Modern Money, Forget Theory: Debunking the MMT S(TAB) Hypothesis

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Intro:

The Deficit Myth by Stephanie Kelton is the apex of MMT thought so that is where I am going to focus my efforts in debunking their theory that the government spends money into the economy before taxing and borrowing can occur. Their acronym of choice is S(TAB) government Spending before Taxes and Borrowing. Sometimes it is what you don't say that can be deceptive and in this case Kelton and other MMT advocates completely ignore the fact the majority of money in circulation is created by privately owned commercial banks through the loans process and is not contingent on any funds from the government. This alone should dissuade any objective thinker from taking their theory seriously. To the casual reader unaware of this fact they can be led down the rabbit hole and I'm going to show you how MMT does it.

S(TAB) is the cornerstone in the erroneous MMT descriptive analysis of how the monetary system works which leads to other fallacious concepts such as taxes don't actually pay for anything at least at the federal level.

Following that I will explain the basics of government financing which is consistent with Taxes and Borrowing before Spending (TAB)S. Finishing with a statement from the Department of Finance, "All spending undertaken by the Government is financed in advance."

Video Content

Have you ever heard the expression, one lie leads to another! Well, the Modern Monetary Theory's S(TAB) hypothesis, is one of those lies. As Joseph Goebbels once said; "If you tell a big enough lie, and keep repeating it, people will eventually come to believe it." (1)To be clear, in no way am I comparing MMT followers to nazi sympathizers, however, the same dynamic is at play here.

The Deficit Myth by Stephanie Kelton is the apex of MMT thought so that is where I am going to begin in debunking their theory that the government spends money into the economy before taxing and borrowing can occur. Sometimes, it is what you don't say that can be deceptive and in this case Kelton and other MMT advocates completely ignore the fact the majority of digital money in circulation is created by privately owned commercial banks through the loans process and is not contingent on any funds from the government. (2) This alone should dissuade any objective thinker from taking their theory seriously. However, to the casual reader unaware of this fact they can be led down the rabbit hole, and I'm going to show you how MMT does it.

I am going to read some passages from Stephanie Kelton's book The Deficit Myth: (3) The following quotes imply that all the money in circulation must first be issued by the government by conflating the currency issuer with all money creation!

By completely ignoring the role privately owned commercial banks play in creating digital money gives the reader the false impression that the government creates all the money in circulation, which couldn't be further from the truth.

Quote - MMT takes as its starting point a simple and incontrovertible fact: our national currency, the US dollar, comes from the US government, and it can't come from anywhere else—at least not legally (p. 17). (5)

So the quote standing by itself is correct if you are only referring to currency which is banknotes and coins and ignore digital money.

Quote - Only the federal government can issue our currency. Everyone else is merely a currency user (p. 18). (6)

Correct again if you are talking about hard currency which is banknotes and coins.

However, most of the money in circulation in both the US and Canada is digital, which can be converted into hard currency at your local bank. In Canada over 97% of all money in circulation was created by privately owned commercial banks through the issuance of loans and the remainder is hard currency. (7)

Additionally, she creates the false premise that governments pay for its own expenditures before taxing and borrowing.

Quote – By Mosler's reasoning (no hard evidence mind you), the government doesn't go around looking for someone else to pick up the TAB, it just spends its currency into existence (p. 23). (8)

Quote - It occurred to him that before the government could subtract (debit) any dollars away from us, it must first add (credit) them. He reasoned that spending must have come first, otherwise where would anyone have gotten the dollars they needed to pay the tax (p. 24)? (9)

Quote - He began by referring to the US dollar as "a simple public monopoly." Since the US government is the sole source of dollars, it was silly to think of Uncle Sam as needing to get dollars from the rest of us (p. 24). (10)

Again, conflating dollars or paper money with digital money and of course they would get that digital money from commercial banks, not the government.

The actual process of government financing is consistent with taxing and borrowing before spending exactly opposite of what MMT suggests.

The implication that the government is the only entity that can produce digital dollars continues to be reinforced in the book. However, it is the private sector or namely privately owned commercial banks that create most of the digital money in circulation, not the government!

Workers are paid with digital money or bank money if you will that entered the economy from a commercial bank through the issuance of loan somewhere down the line of many transactions (infinite regression if you will, a term used in the book). You might ask where did the commercial bank get the digital money from? The answer is nowhere; they simply typed numbers into a database and thereby created brand new digital money exchangeable with the currency of the land. Whenever a loan is issued by a privately owned commercial bank and accepted by a debtor the money supply expands and is not contingent on any funds from the government. As a given, the majority of us pay our taxes in digital money created by commercial banks both in the US and Canada, not currency.

