New Deal—kinds of jobs programs that created an opportunity, a transition job—for anybody who wanted to work and wasn't able to find work in the private sector.

5. *So you bring up some of the issues that people really struggle with in these policies. Aren't the dangers of implementing these policies inflationary?*

Economists usually think of inflation as being caused by one of two things. Either it's going to come from the supply side or the demand side.

What I've been describing, what modern money theorists recommend, is that the government use its power to tax and spend to regulate the economy to maintain itself at full employment. And if you're doing that, you should not have inflation coming from the demand side. We call it demand-pull inflation.

I'm not talking about running your economy beyond its capacity, trying to hire more people than want to work, trying to run your factories beyond capacity. We're talking about getting just enough total demand in the economy to keep you at full employment. If you begin to get price pressure and you think it's coming from too much demand, well, then cut government spending or raise taxes or a combination of the two to cool things off.

The other side is the supply side, and in the U.S., our experience with inflation overwhelmingly has come from the supply side, because we don't operate our economy at full employment. We don't have too much spending chasing too few goods. We don't have the demand problem.

6. *If governments manage currency to keep the domestic economy under control, what about foreign investors in a currency, and trade partners, and rates of exchange? It seems like treating currency as an unlimited resource domestically causes problems in the global economy.*

Exchange-rate determination is very complicated. The value of the yen vis-à-vis the dollar or the euro vis-à-vis the dollar doesn't move in any stable, predictable way, even as government budgets expand and contract and economies operate closer [to] or further away from full employment.... You can say that as long as other countries want to purchase goods from you, whoever you are, they are going to have to get your currency to make those purchases.

Let's take China, for example. Why does China have so many U.S. dollars and Treasury bonds? Because China wants to sell its goods and services to the U.S., and it wants to accumulate dollars. As long as that's happening, the exchange value—the U.S. dollar versus the renminbi or the yuan—is going to reflect that the dollar is a valued, desired currency by foreigners. If the rest of the world decided they didn't want to accumulate and hold dollars because they no longer wanted to sell to the U.S., then the dollar would go down in value.

7. *In your conversations with financial planners, what has been a particular area of concern or disagreement that you've heard when you've spoken about MMT ?*

Well, there's just been one, and it is probably largely my own fault because I didn't anticipate the degree of concern with this specific issue. I didn't deal as carefully as I could have with the issue of inflation. MMT economists never, ever use the term printing money because it's a gold-standard term. That's not how governments spend. It's the imagery, and it frightens people. They say, "Oh my gosh, you want more spending; that's going to be inflationary. You're saying we should just print money to do this."

Well, we don't say that. Why would it matter if the increased spending is coming from government spending directly on things, or indirectly through tax cuts? Either way, the economy is going to experience more spending, and that can happen independent of what the government is doing. You could have a consumption boom that's driven by the household sector going out and borrowing and going on a spending spree. That could push the economy, as it did under President Clinton. We had a private-sector-led economic boom that brought the unemployment rate down to 3.7 percent. Inflation was extraordinarily low during that period; productivity growth rates were very high. That is the closest we have come to full employment in decades. It was driven by the private sector, and it wasn't inflationary.

The private sector isn't going to do the heavy lifting right now, because they are already carrying too much debt. If the household sector isn't spending, why would businesses expand, invest, hire more workers? It's not going to come from the business sector, so we're saying that, in an economic environment like this, the government should be cutting taxes or increasing spending or a combination of the two to get the economy to recover and achieve some close approximation to full employment.

8. *So there's a balance sheet approach between the government sector and the private sector. Some research I did for this interview suggested that the government being a net saver—or running a budget surplus—is a negative in MMT. Is that a view you can explain?*

Any economy can be examined by looking at three sectors: the domestic private sector, the domestic public sector, and the foreign sector. Money flows within and between those sectors. MMT emphasizes the balance sheet relationship: for one of those sectors to be in surplus, to be earning more than it's spending, at least one other sector has to be in deficit, spending more than it's earning.

If you think about those three sectors and you recognize that at least one of them has to be in deficit at any point, you say, "Okay, what are my choices?" Option 1: the domestic private sector is going to be in deficit. That doesn't sound like a great thing, to have them spending more than they're earning, because you want them to have positive net balances. So it makes sense to have that sector in surplus.

That leaves two more sectors. Either the public sector is going to run the deficit or the rest of the world is going to run the deficit. In some countries, they get by because the foreign sector runs the deficit. For example, Germany has been able to run government surpluses and keep its private sector in surplus because the rest of the world is running deficits with Germany. In the U.S., we run trade deficits. We can't rely on the rest of the world to prop up our domestic private sector, to keep them in the black. The only way we can keep our private sector in a surplus position, then, is for our government sector to run deficits.

9. *You call yourself a deficit owl as opposed to a deficit hawk or a deficit dove. What is a deficit owl?*

A deficit owl is someone who understands the role of the government's budget in context, who doesn't view it in isolation. A deficit hawk and a deficit dove focus on the fact that the government is spending more than it's taking in, and conclude that it must be bad. Hawks want to reduce deficits quickly, doves want to reduce them slowly. But they both view the deficit itself as necessarily an indication of a government that's not doing the right thing.

An owl sees the government's budget balance with respect to the other two sectors in the economy: the domestic private sector and the foreign sector. The deficit owl understands the stabilizing role the government's budget position plays in offsetting declines in the private sector's budget position.

It redefines what it means to talk about fiscal responsibility. It would not be fiscally responsible, in the view of the deficit owl, to advise policy makers to cut the government deficit, because they understand that it means cutting the private sector's surplus, and no one who understood the deficit in context would advocate for reducing the private sector's surplus. But everyone who advocates government deficit reduction is, by definition, advocating private sector surplus reduction.

10. *Can you explain why governments' use of a non-sovereign currency is a problem?*

Yes, it explains why there is a sovereign debt crisis in Europe, and it explains why these governments cannot deal with the economic crisis, which was a result of the financial crisis that precipitated it. All of these countries turned themselves into currency users. They earn the currency by collecting taxes. The problem is, when your economy is contracting, the amount of money that comes into the state's coffers drops off precipitously, tax receipts decline.

At the same time taxes are falling, a whole range of government payments are automatically increasing, because there are safety programs in place: unemployment compensation, food stamps, the whole range of things the government spends on when unemployment increases. That blows up your deficit. In Europe, these governments have to go out and borrow the euro to cover that shortfall.

What changed with the adoption of the euro is that there was no perception of default risk when the Italian government was borrowing in lira, when the German government was borrowing in deutsche mark… Now, these governments are trying to borrow in a currency that financial markets recognize the governments don't issue, and therefore they might default. So lenders need a higher premium…. There's absolutely no way these governments can sustain their debt when they're rolling it over, refinancing, taking on more and more, and interest rates are going higher and higher.

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