Book Review

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The Deficit Myth
by: Stephanie Kelton
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Review Symposium of *The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy*[1]

Foreword to the Review Symposium: Reynold F. Nesiba

The Deficit Myth is one of those rare books which contains important ideas, and yet is easily accessible to the public. At a time when public investment is urgently needed to decarbonise and to transition to renewable energy, the book's central message that our current fixation with the budget deficit is misplaced and disingenuous is timely and on point. Kelton points out that since sovereign governments (like the USA, Australia, Japan, Canada) are currency issuers, they can easily supply whatever funds are necessary. Not only does our current fixation on the budget deficit evidence a dearth of imagination, but it takes away attention from the deficits that really matter: good jobs, savings, healthcare, education, infrastructure, climate, and democracy. With a solid understanding of MMT, we can map out a sustainable and equitable economy which can provision for all, as Kelton (2020, p.260) writes,

> "A just and more prosperous world – one that combines ecological sustainability with full-employment, human well-being, a lower degree of inequality, and excellent public services that meet the needs of all – is within reach. As we collectively expand our understanding of public money and shift our nation's focus away from an obsession with budget deficits, we can begin to build a better economy, one that works for all of our people."

Three reviewers contributed to this symposium: Dirt Ehnts (Germany), Zdravka K. Todorova (USA), and Reynold F. Nesiba (USA). Each essay elucidates key elements of MMT, stimulates thinking on how to move progressively forward, while also providing helpful pedagogical tips. It is critical that educators incorporate MMT into the economics curricula in order to inject a healthy dose of realism into macroeconomics, and to provide hope and optimism for our students.

Note

1 Editor's note: a preliminary version of Todorova's and Nesiba's essays was presented at the 42nd annual meeting of the Association for Institutional Thought, April 2021, held virtually. For a YouTube presentation of the session, along with Stephanie Kelton's response, see https://www.youtube.com/watch?v=WLjaojNHEsQ.

Reviewed by Dirk Ehnts

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This book by Stony Brook University professor Stephanie Kelton is as timely as can be. Written before the COVID-19 pandemic, it addresses the question of how we should think about the economy in terms of resources and money and how we can build a better economy. Kelton's book is aimed at a wide audience. Economic jargon is visible in footnotes mostly, while metaphors mimic the models that underpin the book. The book is filled with anecdotes that add to the narrative. The chapters of the book are organised around six myths, followed by a chapter that discusses the 'real' deficits and a concluding chapter. The book is revolutionary not because it contains new insights, but because it makes these insights accessible to the public in a very easy way.

In order to grasp its significance, let us move back to early 2019. Modern Monetary Theory (MMT) just gained currency with the rise of Alexandria Ocasio-Cortez, a Democrat Congresswomen from New York City. Mainstream academics hit back by letting it be known that they would not agree at all with this new theory. The Initiative on Global Markets (IGM) at Chicago Booth invited its panel of experts to express their opinions. Two statements that supposedly represent MMT were given. While the second was a dud, the first question came close enough to represent MMT: "Countries that borrow in their own currency should not worry about government deficits because they can always create money to finance their debt."

Apart from the fact that according to MMT, countries – or rather federal governments – do not 'borrow' their currency, it is true that MMT states that (federal) government deficits can always be financed. The experts of the IGM disagreed (26%) or strongly disagreed (57%) with that statement; 7% had no opinion and 10% did not answer, but no economist either agreed or strongly agreed with the statement.

Fast-forward to the end of 2020. In fiscal year 2020, the public deficit increased three-fold to three trillion (!) US dollars. Was there a problem? Did the US Treasury have problems paying its bills? Did the Federal Reserve change its operating procedures to allow such a deficit? No. MMT economists got it right. The mainstream economists failed miserably. Against this background, the book is tremendously important to reform macroeconomics and economics. If economics wants to at least pretend that it is NOT a dismal science, it will have to change. Otherwise, student numbers will drop as bright young people will turn away from a discipline that has lost contact with empirical reality.