In Canada we don't even have reserve requirements and haven't since July of 1994, which means even hard currency issued by the Bank of Canada is not required to leverage loans. Rather capital adequacy requirement ratios are used to backstop the amount of loans that private banks can issue although they do not fully constrain it. (11) https://progressivemoney.ca/money-creation

https://www.bankofcanada.ca/rates/banking-and-financial-statistics/bank-of-canada-assets-and-liabilities-month-end-formerly-b1/ (12)

And as of March 26, 2020, there are no reserve requirements in the U.S. either! (13) Essentially the US system is the same as ours where banks are required to keep a certain percentage of capital on their books at all times (supposed to). There was an excellent article by John Carney on what really constrains bank lending in the US, albeit the most important aspect of limits to lending is (d) the credit-worthiness and credit-hungriness of borrowers. (14)

Further, even when there were reserve requirements, empirical research initiated by Basil Moore in the late 70's (1979, 1983, 1988a, 1997, 2001) and later independently corroborated by numerous researchers, including Kydland and Prescott (1990), confirmed a simple operational observation about how banks actually operate by the then senior vice-president of the New York Federal Reserve, Alan Holmes. He said, "The 'Money Multiplier' model assumes that banks need excess reserves before they can make loans. The model process is that first deposits are made, creating excess reserves, and then these excess reserves allow loans to be made, which create more deposits. Each new loan reduces the level of excess reserves, and the process stops when this excess has fallen to zero. But in reality, Holmes pointed out, banks create loans first, which simultaneously creates deposits. If the level of loans and deposits then means that banks have insufficient reserves, then they go get them afterward – and they have a two-week period in which to do so. In contrast to the Money Multiplier model where banks are unable to lend until they receive more deposits, the real-world practicality of banking was that the time delay between deposits and reserves meant that the direction of causation flowed, not from reserves to loans, but from loans to reserves. (15)

Okay more on taxes

Quote - Your taxes don't actually pay for anything, at least not at the federal level. The government doesn't need our money. We need their money. We've got the whole thing backward! (p. 23) (16)

Okay, if taxes don't pay for anything what are they for?

Quote - "The government doesn't want dollars," "It wants something else." "It wants to provision itself," (p. 24) (17)

So Mosler creates almost a mysticism around taxation by stating the government doesn't want dollars. Then introduces a new word for the purpose of taxation "It wants to provision itself" Which is just another way of saying the same thing, the government wants to get stuff like parks, hospitals, roads, and health care… you know that kind of stuff. And of course, that is exactly what taxes are for.

Quote - "The tax isn't there to raise money. It's there to get people working and producing things for the government" (p. 24)." (18)

What he does here is create a paradox by stating that the tax isn't there to raise money. It's there to get people working and producing things for the government. So, how does the government get people working and producing things without money? The answer is it can't, so why does he create this paradox? He does it to support the S(TAB) hypothesis. What is implied here is that instead of raising money through taxation the government simply spends this money into existence to get people working and producing things.

Quote - The tax is there to create a demand for the government's currency (p. 25). (19)

People go to work in order to survive and thrive and need currency or money to do that, taxes are the very last thing on their list of priorities, I know they are for me. Survival trump's the need to pay taxes even if you might go to jail. Here are some examples that counter this MMT assertion that taxes drive money. One is the use of cash in the underground economy, where people use the currency precisely to avoid paying taxes.Two, is the use of local currencies to encourage commerce within a community. An example of a successful local currency from my home province of British Columbia is Salt Spring Island dollars https://saltspringdollars.com/all-about-salt-spring-dollars/ . Third, is the introduction of Bitcoin and other cryptocurrencies that can be used to hide wealth and thereby avoid taxes. As Kelton continues attempting to illustrate the point that taxes are there to create a demand for government currency, we get Warren

Mosler's improbable story which I will not get into here. Suffice to say that his story about his kids uses more pretzel logic to mislead the reader into believing the S(TAB) hypothesis. You can read my breakdown in a previous publication and the link is posted below the video. (20)
https://progressivemoney.ca/the-deficit-myth-revised

Later on, in the book Kelton states that taxes are for other things which is correct, taxes can do more than one thing. For example, a sin tax that is used to dissuade unhealthy activities like drinking alcohol. Not only does it raise money for government programs it also dissuades people from drinking too much or at least that is its intended purpose. Whereas MMT would have you believe the main purpose of taxation is to subtract excess reserves from the system. Another false narrative introduced by Kelton in a working paper she published in 1998 titled "Do Taxes and Bonds Finance Government Spending" Again, to support their S(TAB) hypothesis. (21)

Kelton continues to use language throughout the book to drive home the false assumption that taxes don't pay for anything. The following quote is meant to support another false narrative by MMT, the oversimplified three sector accounting identity which is beyond the scope of this presentation but it's more of the same pretzel logic.

Quote - the US government buys some bulldozers from Caterpillar Inc. and hires some American workers to build a bridge, dollars will flow into the US private sector bucket as the government makes those payments. American workers and (most) US businesses also pay federal taxes, so Uncle Sam subtracts some of those dollars away from the private sector bucket (p. 132). (22)

Notice the way this statement is worded, instead of saying taxes are used to pay for bulldozers the government pays for them first and then subtracts the taxes which is false. Kelton provides no empirical evidence to support this claim, it's all conjecture.

