CHAPTER ONE

THE MODERN MONETARY THEORY WORLD

At the height of his career, Nicolas Cage was one of Hollywood's highest paid actors—he once made $40 million in a single year. He also had very expensive tastes. He bought 13 houses, two private islands, a private jet, and two castles in Europe, although he never even stayed in one of those castles. In one year alone, Cage bought 22 cars, including nine Rolls-Royces.[1] He also paid $276,000 for a dinosaur skull.[2]

Cage soon found himself on the verge of bankruptcy—he'd depleted his bank accounts and taken on too much debt. In 2009, he couldn't afford to pay an income tax bill and started facing legal issues. Some of his properties were seized and auctioned away by the banks. He reportedly started "taking roles left and right to help pay off his debts."[3] Notably, he took roles in 29 quickly produced, low-budget movies that were never screened in cinemas.

Regardless of your income, you need to be careful about your spending. All households—yours, mine, and Nicolas Cage's—are financially constrained. This means you must make sure to spend less than you bring in. Otherwise, you'll soon find yourself in trouble. Even if banks may help you out—through credit and loans—they won't do so forever.

We tend to think of the government in a similar way. Just like a household, the government must collect enough income—in the form of taxes—to pay its bills. If it doesn't, it risks running out of money. If the government spends more than it collects, it must borrow money from the private sector to bridge the gap. However, many people are afraid that too much borrowing will burden future generations with higher taxes. Moreover, if a deeply indebted government fails to pay its debts, which is known as a *default*, its credit score will go down, and it will find it harder and more expensive to borrow money in the future.

Governments run their budgets like households, so they try to contain their spending and limit their borrowing. For example, the US government sets a limit to the amount of money it can borrow, and the EU imposes a similar restriction to its member countries.

The household view of the government is espoused by politicians all over the political spectrum. During a speech, senator and future president Barack Obama explained:

> The fact that we are here today to debate raising America's debt limit is a sign of leadership failure. It is a sign that the US government can't pay its own bills. It is a sign that we now depend on ongoing financial assistance from foreign countries to finance our government's reckless fiscal policies.[4]

At a conservative conference, Argentine economist and future president Javier Milei explained:

> The problem with government debt is that it's future taxes, which means the cost of partying hard by current generations is passed on

> to our children, grandchildren, and people who haven't even been born yet, let alone voted. In fact, one of the things I've proposed in Argentina is that, in order to make childbirth less traumatic, instead of giving babies a spank we should tell them how much money they owe—this will make them cry like crazy![5]

The household view is also echoed by the media. A *New York Times* article explains:

> The so-called X-date is the moment when the United States is unable to pay its bills, including interest payments to investors who hold government debt. Failure to meet those obligations could result in the United States defaulting on its debt. The U.S. has never defaulted on its debt.

Modern Monetary Theory—from now on we'll call it MMT—does not agree. In fact, MMT says the household view is the *worst* way to analyze the economy of the United States and of many other countries. MMT proponent Stephanie Kelton tells us, "Don't think of a household" and adds:

> If you've heard someone complain that Washington needs to get its fiscal house in order, you've heard a version of the household myth. It derives from the flawed idea that we should look at Uncle Sam's budget through the same lens we use to manage our own family budgets.[6]

MMT focuses on countries that have their own currencies, like the United States and the United Kingdom. In these countries, the government could technically create as much money as needed to pay for stuff and repay its debts. So, they don't have money problems or financial restrictions. According to MMT, this makes them very different from households.

MMT proposes an alternative way of understanding the economy, in which the government is nothing like a household. Stephanie Kelton says, "What if I could convince you that we can have an economy that puts people and planet first? That finding the money to do this is not a problem? … Another kind of society is possible, one in which we can afford to invest in healthcare, education, and resilient infrastructure."[7]

This chapter explains MMT's proposed way to model and understand the economy. We will call it the *MMT world.* I'll add caveats to supplement and question the model as we go. We'll also analyze the model's relation to many topics, such as the value of money, the role of taxes, and the meaning of government debt.

I must warn you about something though. The MMT world is an imaginary world—it is a very simple, hypothetical model of an economy, and it does not necessarily correspond to reality. MMT proponents argue that, despite its simplicity, the MMT world is still the most useful and accurate way of thinking about most economies. They often say we should analyze policies *through the lens of MMT* instead of through the lens of a household. Very often, MMTers speak of current governments, such as the United Kingdom and the United States, as if they already operated just like in the MMT world, thus putting the hypothetical model and the real world in the same bag. This has made readers confused and frustrated.