Kelton's book dispels the myths that are taught in mainstream macroeconomics classes around the globe. She starts with the myth that the federal government budgets like a household or private business. The actors in the economy can be divided in two camps: issuers and users of currency. The federal government is a currency issuer; households, businesses, and state and local governments are currency users. Those who cannot create US dollars need to acquire them before they spend. These are the users of currency. The issuer of currency is the federal government. As Kelton notes, the US constitution grants the federal government the exclusive right to issue currency (p.17). Effectively, it has a monopoly as there is just one supplier. A country that issues its own nonconvertible fiat currency attains monetary sovereignty, i.e., "[t]hey can use their currency-issuing capacity to pursue policies aimed at maintaining a full employment economy" (p.19). In other words, such a government cannot run out of money. Almost all governments of modern states are currency issuers, e.g., the US, the UK, Australia, and Canada. Countries that fix their exchange rates or issue public debt in foreign currency have little or no monetary sovereignty; they face constraints like a household and hence must worry about running out of money.

Once it is established that the US Federal Government is a currency issuer and not a currency user, it follows that taxes and bonds do not finance government spending. This is the core idea of MMT. There is no such thing as taxpayer money. We cannot issue US dollars. All money ultimately comes from the central bank (banks create bank deposits, not money). Therefore, the idea that taxes and government bonds precede government spending is mistaken. There is no such thing as financing government spending for a currency issuer with monetary sovereignty. There cannot be such a thing as financing even! (Kelton recounts the first time Warren Mosler – the father of MMT – told her that government spends first and taxes later and that logically it could not be otherwise). The government does not want dollars (which it creates as a monopoly); rather it wants to provision itself. It taxes people to force them to offer work and produce things, like public parks, hospitals, and roads. The tax is not there to create an income. Taxes instead create demand for currency. When taxes are paid to the government, it does not actually get any dollars. It is just reducing the amount of money that we have. Kelton describes this as 'our first Copernican moment'.

The logical question becomes why does the government tax and borrow? If it does not finance the government, why bother? Four reasons:

1 the government needs to create demand for its currency in order to provision itself
2 taxes reduce purchasing power in the hands of the non-government sector, which reduces inflation
3 taxes alter the distribution of income and wealth
4 taxes can be used to discourage consumption of goods characterised by negative public consequences.

Given today's extreme concentrations of income and wealth, firms are already struggling with their sales. Redistribution is good for business, Kelton writes. Also, taxes can and do influence prices and can encourage or discourage certain behaviours. Taxing cigarettes or excessive speculation are given as examples. After all, taxes are important.

So what about borrowing? In contrast to taxation, borrowing is not technically necessary. Government does not need to borrow, since it can print as much money as it wants. It chooses to offer an interest-bearing money to those who want it. In order to buy it, you need cash. Kelton calls cash 'green dollars' and bonds 'yellow dollars'. When the government spends, it increases green dollars. When it taxes, it withdraws green dollars. The US Government chooses to sell US Treasuries in an amount equal to its deficit spending, which is the difference between spending and tax payments. It allows its people to exchange green dollars into yellow dollars. That is all. The government, Kelton states, can never run out of money. That does not mean that there are no limits: "MMT is not a free lunch" (p.37).

MMT distinguishes real limits from self-imposed constraints. Kelton discusses the latter, e.g., the PAYGO (pay as you go), a political rule that currently operates in the USA House of Representatives, whereby any increase in spending must be offset by an increase in taxes or a reduction in spending. However, since PAYGO was imposed by Congress, it can be suspended by Congress. Kelton notes that Congress "frequently unshackles itself" (p.39). So why even bother with the rules? The answer is that many politicians find these constraints politically useful. They can express sympathy for those demanding more spending while hiding behind the deficit myth. The real limits are resource constraints. Kelton proposes to budget real resources instead of focusing on the deficit.

The second myth is that a federal deficit is evidence of overspending. Kelton disagrees – *inflation* is evidence of overspending. The current policy framework asserts that lower inflation can be traded for higher unemployment and vice versa. The central bank increases the interest rate once inflation is deemed to be excessive. Kelton thinks that the Fed is too quick in raising interest rates, stalling the economy before it reaches its resource limit. The result is that millions of American are unemployed for no good reason. Kelton discusses the problems associated with the NAIRU and its measurement. She also questions the ability of the central bank to manage inflation. Kelton proposes a "better mix of fiscal and monetary policy to keep the economy operating at its full employment potential" (p.55) – the quintessence of MMT's practical macroeconomic policy making.

