

# Smith, MMT, and science in economics

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 [johnhcochrane.blogspot.com/2019/05/smith-mmt-and-science-in-economics.html](http://johnhcochrane.blogspot.com/2019/05/smith-mmt-and-science-in-economics.html)

Many blog readers have asked for my opinions of "Modern Monetary Theory." I haven't written yet, because I try to read about things in some detail, ideally from original sources, before reviewing them, which I have not done. Life is short.

From the summaries I have read, some of the central propositions of MMT draw a false conclusion from two sensible premises. 1) Countries that print their own currencies do not have to default on excessive debts. They can always print money to pay off debts. True. 2) Inflation in the end can and must be controlled by raising taxes or cutting spending, sufficiently to soak up such printed (non-interest-bearing) money. True. The latter proposition is the heart of the fiscal theory of the price level, so I would have an especially tough time objecting.

It does not follow that the US need not worry about deficits, and may happily borrow tens of trillions to finance all sorts of spending. Borrow \$50 trillion or so. When bondholders revolt, print money to pay off the bonds. When this results in inflation, raise taxes to soak up the money. OK, but this latter step is exactly raising taxes to pay off the bonds. Moreover, if bondholders see that the plan is to pay off bonds with printed money, they refuse to buy or roll over bonds in the first place and the inflation can happen right away.

This may reflect a common confusion between today's money with the new money that pays off debt. It would only take \$1.5 trillion in extra taxes or lower spending to retire current currency (non-interest bearing government debt) outstanding. But that's not the task after the great bond bailout. Then we have to raise taxes or cut spending by, in my example, the \$50 trillion printed to pay off the bonds. Large debts are either paid or defaulted, and inflation is the same thing economically as default. Period. (Currency boards run in to some of the same problem. Backing today's currency is not enough to avoid devaluation, if one does not back all the debt which promises to pay currency.)

I must admit some amusement that Keynesian commentators, having urged fiscal stimulus and decried evil "Austerians" for years, are apoplectic to be passed on the left. But that does not make the ideas of those passing on the left any more right. There is also a different and interesting strain of thought, exemplified by recent writings by Larry Summers and Olivier Blanchard, that the current low interest rate environment might allow for somewhat, but not unlimited, extra borrowing. Those ideas are completely different analytically. I hope to cover them in a later blog post.

## ***Noah Smith and guru-based theory***

But, as I said, I have not studied MMT, so perhaps I'm missing something. Enter [Noah Smith](#), who has delved in to figure out just what MMT is and whether or how it hangs together.

Noah interestingly characterizes MMT as "Guru-based theory." Noah:

## Formal Models vs. Guru-Based Theories

These days, most economic theories are collections of mathematical models. If you want to know what the theory says, you can parse out the models and see for yourself. You don't have to go ask Mike Woodford what New Keynesian theory says. You don't have to go ask Ed Prescott what RBC theory says. You can go read a New Keynesian model or a Real Business Cycle model and figure it out on your own.

MMT is different. There are many wordy explainers and videos that will explain some of the concepts behind MMT, or tell you some of MMT's policy recommendations. But that's different than having a formal model of the economy.

... formal models have important advantages. For one thing, a good formal model can be compared with quantitative data, to see whether it works or whether it fails. Formal models can make testable predictions.

A second advantage of formal models is that you can figure them out for yourself, without having to ask any gurus. If you have to run to the gurus to ask them what the theory says any time you think you've found a flaw, it becomes almost impossible to skeptics or outsiders to evaluate the theory objectively.

This is a good insight, and well supported by the rest of Noah's post. After an exhaustive tour of Noah's struggles with one paper that does seem to offer a framework, he offers

I'm not confident in my ability to answer these and other important questions by reading L. Randall Wray blog posts, or long online explainers, or wordy MMT papers. I want to be able to read a concrete, formal, well-specified model like the Tcherneva model above, and answer these questions myself. And the rest of the non-MMT econ deserves this as well.

(The paper is "Monopoly Money: The State as a Price Setter" By Pavlina R. Tcherneva, published in *Oeconomicus*, which as far as I can tell is a newsletter of the University of Missouri-Kansas City.)

There are plenty of guru-based theories around. Much of literature and philosophy is concerned with "what did x really mean?," from Shakespeare to Marx. The impersonality of theory is the main distinction of science. If you want to know what Newton really meant, you do not learn latin to read the original, you pick up the most recent undergraduate textbook.

### ***The sociology of science***

I view it somewhat differently however.

In fact, formal models don't totally speak for themselves, especially on the research frontier. New-Keynesian models are a good example since there is an active debate on just what the equations say and how to interpret them. I've devoted a lot of energy to this debate. It is conducted in the pages of peer-reviewed journals. There is, or was, an active debate on what the equations of quantum mechanics and general relativity say too. And while the occasional testable prediction makes for spectacular rhetoric, economics like other non-experimental

sciences is pretty thin on testable predictions. Otherwise, we would still not be debating what really caused the Great Depression, whether minimum wages help or hurt disadvantaged people, whether the government borrowing money and spending it, even on totally useless projects, stimulates the economy or not.

I read Noah's story instead as a good documentation of how MMTers, and especially MMT advocates in the policy world, ignore the scientific *sociology* of contemporary economics. There are no MMT articles in major peer-reviewed academic journals. There are essentially none at major professional conferences, such as the American Economic Association meetings. There are no academic MMT articles in the major working paper series. There are no MMT books from university presses. While Noah points to the content, the lack of formal modeling, I found Noah's characterization of the messenger just as interesting. It is almost entirely a creature of tweets, blog posts, youtube videos, and so on.