So, to make things easier, in this chapter we won't focus on the real world. Instead, we will analyze the fascinating hypothetical MMT world and the conclusions we can draw from it. I ask you to suspend disbelief for now. We will discuss MMT's relation to the real world later on. Let's get started!

THE ESSENCE OF MMT

Imagine that the government wants to build a bridge. After receiving quotes from multiple suppliers, it picks a firm called Smith Engineering. The firm quotes $10 million for the job.

In the MMT world, the government has a peculiar way of paying for stuff—it just creates new money out of thin air. In this example, the government creates a new $10 million and deposits it in Smith Engineering's bank account. In this world, the government just spends money into existence.

This is technically very easy to do in the modern era because most money is digital, which means that bank account balances are just numbers inside computers. You can think of it as a long Excel file that says who has how much:

Account Holder	**Balance**
Paul Jones	$1,400
Jane Doe	$35
Smith Engineering	$50,000

In order to pay Smith Engineering, all the government must do is replace the relevant number with a higher number inside the computer:

Account Holder	**Balance**
Paul Jones	$1,400
Jane Doe	$35
Smith Engineering	~~$50,000~~ $10,050,000

The engineering firm now sees a higher balance in its account, which it can use as it wishes. In practice, this may require a few coordinated operations between the government and banks, but the details are not necessary to understand MMT.

The government also has a peculiar way of receiving payments, such as taxes and fines. Suppose Smith Engineering must pay a $2 million tax bill to the government. When the firm transfers the money to the government, the latter simply makes that amount disappear from the record. For this, the government just replaces the relevant number with a lower number inside a computer:

Account Holder	Balance
Paul Jones	$1,400
Jane Doe	$35
Smith Engineering & Co.	~~$50,000~~ ~~$10,050,000~~ $8,050,000

Note that the government doesn't even need to have a bank account with a certain balance recorded in it. Instead, whenever it spends, it creates new money, which increases the total amount of money in others' bank accounts. When it collects taxes or other payments, it destroys money, which reduces the total amount of money in others' bank accounts. The government faces no technical impediments to do this.

This process is very different from how the rest of us spend. Regular folks don't have the power to create or destroy money, which would be a lot of fun. When we spend, we move money across accounts, but the total amount of money remains unchanged:

Account Holder	Balance
Paul Smith	~~$1,400~~ $1,000
Jane Doe	~~$35~~ $435
Smith Engineering & Co.	$8,050,000

Note that, in the MMT world, the government may not necessarily create the same amount of money that it destroys. If the government spends more money than it destroys, it increases the total amount of money in the hands of the public. This money can then be used by the public for private payments, so it can circulate around the economy. Conversely, if the government creates less money than it destroys, it decreases the total amount of money in the hands of the public.

This is the essence of MMT. It can be summarized using the following statement: The central government spends and receives payments by creating and destroying money.

While this may seem very simple at first, it can be a useful tool to analyze a model economy, and, as we'll see throughout the rest of this chapter, it provides some fascinating answers to many questions.

But there's a catch: the MMT world cannot possibly function in *any* country. There are a few conditions. Let's quickly go through them.

THE THREE CONDITIONS OF MMT

There are at least three important conditions to make the MMT world possible. First, the country must be *monetarily sovereign*. This means that it must issue its own national currency. A country like Ecuador, which uses US dollars instead of having its own currency, cannot operate the MMT way. This is because it doesn't have the power to edit the computers that keep track of dollar balances, which are controlled by the United States. Later in the book, we'll talk more about Ecuador and why it uses US dollars.

A second condition for MMT is that the country must use *fiat* currency, which means the government doesn't promise to exchange it against anything else, such as gold. This was the case for a long time in history—central banks stored gold in their vaults, and people could turn up and ask to exchange their banknotes for physical gold. This isn't admitted in the MMT world. This is because such a promise prevents the government from creating money freely, as the amount of money must be matched by a sufficient amount of gold stored in its vaults.

The third condition is that the country must have a *floating exchange rate*, which means the government does not promise a predetermined, guaranteed exchange rate against a foreign currency. Otherwise, it faces the same problem as with gold—it needs to keep enough foreign currency in its vaults to be able to fulfill its promises. Countries like Jordan and the UAE, which offer a guaranteed exchange rate of their national currencies against the US dollar, cannot operate the MMT way.

MMT also assumes that only the highest level of government, usually known as the central or federal government, has the power to create and destroy money. Regional and local governments, such as the city of New York, are not allowed to do that. So, lower-level governments are akin to households—they must think carefully about their budgets and can find themselves in Nicolas Cage–style situations.

One final remark is that there is no central bank in the MMT world. We usually think of the central bank, such as the US Federal Reserve ("the Fed") or the Bank of England, as the entity in charge of creating, destroying, and managing the national currency. In the MMT model, there is none.