Kelton invokes John Maynard Keynes to explain the absence of full employment in the US economy. Capitalist economies tend to operate with insufficient aggregate demand. Firms will not fix this problem. Borrowing more puts them on the hook for more debts. Firms, as well as households, are currency users. Driving them into debt is what we usually call monetary policy. However, after the last financial crisis Americans wanted to reduce their debt and not increase it. Monetary policy is not powerful enough to expand the economy, fiscal policy needs to take over. Since this probably will not change for the foreseeable future, Kelton recommends "a shift away from the current reliance on central banks to deliver on the twin goals of full employment and price stability" (p.59). Utilising Lerner's functional finance approach, she suggests adjusting taxes and government spending in order to balance the economy in terms of the two policy goals. A job guarantee would ensure that everyone who wants to work but cannot find a position gets a job. The federal government will pay a wage to workers employed in this program. This is a buffer stock approach. The government provides many jobs in bad times and some jobs in good times so that full employment does not depend on the position of the business cycle. Recessions will still happen, and thus the problem of involuntary unemployment cannot be solved by government spending. The job guarantee will smooth the price level, since unemployed workers get higher incomes in times of crisis. Also, in boom times, workers transition out of paid guarantee jobs but not out of unemployment. This softens the increase in income during the boom. Kelton suggests that jobs should evolve around the things we care for: people, communities and the environment. In wrapping up the chapter, Kelton returns to the issue of taxation. There is a strong case to tax the rich, she writes, because of the extreme concentration of wealth that is a threat to our democracy and the functioning of the economy.

Chapter 3 deals with 'the national debt (that isn't)'. Kelton makes the point that "the currency issuer's spending is *self-financing*" (p.87). The government spends first, only later is that money used to make tax payments or purchase government bonds. The purchase of government bonds therefore does not finance the government as it just returns money to itself already spent. Instead, government bonds are issued to support interest rates. Kelton calls reserve balances at the Fed green dollars and US Treasuries yellow dollars. Holders of reserve balances have the option to turn green dollars into yellow dollars. This is probably the centrepiece of MMT, as this turns conventional wisdom on its head. While most people believe that taxes and bonds finance government spending, in reality it is the reverse: government spending finances taxes and bonds. This also means that government expenditures create an equivalent private income: Each dollar spent is a dollar earned. The US debt clock should be seen as a US dollar savings clock as Kelton suggests.

Kelton points out that China does not finance the US Government. It just prefers to hold the dollars it earns through trade in the form of yellow dollars instead of green. Greece, however, is another story altogether. The country introduced a currency it could not issue, (i.e., this would be analogous to Georgia or Illinois in the US context). Relegated to the status of a currency user, Greece "depended on tax revenue and borrowing to pay the bills" (p.84). Financial markets tend to demand a premium because of the default risk, which became a problem in the Euro crisis. Bond yields on ten-year Greek Government bonds rose to more than 35%. Contrast this to the US and the UK, both sovereign currency issuers, where interest rates fell, where, "the central bank has ironclad control over its short-term interest rate, along with substantial influence over rates on longer-dated securities."

This is very important in the context of current discussions about "how to finance the Corona debt." There is nothing to 'finance' – governments spent a lot of money, causing deficits and public debt to increase. Economists arguing to stabilise public debt with a view towards the rate of interest (i) and the rate of growth (g) make a major mistake. They take the interest rate as an endogenous variable whereas in reality it is determined by the central bank. This invalidates the view of those like Olivier Blanchard claiming that governments can increase spending (and debt) while $i < g$, as the economy will grow out of its public debt. It also invalidates those concerned with rising interest rates in the future. Kelton quotes Alan Greenspan saying "investors face zero probability of default" (p.87). Kelton writes: "[T]he federal government can always meet its obligation to turn those yellow dollars back into green dollars. All it has to do is change the relevant numbers on the Federal Reserve's balance sheet" (p.87).