In 1998 Stephanie Kelton visited Warren Mosler in his West Palm beach home where he told a story about his kids. Suffice to say soon after she wrote her working paper with the S(TAB) hypothesis firmly fixed in her mind.

In her abstract she makes an absurd claim, Quote -"That after carefully considering the complexities of reserve accounting, it is argued that the proceeds from taxation and bond sales are technically incapable of financing government spending and that modern governments actually finance all of their spending through the direct creation of high-powered money."

After reading her paper I wouldn't characterize it as careful consideration. Rather it is skewed reasoning resulting from her belief in the S(TAB) hypothesis that the government creates all the money in existence, and when taxes are received that money is destroyed, in order to drain excess reserves from the system. (21)

So, is there real-world data to support S(TAB)? No, the real-world data shows the opposite (TAB)S. The governments of all G7 countries have dedicated accounts with their respective central banks in which all taxes and revenues flow into followed by all disbursements flowing out.

In Canada the account is called the Consolidated Revenue Fund (CRF). The Receiver General uses a centralized banking system (Government Banking System or GBS) to record the inflow of funds to the CRF. Using this system, cash balances at the Bank of Canada are reviewed and approved each day by the Receiver General. (23)

https://open.canada.ca/data/en/dataset/c31a17df-9964-4565-ad3f-42bcd82dba59

https://www.bankofcanada.ca/wp-content/uploads/2010/06/r952d.pdf

The main priority in managing these balances is to ensure that the government has sufficient cash to meet its daily needs. This requires careful forecasting and monitoring of the daily flows, as well as an ongoing borrowing program to refinance maturing debt and to replenish the balances during periods when outflows, on average, exceed inflows. Which means money must be in the CRF before it can be spent. (24)

There are a number of data sets freely available to the public that show where and when funds are transferred to and from the Consolidated Revenue Fund. What this data shows is that taxes, revenue, and borrowing (TAB)S precede government spending. (25)

So to wrap up here, I posed three questions to the DoF Canada:

1.When the federal government runs a budget deficit or spending exceeds tax and other revenue does it immediately produce securities (bonds and treasury bills) for auction at the Bank of Canada to primary dealers?

2.Do the funds created by the sale of these securities have to be in government accounts through the receiver general before they can be spent?

Or

3.Does the government credit programs first and then acquire funding through the above process later?

I eventually got a response with a statement from Nathalie Gauthier, Manager of Consultations and Communications Branch of the Department of Finance Canada, dated October 9, 2020:

To make up the shortfall between the revenue and spending, the Government of Canada issues bonds and treasury bills to raise the necessary funds. The Bank of

Canada, as the Government of Canada's fiscal agent, conducts auctions on behalf of the Government where these securities are sold.
The funds raised through the sale of the Government of Canada securities flow into the Receiver General account. From there, these funds are used to finance program payments or extinguish obligations due.

All spending undertaken by the Government is financed in advance.

So, in conclusion

There is no empirical evidence to support the MMT S(TAB) hypothesis. It is based on nothing but supposition, conjecture and misleading statements. All available evidence shows the opposite is true, governments tax and borrow before they spend. Thanks for your time.

Endnotes: Are organized by the order in which they are presented.

1. https://www.jewishvirtuallibrary.org/joseph-goebbels-on-the-quot-big-lie-quot

2. https://progressivemoney.ca/money-creation

3. The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy
   By Stephanie Kelton
   References to quotes from the book will be given by page number and the order in which they are presented.

4. p. 3

5. p.17

6. p.17 & 18

7. https://progressivemoney.ca/money-creation

8. p. 23 Warren Mosler and American economist

9. p. 24

10. p. 24

11. https://progressivemoney.ca/money-creation
    / Capital Adequacy Requirement Ratios

12. Reserve requirements ended in July of 1994 / Notes:

https://www.bankofcanada.ca/rates/banking-and-financial-statistics/bank-of-canada-assets-and-liabilities-month-end-formerly-b1/

13. Reserve requirements the US Federal Reserve: https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20201222a1.pdf

14. John Carney, What actually constrains bank lending: https://www.cnbc.com/id/46970418

15. Source: Revised And Expanded Edition Debunking Economics The Naked Emperor Dethroned/Steve Keen/2011/Zen Books Ltd./page #308

16. p. 23

17. p. 24

18. p. 24

19. p. 25

20. Warren Mosley's Improbable Story: https://progressivemoney.ca/the-deficit-myth-revised

21. Do Taxes and Bonds Finance Government Spending? Stephanie Kelton

22. p. 132

23. Consolidated Revenue Fund: https://open.canada.ca/data/en/dataset/c31a17df-9964-4565-ad3f-42bcd82dba59

24. Managing the federal governments cash balances: https://www.bankofcanada.ca/wp-content/uploads/2010/06/r952d.pdf