MMT doesn't say that a central bank cannot exist. However, it is pointless to study it separately because the government can create and destroy money freely. So, the central bank would be under full control of the government—it would be a government department like any other. MMT absorbs the central bank as part of "the government."[8]

We can summarize the conditions of MMT into the following statement: *The national currency has zero strings attached.* In other words, there are no promises to convert it to gold, foreign currency, or anything else. This way, there are no technical restrictions that would impede the central government to create and destroy money.

We're now ready to use the MMT lens to answer all sorts of important questions. Why are taxes needed? Is debt a burden? Does the government face any limits? Let's go!

TAXES DRIVE MONEY

In 1690, the government of the Massachusetts Bay Colony found itself in quite a pickle. After trying and failing to occupy Quebec, the returning troops—who were starving and plagued with smallpox—wanted to be paid. But the government was completely broke. At that time, payments were usually made using tangible goods like precious metals, grains, and land, but the Massachusetts government had very little of that to offer. Its coffers were empty of precious metals, and the government had already committed future grain stocks to settle other debts. Moreover, the colony's existing land belonged to the King of England and not to the colony's administration, so it couldn't be offered for payments.[9]

The government had no choice but to pay the troops and other suppliers by issuing pieces of paper, which they called *bills.* These pieces of paper were stamped and signed by the authorities, and they contained a written monetary value, such as "twenty shillings."[10]

The government could not make any credible promises to exchange such bills for silver, grains, land, or anything else. So, its bills weren't "backed" by anything—they were flimsy pieces of paper that couldn't be exchanged against tangible stuff.

The challenge was to make people accept those bills for payments. Imagine I offered to buy your car in exchange for a napkin on which I wrote the words "ten thousand dollars." Would you give me your car? At first sight, the Massachusetts bills weren't much better than that.

The government had to get creative to have its bills accepted. So, it came up with a clever idea: It announced that the public could use these bills for future tax payments. In fact, taxpayers would get a 5% discount on their taxes if they paid using those bills instead of the usual grains. So, the bills were not that flimsy after all—they were useful to pay taxes. The government promised that, once it recuperated its own bills through tax payments, it would destroy them. It once publicly burned the bills after tax collection to reassure the public about its commitment to this operation.

At first, people were a bit skeptical about the bills. However, they soon started accepting them as payments from the government, as they knew they could use them to pay future taxes. People soon started using the bills to buy stuff from one another in private transactions, replacing old forms of money like grains and silver. So, these apparently flimsy bills become the colony's currency of choice for most transactions.

Let's travel back to the present day. The MMT world is a modern version of the Massachusetts colony—the government creates new money when it spends and destroys it when it collects taxes. Instead of printing and burning pieces of paper, it does so in a digital way, but the principle is the same.

MMT says that, in the world of MMT, the reason people accept payments in the government's digital money is the same as in Massachusetts—it's taxes. The government imposes taxes on individuals and businesses, and it only accepts its own digital money for tax payments. This creates a demand for the government's money, as people must obtain it to pay taxes. Smith Engineering is willing to build a bridge for the government in exchange for its newly created money because it knows it will need that money later to pay taxes—or someone else will.

In the MMT world, you may not be able to convert the government's digital money into gold, but you can convert it into the privilege of not finding yourself in court for failing to pay your tax bill. So, MMTers often say that *taxes drive money.*[11] They say there may exist other reasons why people accept the government's money, but taxes are *sufficient* for it.[12]

There's a meme circulating around the internet that says, "If you can just print money, why do I pay taxes?" MMT has an answer to that—taxes are a tool to guarantee that the money "printed" by the government is accepted by the public.

Note that, in the MMT world, taxes are not *needed* to fund the government because the government just creates new money whenever it spends. From a logical point of view, government spending comes first, during which new money is created, and taxation comes second, during which the previously created money is taxed out of existence.

ARE TAXES ENOUGH THOUGH?

During a recent trip to Argentina, I walked by a store that sold secondhand computers. I noticed their prices were all quoted in US dollars instead of the local currency—the Argentine *peso.*

At the time of my trip, Argentina had been suffering from years of rampant inflation. This meant that prices had been going up and up over time, or equivalently, the peso had become increasingly less valuable, as one peso could buy you less stuff over time. In the year preceding my trip, for example, inflation had been around 200%, which meant prices had more than tripled.[13] Or, equivalently, the peso had lost so much value that by the end the year you could buy three times less stuff with one peso than in the beginning of the year.

The owner of the computer store must have gotten tired of updating and updating price labels. So, he went for US dollars instead, whose value tends to be much more stable over time.

