Book Review - The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy

Author: Stephanie Kelton

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Abstract

Conventionally, deficit is understood to be disastrous to a currency and the country itself. However, Professor Stephanie Keltonhas tried to shatter the mythssurrounding deficit through her book titled "THE DEFICIT MYTH: Modern Monetary Theory and the Birth of the People's Economy." She demonstrates that public deficits can be very healthy for an economy provided government spending is properly targeted, leading to faster growth in economy. Through this book review, an attempt has been made to understand the principles underlying the mechanism of using deficit as a growthengine, preconditions for its success and relevant challenges in its implementation.

Key Words: Deficit, Economic Growth, Modern Monetary Theory, People's Economy

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"We can't use deficits to solve the problem if we think of the deficit itself as a problem." Stephanie Kelton

The effects of COVID-19 have been devastating for the world economy. Most of the economies were shut down and frozen to combat COVID-19. After opening of the economies, the governments came up with a series of efforts ranging from direct monetary benefits, tax cuts to stimulus packages to boost the economy. The massive increase in government spending has certainly offered relief to households and businesses. However, it has put a lot of burden on the budgets of the countries resulting in huge government debt. Public debts levels are likely to cross 100% of the gross domestic product (GDP) for the most advanced countries like United States and United Kingdom. Japan's public debt to GDP ratio is expected to grow above 250 per cent. The IMF anticipates that the average debt-to-GDP ratios in advanced economies will rise above 120 per cent.

In the opinion of many mainstream economists, such high debt to GDP ratios will reinforce an increase in taxes and reduction in public spending in future. The increase in taxes will cause decline in consumption spending of households and investment spending bybusinesses. The overall result will be slower GDP growth and stagnation in worker's wages and salaries. Thus, the measures which are being taken to stimulate the economyand take them to the path of recovery, growth and development are likely to boomerang/backfire resulting in economic slump. However, even after decades of policy debate over deficit, public debt and economic slowdown, fiscal policy measures seem to be the only answer to boost the economies.

In this backdrop, Stephanie Kelton's The Deficit Myth, offers an altogether different approach to looking at the deficit, a complete 180 degree turn from how we see it. Stephanie Kelton is a professor of economics and public policy at the State University of New York at Stony Brook. She is one of the key propagators of progressive economics. She is a leading expert on Modern Monetary Theory (MMT) and a former Chief Economist on the U.S. Senate Budget Committee (Democratic staff). She was named by POLITICO as one of the 50 most influencing peoples in the policy debate in America. Professor Kelton advises policymakers and consults with investment banks and portfolio managers across the globe. She is a regular commentator on national radio and broadcast television.

Herein, Stephanie Kelton, has tried to dispel myths surrounding conventional understanding of Deficit as a problem, thereby making a strong case for using deficit as an engine to strengthen economies leading to faster growth.She has tried to explain how government financing really works, and how it interplays with economic policy in a simple, easy to understand language.

Conventionally deficit is understood as disastrous to a currency and the country itself. Kelton shatters the conventional wisdom regarding the deficit that it impedes economic growth and weakens the economy. With a sound theoretical base of MMT, she demonstrates that concerns about deficit are ill-founded and in fact public deficits can be very healthy for an economy provided government spending is properly targeted, leading to faster economic growth. “The Deficit Myth” states that the US Government can create unlimited amounts of money, therefore debt and deficits do not matter.

The subtitle of the book includes “the Birth of the People’s Economy”.People’s Economy refers to “a just and more prosperous world—one that combines ecological sustainability with full employment, well-being, lower degree of inequality, and excellent public services that meet the needs of all”. To achieve the People’s Economy, in the words of Kelton, “we do not need hard choices, technological advances, or arms treaties; we just need to print more money”. It is all within reach if principles of MMT are put into practice properly.

The book is divided into eight chapters.The first six chapters shatter the six primary myths around conventional monetary theory that regarddeficits as anevil playing havoc with a country’s growth, putting it in an inflationary wage-price spiralultimately resulting in slump in the economy. Conventionally, deficit is understood as a sign of profligacy/reckless spending putting burden on future generations, crowding out private investment and making economies like the US increasingly dependent on foreign countries. In addition, increased spending on Social Security and public health programs leadsto a fiscal crisis So, Kelton strategically starts busting our beliefs/myths regarding fiscal deficits one by one. Through this, Kelton lays down the foundation of Modern Monetary Theory. In last two chapters, the deficit has been explained in the right perspective, which according to her is a growth engine. Kelton goes on to explain how deficits can be used for expandinggrowth in difficult times, resulting in a strongerand more balanced economy with reduced inequality and other social ills and prosperity for all, suggesting descriptive and prescriptive policy changes to achieve all this.

Subsequently, Kelton presents the idea of a just society and smashes the 'misguided' goal of a balanced budget. She asserts how the US federal government should freely print money to boost public spending with no concern about deficits.