Having cleared that up, Kelton argues that income from increasing interest rates can be expansionary. Interest payments create income, and some of that income will be spent. Since government pays interest, a rising interest rate might fuel inflationary pressure. However, since about 40% of US public debt is held by foreigners this is a remote possibility at the moment. More relevant might be the distributional implications. Kelton also discusses the argument that the government should not pay interest at all, since it would only go into the pockets of those that already have money, increasing inequality further. Kelton also addresses the case of Japan. At 240%, its public debt-to-GDP ratio is the highest in the world. The nominal public debt is more than one *quadrillion* (a million billion!) yen. The Bank of Japan ensures through its policies that the yield of ten-year government bonds is at or near zero. It holds more than half of all outstanding Japanese Government bonds. Effectively, Kelton argues, it has retired (paid off) half of its public debt. It could even retire all of its public debt and become the least indebted country in the world.

This leads Kelton to the only episode in US history with no public debt. In 1835, Andrew Jackson paid down the federal debt to the last cent. Two years later, a depression started. The cycle of good times – leading to public budget surpluses and private sector deficits – and bad times – with the reverse effect – repeated itself over the 19th century and up to the Great Crash of 1929. Discussing the Clinton surplus of the 1990s and the Great Recession, Kelton argues that public surpluses are ultimately unsustainable. This is the antithesis of the thinking of most economists.

Chapter 4 makes the point that government spending, rather than crowding out private investment, adds to our wealth and collective savings. Kelton praises Wynne Godley and utilises his simple model consisting of the government and the non-government sectors. Kelton examines payments between these two sectors. It is obvious that all government payments create income (and hence savings) in the private sector. Tax payments drain savings from the private sector. Government deficits are matched dollar-by-dollar by a financial surplus of the non-government sector. Therefore, public spending (and the resulting deficit) adds to our wealth and does not crowd out our financial ability to invest. The crowding-out myth is taught in practically all macroeconomics classes in the context of the (supposedly Keynesian) IS/LM-model. It relies on the interest rate increasing as government increases its spending.

Kelton goes into more detail regarding the point that the interest rate is a policy variable. In the US, increased government spending injects reserves into the banking system. Since (most) banks have more reserves but certainly do not need all (some to convert into cash for customers and some for clearing), the supply on the interbank market increases. The only way for the interbank market to clear is an adjustment of the interest rate *downwards*. This is the exact opposite of what the IS/LM-model says. The central bank uses bond sales to mop up the excess reserves and restore the interest rate on the interbank market. Kelton describes the workings of the primary dealers and other parts of the fiscal-monetary nexus. In the end, well-designed fiscal policy can crowd-in private investment rather than crowd it out.

The next myth concerns the way we understand (international) trade. Usually, the US trade deficit is portrayed as the US losing. Instead, Kelton argues that it represents the US getting extra stuff. Kelton invokes Donald Trump's idea that the US would be losing well-paid jobs. To him, the current account deficit is a loss of dollars. Kelton mentions that when Trump complained about the US sending wheat to Japan and getting cars in return, her son thought it would be a very good deal. She recognises that there is a financial and a real side to trade. The US would 'win' on the real side and 'lose' on the financial side. In trade, the US sends more dollars abroad than it receives from the rest of the world. Matching the financial side, the US imports more than it exports, allowing it to consume more than it produces. However, importing goods and services can crowd out domestic jobs, and this is what Kelton emphasises. She describes the problems of US workers whose jobs have been exported and the Democratic Party's "tone-deaf response" (p.130). Here, she writes about politics, wondering why the Democrats gave up on many working-class voters.

Kelton returns to Godley's financial balances and explains that "as long as the federal government stands ready to use its fiscal capacity to maintain full employment there is no reason to resort to a trade war" (p.131). She recommends a federal job guarantee, through which everyone wanting and able to work to work would get a government-provided job with a living wage. This would allow us to focus on real resources, social needs, and environmental benefits.