The prevalence of inflation contributes to Argentineans' recurring use of dollars to quote prices. Argentineans constantly mix pesos and dollars when they talk about prices. The higher the stakes, the least Argentineans use pesos. For example, house prices are only quoted in US dollars. If you tell an Argentinean how much you paid for your house in pesos, they will mentally convert it to dollars to understand what you mean.

If you go to mercadolibre.com.ar, the Argentinean version of eBay, you'll see cars are sometimes quoted in pesos and sometimes in US dollars. On a quick browse, I just saw a Toyota Hilux going for 18,000 US dollars next to a Chevrolet Onix going for 24,999,500 Argentine pesos. Living in Argentina requires doing some interesting mental gymnastics.

Argentineans often use US cash to buy stuff from one another, and dollar bills circulate widely around the economy. In fact, you can *only* buy a house using US cash. One of my Argentinean friends once escorted another friend to the real estate agency to help him feel safer, as he was carrying a bag with 50,000 US dollars in cash to buy an apartment. This was a legit transaction, and neither of my friends was a drug lord.

A website that helps foreigners buy property in Argentina explains:

> Most transactions are conducted using cash, primarily in the form of US $100 bills. It sounds primitive but this is how it is … If you plan to make a purchase, you should prepare for the need to transport a substantial amount of US dollar bills into the country—potentially as much as $250,000 … You will be required to provide a justification for the source of the money to AFIP [the tax bureau] through a local accountant. UIF [which investigates money laundering] will almost always request information.[14]

Inflation is a major contributor to this phenomenon. As a house seller, would you want to receive a large sum of pesos, whose value may drop dramatically before you even have time to spend it?

Argentineans never save money using pesos. Due to inflation, this would be like saving in icicles and putting them out on the balcony in the middle of the summer. If an Argentinean finds themself with spare pesos, they will immediately try to exchange them to protect their savings. Most commonly, they will exchange them for US dollars, but they may also buy other currencies or even stuff, like a fridge.

At the time of my trip there, it was illegal to buy foreign currency except in very limited circumstances. So, Argentineans routinely exchanged their spare pesos for dollars in the black market. The black market was extremely well developed and completely overt. On a walk around downtown Buenos Aires, you were offered many chances to exchange currency in the black market. Black-market exchange rates were announced on every news program on TV under the name "blue dollars."

Economists consider something to be *money* if it fulfills three main roles. First, it should be a *unit of account*, which means a standard unit used to price things. The Argentine peso fulfills this role in a mediocre way, as people often price things using US dollars instead.

The second role of money is to be a *medium of exchange*, which means buyers and sellers use it as a token to facilitate trade. The Argentine peso also performs this role poorly. Notably, you can't buy a house using pesos.

The third role of money is to be a *store of value*, which means that people keep it as savings for future consumption. The Argentine peso fails spectacularly at this role.

So, while the peso may be Argentina's national currency, it's not quite what we usually understand by money.

This story tells us that the MMT mantra "taxes drive money" should be taken with a grain of salt. Argentineans pay taxes using pesos. However, pesos fall short of being a proper form of money.

In the MMT world, the best-case scenario is that the government's currency becomes widely accepted as a unit of account, medium of exchange, and store of value. In the worst-case scenario, people may only want the government's currency for the bare minimum. Perhaps they'll only want it to pay taxes—because they must—and they will flee the currency for anything else.

A better mantra might be "taxes drive the money needed to pay taxes." The acceptance of government currency beyond taxes is not guaranteed. This can complicate things a little for MMT. For example, if the government wants to spend more money than it collects from taxes, it might struggle to get its money accepted.

MMT doesn't tell us much about which conditions, other than taxes, may be necessary to guarantee that the government's currency is *widely* accepted by the public. To MMTers, it all seems to come down to taxes. MMT proponent Randall Wray explains:

> The situation can be very different in developing nations … The tax liability can be limited by tax avoidance and evasion … With a foreign currency used in private payments, and with widespread tax avoidance and evasion, the population might not want much of the government's own currency.[15]

Wray doesn't explain why in these countries people use foreign currency for private payments in the first place. He doesn't explain either if there's a minimum level of tax to make sure that "taxes drive money" in a wider sense. For example, if taxes are 30% of GDP, is that enough to have properly functioning money that fulfills all its roles? Or should taxes be, say, 40%? MMT doesn't explain this.