According to Kelton, in monetary sovereign countries (i.e., countries which issue and control the supply of theircurrency) like USA, UK, Japan, the Government is self-financing, which reduces the need to focus on deficit and public debt. They can never run out of currency. They can print money as much as they like. In the present COVID times, the main threat to an economy is reduced consumption demand from households and investment demand from businesses making a case for deflation and slump in the economy. Inflation is no threat whatsoever. Therefore, they should help the people by way of monetary allowances and tax cuts, to boostdemand for consumer goods. Governments need not worry about deficit. Kelton suggests that the jobs guarantee funded by new money would act as an automatic stabilizer. This will lead to growth in economic activities and create investment demand from businesses. Real concern at this stage will be availability of real resources which can be employed to work, conscious and targeted use of the money so financed through debt for the benefit of general public and not for funding wars etc., and removing bottlenecks in the process. Once the economy begins to recover, policymakers will have to keep their eye on inflation. Kelton argues that taxes enable the governments to provision themselves, to remove inflationary pressures, to alter the distribution of income and wealth, to encourage and discourage certain behaviors. If policy makers can fine tune tax and spending, inflation can be controlled.

With no inflation and no bottlenecks, the governments can work towardsbuilding an economy keeping public welfare at the center. They can undertake investments in infrastructure, healthcare, education, green climate, and programs for public welfare without bothering about how it is paid for.

The book is remarkable in its understanding of MMT. It draws our attention towards some of the important aspects working beneath the conventional monetary theory and is successful in enabling us to see the deficit differently. It shatters two main myths about deficit financing:

- First, Kelton shatters the Household view of making of Government budgets. The conventional story contends that governments work on household model (TAB)S, wherein taxes and borrowing precede spending by the federal government. If government wants to spend more money than what it collects by taxes, it needs to raise additional funds by borrowing from savers.However, unlike households, governmentsare currency issuers, not currency users. Kelton states that monetary sovereign countries like UK, USA need not to worry about deficit as they can never go out of money as they are issuers of currency. Therefore, currency issuer's spending is self-financing. Thus, government's ability to spend does not revolve around the taxpayer's dollar rather the government spends first and then taxes or borrows i.e., issuer model S(TAB) spending before taxes and borrowing. Kelton argues that a tax regime is a tool in the hands of the government that enables it to provision themselves, to remove inflationary pressures, to alter the distribution of income and wealth, to encourage and discourage certain behaviors.The problem of inflation arises not due to increased deficit but due to non-availability of real resources of the economy — workers, materials and so on. When the economy employs too many of these resources, their prices increase. Further, with the fine tuning of taxes and spending, inflation can be controlled. In addition, Kelton suggests a jobs guarantee scheme funded by new money that would act as an automatic stabilizer.
- Secondly, Kelton shatters both the deficit hawk and deficit dove views of public debt. Deficit hawks assert that deficit represents irresponsible spending by the government, and therefore it needs to balance its budget at any cost. Deficit hawks argue that public debt is harmful to a currency and the country. Deficit doves too agree on the same but allow the deficit as a short-term measure to be used for emergencies and overcoming economic crises. Kelton contends that the whole debate is based on the faulty idea that deficits are evil. According to Kelton, we need to change our

perspective and be wiser regarding deficits. Kelton calls herself a 'deficit owl' because owls can rotate their heads nearly 360 degrees for better perspectives and are associated with wisdom. However, deficit is like a double-edged sword. Deficits can be both good and evil. They can enrich a small segment of the population, driving income and wealth inequality to new heights, while leaving millions behind or these can help build an economy provided the expenditures financed by such deficits are properly used forconstructive purposes. Kelton asserts that they can be used to sustain life and build a more just economy that works for the many and not just the few provided the spending isrightfully targeted towards creating businesses and job opportunities for the public at large.

Conceptually, MMT and the suggested policy measures do make senseand they seem to take economies to the path of growth and welfare but the application of the same lacks on twogrounds

- By itself, MMT does not guarantee prosperity and a better economy. MMT prescribes expanding money-financed deficits till achieving full employment and imposing taxes to drain out excess demand in order to prevent inflation. Rather its success is dependent on various presumptions such as availability of balance of real resources which can be used, proper and judicious use of government spending like use of new money to provide job guarantee, and fine tuning of tax and spending just at the onset of inflation. Expecting lawmakers to be able to fine tune tax and spending to control inflation at the right time seems a tall order.
- The suggested solutions might work for the US — and other "monetary sovereigns" like the UK, Japan, Australia, and Canada — act like currency issuers rather than currency users. But there is no solution for majority of the countries of the world which are currency users who must gather money before they spend it. For such developing and underdeveloped countries with no monetary sovereignty and risk of hyperinflation, Kelton's idea of increased public spending, seems to be a far-fetched move. In addition, the effect of such policies followed by "monetary sovereigns" on the currency user countries is not discussed.

In all, it can be stated that the descriptive part of MMT is more appealing: that monetary sovereigns really are currency issuers not users. But the success of prescribed policy measures has a lot of ifs and buts. Therefore,a more rigorous and vigilant study regarding the complexities of present economies and complex maze of constraints upon fiscal deficit and public debt expansion imposed by the financial markets, current account imbalances and exchange rates needs to be done.