Modern Money, Forget Theory: Part 3: Debunking Working Paper 244

May 27, 2021

Stephanie Kelton’s working paper written in July of 1998 titled Can Taxes and Bonds Finance Government Spending contain the same logical fallacies included in her most recent publication The Deficit Myth: Modern Monetary Theory (MMT) and the Birth of the People's Economy. Her paper was heavily influenced by Warren Mosler (1) a successful bond trader who she met earlier in 1998 and L. Randall Wray author of Modern Money Theory A Primer on Macroeconomics for Sovereign Monetary Systems.

All her misconceptions about how Federal Governments finance their spending is borne out of the MMT S(TAB) Hypothesis (The federal government must spend first before taxing and borrowing can occur) which I have already debunked (2). In her paper she introduces a red herring called “reserve effects” and suggests that taxes are not there to finance government spending rather they drain excess reserves from the system and when taxes are received money is destroyed. She selectively ignores time lags in reserve accounting which she is aware of as evidenced by her own written acknowledgement of them. As of March 26, 2020, there are no reserve requirements for all depository institutions in the U.S. (3). As she goes forward in the paper every now and then she will throw in a statement supporting the S(TAB) hypothesis with no logical thread leading into it. For example, while she is creating the false premise of reserve effects in the notes at the bottom of the page she throws in, “It is worth noting that government spending must originally have preceded taxation.” There are other examples like that throughout her paper so instead of laboriously explaining all the logical fallacies in her working paper you can access my annotated and highlighted version of Kelton’s paper in the description box below the video.

So, in the real world the US Treasury works the same as the Consolidated Revenue Fund in Canada. The US Government’s Treasury has a daily cash balance that is maintained to ensure obligations and payments are made. The inflows among other things include the proceeds from securities sales and taxation. The outflows are used to fund government programs and make payments. (4)

When Kelton first wrote her paper the Government’s daily cash balance was structured a little differently. Starting from the top as you can see the governments operating cash account was comprised of the Federal Reserve account and the Tax and Loan Note accounts. Moving to the bottom of the page on the left-hand side are the deposits or inflows to the Treasury. The right-hand side is the total amount of withdraws or outflows. And the net change in the operating cash balance.

Today the US government’s cash balance is composed of Federal Reserve Account, Supplementary Financing Program Account, and the Short-Term Cash Investments.

The bottom of the page is the same as the previous document which includes deposits on the left, withdraws on the right, and the net change in the government's operating cash balance.

In conclusion, government finances can be compared to your own household finances with the especially important exception of the money creation process employed by the Central Bank and the commercial banking sector. Whether it is the US Treasury or the Consolidated Revenue Fund in Canada, both are government accounts held at their respective central banks where taxes, revenue, and proceeds from securities sales flow into the accounts before governments can spend.

Notes:

1. The Deficit Myth and Modern Monetary Theory Revised: The Canadian Version, Warren Mosler's Improbable Story Pg.8, https://img1.wsimg.com/blobby/go/ff93be0f-e4df-4288-8750-c2891b9cb7ea/downloads/descriptive%20analysis.pdf?ver=1621788449174

2. Progressive Money Canada, Debunking MMT, https://progressivemoney.ca/debunking-mmt

3. Same as 1. Pg. 6

4. Daily Treasury Statement: https://www.fiscal.treasury.gov/reports-statements/dts/