MMT proponent Éric Tymoigne adds that, if people don't widely adopt the national currency, it is because they don't trust "the government's ability and willingness to impose and enforce tax."[16] He says this can happen due to "wars, political instabilities, technical problems, errors in setting up a monetary system, and ignorance."[17]

MMT critic Marc Lavoie is not convinced. He says, "MMT authors often claim that a currency has value only because it must be used to pay taxes … but this seems to overly minimize the importance and role of confidence and credibility for the worth of a currency."[18]

I'm not entirely convinced by MMT's story either. It seems to me that the government's currency must fulfill other requirements to become widely accepted and turn into properly functioning money. At the bare minimum, it must have a more-or-less stable value. Otherwise, people will run away from it—just ask an Argentinean.

OTHER ROLES OF TAXES

In the MMT world, taxes drive money. There are, however, at least three other uses of taxes. Let's quickly review them.

First, taxes can be used for redistribution of income. If we think in terms of "stuff" instead of money, which many economists like to do, we can interpret income as the right to obtain a portion of the goods and services produced in the economy every year, such as a mattress, a holiday, or a doctor's consultation. A person's income determines the share of that production they can buy—a higher earner can buy higher-quality mattresses, go on longer holidays, and access exclusive healthcare. The allocation of income is not always seen as fair. The role of taxes is to redistribute it, transferring it from the richer to the poorer, so that lower earners end up accessing a higher proportion of the production than they would otherwise. MMT proponent Stephanie Kelton says, "We can, and must, tax the rich. But not because we can't afford to do anything without them."[19]

Second, taxes are a tool to fight inflation. MMT says that, in some rare circumstances, a surge of spending in the economy can cause prices to go up because people bid increasingly more on products and services. A surge of spending could come from the private sector. For example, companies may become optimistic about a new technology and invest in it. It could also come from the public sector. For example, the government may embark upon an epic infrastructure project. An increase in taxes can be used to discourage private spending and thus reduce outbidding to keep inflation under control. Stephanie Kelton explains:

> If the government wants to boost spending on healthcare and education, it *may* need to remove some spending power from the rest of us to prevent its own more general outlays to push up prices. One way to do this is by coordinating higher government spending with higher taxes so that the rest of us are forced to cut back a little to create room for additional government spending.[20]

Remember that, according to MMT, such a tax increase is not a way to "pay" for healthcare and education, as the government can spend money into existence. A tax increase is just a tool that may *optionally* be used if such spending risks causing inflation. We shall have a lot to say about MMT's understanding of inflation later on.

The final role of taxes is to encourage or discourage certain behaviors. Examples of this are cigarette taxes and tax abatements for electric vehicles.

To summarize, taxes have four functions:

- Make people accept the government's currency for payments.
- Redistribute income.
- Reduce consumption to fight inflation, if necessary.
- Deter undesirable behaviors and promote desirable ones.

Note that funding the government does not appear in this list. The government spends money into existence, so taxes aren't needed to fund its spending in any way.

Let's now move on to some of MMT's most remarkable conclusions, which have been widely publicized in books, blogs, and newspapers.

THE GOVERNMENT CANNOT RUN OUT OF MONEY

MMTer Randall Wray explains, "Government cannot run out of money; it can always financially afford to take care of our own."[21] MMTer Stephanie Kelton adds, "There is absolutely no good reason for Social Security benefits, for example, to ever face cuts. Our government will always be able to meet future obligations because it can never run out of money."[22]

The idea that the government cannot run out of money is one of the most publicized corollaries of MMT. Sometimes it's explained using more technical words, such as, "the government has no hard financial constraints," but it means essentially the same thing—that the government doesn't have money problems. MMTers have called this "one of the main contributions of MMT."[23]

There are two things I'd like to point out about this. First, it is true that, in the MMT world, the central government cannot run out of money. Second, such an observation isn't particularly insightful—if a government can create as much money as it wants, then *evidently* it cannot run out of it. When MMTers say that the government cannot run out of money, they assume that the government operates the MMT way—it is allowed to spend money into existence. So, it automatically follows that it cannot run out of money. This "main contribution" of MMT is a truism because it simply restates MMT's assumptions using different words.

It is well understood that a government cannot run out of money *if it is allowed to create it.* Most economists don't like the idea of giving the government the power to create money because they're afraid of the consequences, not because they think it's technically impossible. MMT critic Thomas Palley says, "The critical question is not whether government can finance spending without taxes. Everybody knows it can [by creating money]. Instead, the question is what are the macroeconomic consequences of doing so and should the government do so?"[24]

Imagine we gave Nicolas Cage the possibility of spending money into existence. Can we trust him not to engage in indiscriminate spending and cause a mess? Perhaps he'd try to buy the entire Santa Monica coastline, which will increase property prices in Santa Monica for everyone else and affect related markets, such as construction and decorating. Economists don't want governments to be allowed to spend money into existence for the same reasons they don't want Nicolas Cage to be allowed to do so.