Kelton then discusses the special position of the US dollar in the world economy and the spectrum of monetary sovereignty. She notes that the US must run trade deficits in order to supply other countries with US dollars, who need to buy food, medicines, and other critical imports as well as pay down IMF loans and other foreign currency-denominated debts. Kelton also discusses the Eurozone, making the point that under the normal rules (which had been either temporarily shut down or amended) all Eurozone members are relegated to currency users. This is crucial for understanding why the Greek government ran out of euros whereas this cannot happen to the US.

Kelton follows up with a discussion of developing countries, pointing out that they can get into a vicious circle when they sell domestic currency to acquire dollars in order to buy needed imports, leading to import-led inflation and political turmoil, e.g., Venezuela, Argentina, and Tunisia. Kelton recognises that developing countries with trade deficits or debts denominated in foreign currency are more vulnerable than sovereign currency issuers like the USA. If they cannot earn or borrow the foreign exchange they need, this means real trouble. She notes that the recommendations given to developing countries by the developed world are the opposite of what they did at the same stage of developing. Kelton replicates the 'kicking away the ladder' argument by Ha-Joon Chang. She states that "trade is not about competition among countries but about power relationships among specific interests within specific countries" (pp.150–151).

Kelton recommends the US should lead through a Green New Deal, and low interest rates, and thus promote economic tranquility. Countries with monetary sovereignty, including Mexico and Argentina, can afford to run their own job guarantee schemes to ensure that trade does not lead to unemployment. Kelton also wants to reform trade arrangements by demanding ecological standards and labour protections. She argues that lack of food and energy are solvable problems. Kelton suggests that developing countries regulate financial transactions across borders since foreign investors can increase exchange rate volatility, which is not helpful. Monetary sovereignty increases when there is no threat that foreign investors selling assets can drive down the exchange rate.

The sixth chapter deals with the supposedly financially unsustainable programs like Social Security and Medicare. Kelton declares that the federal government can always make the payments if it wants to; thus, it is the capacity to produce the real goods and services that matters. She explains why FDR, when he created Social Security, created a trust fund to pay for it. It was supposed to show people that they will get back what they put in. The monetary reality, however, tells us that the government always creates new money when it spends. So, the trust fund does not pay for Social Security. As long as the US Government does not run out of money, Social Security will not and cannot go broke. Billionaires like the late Peter G. Peterson have spent hundreds of millions on public relation campaigns undermining popular social programs; nevertheless, their underlying economic logic is sound. Even Alan Greenspan knew that, telling Congress: "There's nothing to prevent the federal government from creating as much money as it wants and paying it to somebody" (p.182). He went on to point out the real issue: "How do you set up a system which assures that the real assets are created which those benefits are employed to purchase?" (p.183). So, Kelton summarises, we need an economy that delivers the goods and services we need. How do we do that? She presents her solution in the next chapter.

Fiscal deficits are usually emphasised by US policy makers. In Chapter 7, Kelton turns this around and discusses the good jobs deficit, the savings deficit, the healthcare deficit, the education deficit, the infrastructure deficit, the climate deficit, and the democracy deficit. These critical sections are where Kelton develops a progressive political program. The good jobs deficit is easy to spot. Many Americans work in bad jobs, often more than one. However, the federal government cannot run out of money, so why should all these bad jobs not be good jobs? Next up is the savings deficit. Kelton finds that 77% of Americans do not have adequate retirement savings. This is mostly because incomes are very unequal and those who earn little cannot save. This is especially relevant for black and Hispanic families and for women in general. Understanding MMT, there could be a public retirement system that takes care of this deficit. Health care, education and infrastructure, are also deficits where the solution is obvious: use the government to pay for eradicating these deficits.