Now, the sociology of science is no guarantee of correct results. Nine out of ten or more published articles are wrong, or just plain silly. From a free-market economists' point of view, whole academic fields, journals, and professional societies seem to have gone off the deep end, especially in the humanities. Fads have come and gone in the pages of the American Economic Review too.

But as many bad ideas survive in the society of "science," the number of genuinely successful ideas, ideas eventually seen to be logically and scientifically correct, and (most of all) ideas that are ready to be reliable guides to policy, that ignore this scientific sociology is vanishingly small. Yes, there are new ideas that begin new fields -- economics itself started with a book by Adam Smith. But monetary economics is a well established field, and this range of ideas -- the nature of money, the tax backing of money, the interaction of monetary and fiscal policy, government budget constraints and so on -- is well within the range that current intellectual institutions debate knowledgeably. The fraction of good solid ready-for-policy ideas of that sort outside the scientific mainstream is vanishingly small, and the fraction of crackpot junk science there is pretty large.

I do not blame the MMTers. They have some ideas, and they have found an audience ready to listen via this nontraditional method. The curious thing is that those who frame the national discussion of economic policy, in politics and media, take so seriously ideas that have not made it in to the "scientific" mainstream.

That larger society of economic discussion and policy bears some of the blame. While disparaging MMTers, their commitment to science-based policy in general is not deep. Most macroeconomic policy analysis takes place within late 1970s era Keynesian ISLM framework that has not been seen in major peer-reviewed journals since that time. Perhaps, as even luminaries such as Larry Summers and Paul Krugman have written, everything since then has been a misguided waste of time. Such things do happen in economics. But then we can't complain too much and get on our scientific high horses about MMTers relying on guru-based views of the world that avoid the trappings of economic science. Traditional Keynesianism is at this point pretty much a guru-based enterprise and a verbal tradition, not based on formal models (which were eviscerated in the 1980s) published in academic

journals. Likewise, much of what the Fed tries to digest and control -- anything with the words "systemic risk," "liquidity," "contagion" for example -- goes, to put it politely, far beyond anything of which we have solid scientific understanding. The rest of economic policy is even further removed. There isn't much scientific basis for the SEC's micro-management of asset markets, the FTC's ideas about competition, the labor departments intensely specific rules, and so on. What study there is tends to be academics jumping in after the fact to find new questions to which policies might be the answer.

In sum, the policy and political world would have a lot more room to complain if they demanded more "science," both in the method of analysis and the form of its communication, before acting.

## **MMT**

I did a little background research, beyond reading Noah's blog post, to find the academic articles on MMT and to document the above views in more detail. If I am missing important things, especially crucial peer-reviewed publications, feel free to let me know via comments.

I started with the [social science research network \(ssrn\)](#) which has pretty much every academic article on economics written since its founding. It has a lot of other stuff too. And it's open to everyone, unlike (say) the NBER working papers. (needless to say the same search in [NBER working papers](#) came up empty). I searched for "modern monetary theory" and found a grand total of 11 results. Several of those were spurious -- modern monetary theory, can mean, well, modern (monetary theory) not (modern monetary theory), i.e. new-Keynesian models, micro foundations of money, and so on. All I found were three blog posts,

- Modern Monetary Theory - A Primer on the Operational Realities of the Monetary System, by Scott T. Fullwiler
- Modern Money Theory: A Response to Critics, by Scott T. Fullwiler, Stephanie Bell and L. Randall Wray
- The Conscience of a Neo-Liberal Scott T. Fullwiler

Only one that looks like a paper

Is Very High Public Debt a Problem? Pedro Leão

And a critique

Does Government Spending Increase Your Saving? Hak Choi "This paper works out the rights and wrongs of government spending, but disproves the extreme part of the modern monetary theory."

Another way to do this is to find writings by specific authors, Scott Fullwiler, and Stephanie Kelton. I found their author pages on ssrn, but that's not comprehensive. I searched for their CVs. Normally, academics post their cvs, or their departments' web administrators do, so you

can get a full list of their publications that way. Strangely, I couldn't find CVs for either, even on [Kelton's snazzy website](#). [Pavlina R. Tcherneva has a publication list](#), but it does not include any peer-reviewed articles. If you know where these are hiding, let me know.

This search did turn up some academic articles.

Setting interest rates in the modern money era ST Fullwiler - Journal of post Keynesian economics, 2006

Timeliness and the Fed's daily tactics ST Fullwiler - Journal of Economic Issues, 2003 s

Macroeconomic stabilization through an employer of last resort ST Fullwiler - Journal of Economic Issues, 2007

Paying interest on reserve balances: it's more significant than you think. ST Fullwiler - Journal of Economic Issues, 2005

In [one ranking](#), the Journal of Post-Keynesian economics is #453, and Economic Issues #972.

### ***Last thought***

Now I really don't want to be snooty here. As there is a place for blog posts in throwing out ideas and discussing them (I'm obviously a big believer in discussing economic ideas via blogs!), there is an important place in science for niche journals. Many important new ideas have had to start their own journals, create a community of peers that will review papers, and advance a research agenda that way before breaking in to the mainstream.

But these ideas have clearly not yet made it in to that mainstream. The real question is, *when is an idea ready for widespread implementation in public policy?* How much of the sociology of science should we wait for before spending trillions of dollars? Though some good ideas have indeed been disparaged by the mainstream and took a long time to be accepted, there are so many bad ideas out there, that I think the answer is, a bit longer. Certainly the advocates of MMT seem not too interested in, say, writings on climate change expressed entirely on critical blog posts, u-tube videos, and nice climate-skeptic journals. Their embrace of MMT has made a mockery of their embrace of "science" on climate questions. But there is plenty of hypocrisy going around on those subjects.

(Note to readers: Yes, the blog is back. I had to take a few weeks off to get through some screaming items on the in-box.)