Note that, in the MMT world, local and regional governments operate just like a household—they cannot create and destroy money. But why stop MMT at the central government? Why not also let the government of New York City or even Nicolas Cage spend money into existence? MMT's implicit assumption is that the central government can be trusted to use that power in a benevolent and safe way while others cannot.

GOVERNMENT DEBT ISN'T DEBT

Every week, the US government conducts an auction where the public can give it money in exchange for a certificate that says, "I owe you." The certificate stipulates a schedule in which the government pays the bearer their money back, plus interests. For example, you give $100 to the government, and the certificate says you will receive $100 ten years later plus $5 every year until then. This certificate is known as a *government bond.*

We typically say that the government *borrows* when it issues or "sells" a bond, and we describe outstanding government bonds as the *national debt.* When the government wants to spend more money than it collects from taxes, it borrows money from the public to cover the difference, and it does so by issuing bonds.

Let's now travel to the MMT world. Is there a place for bonds in this world, given that the government can create money and thus doesn't need to borrow? Surprisingly, MMT says, "Yes." However, we should not think of bonds as "debt" or "borrowing."

In the MMT world, bonds are just an alternative form of government money. The difference with ordinary money is that bonds pay the holder an interest over time. Stephanie Kelton calls ordinary money "green dollars," and she calls bonds, which are just interest-bearing money, "yellow dollars."

When the government "borrows" money, all it does is remove some "green dollars" from the economy and replace them with "yellow dollars." For example, if the government "borrows" $100 from the private sector, it withdraws $100 green dollars and replaces them with a $100 bond. Stephanie Kelton explains, "What we call government borrowing is nothing more than Uncle Sam allowing people to transform green dollars into interest-bearing yellow dollars."[25]

The government voluntarily chooses to perform this "swap" if it thinks it's a good idea to help people collect interest. This decision is voluntary. Stephanie Kelton says, "Why does the government need to borrow? The answer is, it doesn't. It *chooses* to offer people a different kind of government money, one that pays a bit of interest."[26]

Let me add a few comments to this. First, it is true that, in the MMT world, the government doesn't need to "borrow" in the usual sense. Second, this isn't surprising. MMT assumes the government is allowed to create money whenever it wants, so it naturally follows that the government doesn't need to "borrow" and that bonds aren't really "debt." This is a direct conclusion of MMT's assumptions. Once again, MMT offers a truism rather than an interesting insight.

Finally, I'm not sure I'd describe bonds as a different type of "money." This is because bonds are usually not used for payments. When was the last time you paid for your groceries using a government bond?

Unlike a $100 bill, which is worth exactly $100 now, a bond says, "I'll pay you $100 in ten years." As a result of impatience and uncertainty, people won't accept bonds at face value in the present. Instead, a bond that promises $100 in the future may be resold in the present for, say, $80, and this value may change quickly. This makes bonds difficult to use as money for ordinary transactions. So, it's a little too simplistic to declare bonds to be a type of money.

THE GOVERNMENT COULD PAY OFF ITS DEBT TOMORROW

Stephanie Kelton says, "The entire national debt could be paid off tomorrow, and none of us would have to chip in a dime."[27]

In the MMT world, because the government can create money, it can easily pay off any debt it owes in its own currency. So, MMT tells us not to worry about the government accumulating debt, as it can be wiped out through a few keystrokes. Kelton explains, "There is zero risk of the US being forced into default by its creditors. That's because the government can always meet its obligation to turn those yellow dollars into green dollars."[28]

While this is technically true, there is a major caveat. The government can still default on its debt but in a different way.

Suppose you buy a government bond for $100. The bond promises to pay you $100 back in 10 years plus an interest of $5 every year until then. Now, imagine the currency suffers from an unexpected bout of inflation over the next few years. As a result, you can afford less stuff with the $5 you receive every year, and the final $100 can't buy you nearly as much stuff as you had in mind. The government still defaults on its promise—as you're worse off than you thought—even if doesn't default on its payments.

So, in the MMT world, the government can still default *economically* even if it cannot default technically—all it takes is for the government's money to lose its value.

Let's go back to Kelton's comment, where she says, "… none of us would have to chip in a dime." Suppose the government creates a vast amount of money to pay off its debt in one go, thus replacing all outstanding bonds with money.

Most of these bonds were probably in the hands of money managers, such as pension funds. After the government replaces them with newly created, ordinary money, the fund managers will want to invest this money in something else, so they can generate returns for their clients. As government bonds are no longer an option, they'll find other ways to invest the money. They may, for example, lend the money to private companies. This would help these companies embark upon new projects. However, this could cause inflation because companies will bid up on products and services to run these new projects.

Perhaps the fund will invest some of the money in shares of Apple. This will increase the price of these shares and could make anyone who owns them feel richer. This could make people spend more and thus also bid up on products and services, causing inflation. This mechanism is called quantitative easing, and we'll have more to say about it later.

So, wiping out debt could cause inflation through different channels, which means money would lose its value and anybody with spare cash would end up worse off. This doesn't sound like the public "not chipping in a dime."

GOVERNMENT DEFICITS MAKE US RICHER

Let's go back to the Massachusetts colony of the late 1600s. If you remember, the colony operated in an MMT-style way by spending money into existence and taxing it out of existence. Initially, the plan was to destroy every shilling that was created, so the amount of tax would exactly match the amount of spending. However, people started complaining about the pressure of paying taxes and asked for relief. The government responded by repeatedly postponing the collection of taxes, so the government kept creating new money without retiring the money as initially intended. Historian Andrew McFarland Davis explains:

> In 1702, the practice was begun of postponing the time for levying the tax through which the bills should be called in. At first it was for one year. In 1704, the retirement of a part of the issues was carried forward to two years. In 1707, the time was lengthened to three years. In 1709, a part of the issues were not to be provided for until five years had elapsed. In 1711, the limit reached six years, and in 1714, another year was added. In this manner the dates for levying the taxes which were to retire the bills were from time to time postponed until 1722, when £6,000 were issued not to be called in for thirteen years. Then an effort was made to cure this evil, and for a brief time short periods were assigned for retirements. These, however, were again lengthened, until, in 1730, £13,000 were issued which were not to be called in until 1741.[29]

The Massachusetts government ran a deficit, which means it spent more money than it collected through taxes. When this happens in the MMT world, the public is left with increasingly more money in its hands, as more of it is created than destroyed.

According to MMT, this makes people richer, as they end up having increasingly more money. MMT proponent Éric Tymoigne explains, "Fiscal deficits are a boost to the saving level of the domestic private sector, state and local governments, and the rest of the world."[30]

MMTer Stephanie Kelton adds:

> Fiscal deficits don't eat up our savings; they enlarge them! … *In purely financial terms*, every fiscal deficit is good for someone. That's because government deficits are always matched—penny for penny—by a financial surplus in the nongovernment bucket … Fiscal deficits will *always* lift our collective (financial) boat.[31]

Kelton adds that this isn't an opinion; it's the cold hard reality of accounting.[32]

I will add two comments to this. First, it is indeed true that, in the MMT world, a government deficit leaves the public with more money in its hands. This is self-evident—if you create more money than you destroy, people will indeed have more money.

Second, there is a gigantic caveat. The new wealth in the hands of the public is *paper* wealth, not real wealth. Real wealth is made up of machines, factories, houses, and so on. These are capable of producing stuff. Paper wealth does not produce stuff—it is a promise that you'll be able to buy stuff with it in the future. In the case of Massachusetts, deficits literally put more pieces of paper in the hands of the public. In the modern MMT world, in which money is digital, deficits simply increase the total amount of money recorded inside banks' computers—think of marking up numbers on Excel spreadsheets.

Stephanie Kelton is careful enough to always add the qualifier "financial" when she says that deficits increase our savings. She says that deficits "lift our collective (financial) boat," that deficits make a "financial contribution" to the public,[33] and so on. The word financial means "paper."

The problem with paper wealth is that it can lose its value over time. An MMT-style government may offer the public a "financial contribution" of, say, $100, by running a $100 deficit. However, $100 may be worth much less in the future if the currency suffers from inflation.

This is exactly what happened in Massachusetts. The government kept spending bills into existence while refusing to collect as much in taxes, which put increasingly more bills in the hands of the public. However, the currency suffered from rampant inflation. Within a few years, the Massachusetts paper money lost most of its value. The public had more bills in its hands, but it didn't seem to be getting any richer.

Due to this remarkable inflation phenomenon, in 1751, the British prohibited the colony from creating anymore paper money, and the colony adopted silver coins as its primary currency. That was the end of Massachusetts' MMT experiment.

WHAT ARE THE LIMITS?

In the MMT world, the central government doesn't have an affordability problem, as it can create as much money as it wants. But surely it must face limits! There must be things money can't buy.

MMT says that the government is limited by the economy's technical capacity to produce stuff. For example, the government cannot build an entire hospital in one day, as this is just not technically possible. It can't either build 1,000 houses if there aren't enough materials or workers to build them. MMTer Randall Wray explains:

> Anything that is technologically feasible is financially affordable. It comes down to technology, resources, and political will. We've got the technology and the resources.[34]

MMTer Stephanie Kelton adds:

> Every economy has its own internal speed limit, regulated by the availability of our *real productive resources*—the state of technology and the quantity and quality of its land, workers, factories, machines, and other materials … MMT is not about removing all limits. It's not a free lunch. It's about replacing our current approach, one obsessed with budget outcomes, with one that prioritizes human outcomes while at the same time recognizing and respecting our economy's real resource constraints.[35]

MMT says we should stop asking ourselves whether the government has or doesn't have the money to pay for something. Instead, we should ask ourselves whether the economy has the technical capacity to do the required work. Are there enough construction workers? Are there enough materials?[36]

MMTers believe that our economies usually have a lot of spare capacity. Stephanie Kelton says, "Peacetime economies never operate at full capacity. There is always slack in the form of unemployed resources, including labor."[37] MMTer Éric Tymoigne adds, "In most cases, economies have more flexibility than what is admitted."[38]

So, while limits do exist, MMTers think they're rarely reached. As a consequence, governments are missing out on the possibility of doing more stuff. MMTers describe this as available *policy space* that isn't fully exploited.

According to MMT, a government that can create money can better exploit the available policy space, as it doesn't have to worry about paying the bills. So, in the MMT world, the government can effectively mobilize spare resources to let the economy operate at full capacity. As a result, the government can conduct more public works, improve healthcare, reduce unemployment, and so on. This comes at no cost.

But what if the government tries to push the economy beyond its technical limits? What if it tries to, say, build a hospital when there are no more available construction workers and materials? According to MMT, the result is inflation. This is because, when companies don't have any more spare capacity to produce products, they start increasing prices.

Thus, the MMT recipe for policymaking is to increase government spending to try to push the economy very close to its maximum productive limits, but it shouldn't try to exceed those limits. *Voilà!*

All I'll add for now is that MMT's views on unemployment, inflation, and policymaking are quite naive. We'll get back to these topics in later chapters.

THE END OF SELF-FLAGELLATION

In February 2025, the Trump administration established the Department of Government Efficiency, or DOGE, whose goal was to cut down government spending. This was partly triggered by the mounting amount of government debt and the fact that interest payments had become the second highest government expense, only surpassed by Social Security.

In the mid of this debate, one of my LinkedIn contacts said, "Countries can't go bankrupt if they issue their own currency. Comparing sovereign debt to a household budget (or even a corporation), means you're either woefully uneducated or deliberately lying. And probably a sadist. You love the suffering, be honest."

This contact, who is well versed in MMT, describes worrying about government debt as an unnecessary act of self-flagellation.

I don't think this is coincidental. For a long time, MMTers have implied the same thing, although using softer words. Éric Tymoigne and Randall Wray explain:

> MMT recognizes that there are some self-imposed constraints on the financial operations of the government … MMT insists there is nothing "natural" about the operating procedures (including restrictions).[39]

Stephanie Kelton adds:

> MMT recognizes the real limits from delusional and unnecessary self-imposed constraints.[40]

The MMT world is free from unnecessary shackles that limit the government.

Let me add two comments. First, it is well known that restrictions are self-imposed and could be removed. We could technically let local governments and even Nicolas Cage spend money into existence—all we need is to authorize them to edit some Excel files stored in banks' computers.

Once again, the important question is not whether restrictions can be technically removed but whether they should be removed and the consequences of doing so.

Second, self-imposed restrictions are only an act of self-flagellation if they impede responsible governments from making valuable progress.

If, however, loosening restrictions makes the government behave like Nicolas Cage, then restrictions are not an act of self-flagellation. They're a safety mechanism.

FINAL THOUGHTS

The MMT model is fascinating—it helps us analyze economies from a different lens and even provide an answer to the question, "If you can just print money, why do I pay taxes?" In case you're interested, Appendix A discusses MMT's views on cryptocurrencies such as Bitcoin. Spoiler alert: MMTers don't believe cryptocurrencies have a stable source of value because they can't be used to pay taxes. And they may have a point.

We've identified at least two major weaknesses of MMT. First, many of its most publicized conclusions are obvious. For example, it is not interesting to say that, if a government is allowed to create money, then it cannot run out of money. Second, MMT often omits crucial things, such as how inflation diminishes its claims.

In this chapter, we discussed the hypothetical world proposed by MMT. But MMT makes a big promise. It tells us that MMT describes how many real-world countries operate, despite appearances. For example, the US federal government *already* creates new money on a daily basis to pay for stuff.

If this is true, the consequences are enormous, as we could extrapolate MMT's conclusions to the real world. We could say, for example, that the real-life US government doesn't need taxes to fund its spending and that it cannot run out of money.

Let's see.