Kelton understands the severity of the climate deficit. We need to overhaul the US and the global economy to eliminate all fossil fuel consumption by 2050. Infrastructure needs to be designed, added, rebuilt, and updated. Massive investment in renewable energy sources is needed, too. Kelton points out that the carbon clock established by the Mercator Research Institute on Global Commons and Climate Change that counts the days until humanity has emitted all the greenhouse gases it can afford and still stay under two degrees of warming is much, much better than the older version showing US public debt. Last but not least, there is the democracy deficit. Kelton notes that inequality of wealth and incomes has risen to heights not seen since the Gilded Age and the robber barons. She wants to strengthen the progressive part of the tax code. She also argues in favour of pre-distribution, which means that the state should prevent inequalities before taxation and redistribution take place. She proposes to strengthen unions through reforming labour laws and thus shifting power to workers. This would be just because workers create wealth but do not get their fair share. To Kelton, democracy means that we all have a voice. Since politics and economics are intertwined, she argues that Congress should use its powers to fix the real deficits just described. This would move us "from a narrative of scarcity to one of opportunity."

The concluding chapter discusses how to build a better economy. Kelton believes that change comes from the bottom up, which is why MMT needs to be understood by the voters. It is not a policy package or something that could be implemented, but rather a description of how money works today. There is a difference between artificial barriers (like the debt ceiling) and legitimate constraints (availability of resources). Most economists that work on policy do not understand that and hence have no understanding of how a monetary economy works. The Biden administration seems to be running into exactly this problem since it has promised to pay for the fiscal packages so that public debt will not increase.[1] The Trump administration, when it cut taxes for the rich, did not offset with 'pay fors' and hence, the public debt increased. It seems that when the US administration gives more money to the rich there is no problem, but when more money is given for progressive causes that benefit the 99% there suddenly is no money, so that additional spending needs to be paid for by cuts in spending elsewhere or tax increases.

Kelton stresses that we should think about government spending in terms of real resource constraints. We should not ask how we pay for it, but rather how we resource it. This is the main message of the book. MMT is about "identifying the untapped potential in our economy" (p.235). With millions of American looking for paid work there is plenty of fiscal space. Irrational policies, based on current economic thinking, have caused a turn away from stimulus and towards austerity, imposing pain on millions of workers worldwide. Kelton understands that restoring economic security to the working class requires more than just increased government spending. Monopolies will have to be tackled, the tax code reformed, labour laws changed, trade and housing policies reformed, and more. This will lead toward a new economic model, where the government takes responsibility for stabilising output, employment, and inflation.

The government would have to play a bigger role in the economy, taking over responsibility from the Federal Reserve. Kelton asks whether we can trust the government with that. She thinks that mainly we already do, since Congress can spend whatever it decides. Also, Congress could stop issuing Treasuries and ask the Fed to supply interest-bearing securities. And if it needs new powers to do that Congress can change the law to achieve just that. Kelton adds that lawmakers should receive some guidance from economists about how much government spending is needed and how to best achieve that. She argues for 'mandatory driverless spending'. She explains how automatic stabilisers work, with the federal government spending more in times of economic distress. That, however, is not enough, so she suggests implementing a job guarantee. This would stabilise the economy more and eradicate involuntary unemployment. The jobs, offered to the unemployed in a decentralised way and paid for by the federal government, would fulfil unmet community needs and shift the economy towards what Kelton calls a 'care economy' which cares for people, communities and our planet. This, however, is not all. In the next section, titled 'Guardrails for discretionary fiscal adjustments', she describes how discretionary spending has a role to play as well. Instead of living within our financial means we must budget toward our biological and material means. While economists would probably want to see more detail, the essential logic should be enough for the average (non-economist) reader. So, we arrive at a people's economy where we can imagine the things we want and then build them if we have the resources and do not end up ruining our planet. With this, Kelton closes her book.

About a quarter century after Warren Mosler first contacted academics, MMT has grown to a theoretical body of knowledge about money and the economy that is perhaps the strongest contender to replace mainstream economics. This is because it has identified the major issue that neoliberalism builds upon: the taxpayer's myth. Margaret Thatcher put it very well in her speech to the Conservative Party conference on 14 October 1983: "there is no such thing as public money...there is only taxpayer money" (p.20). Almost everybody on the political right agrees with that statement, and most on the political left, which has created a neoliberal world where both left and right are 'constrained' by public deficits and public debt because of potentially running out of money. As Keynes (2010, [1936], p.372) noted, the capitalist system by itself fails to generate full employment and produces "an arbitrary and inequitable distribution of income." To enable the state to find solutions to these and other problems requires jettisoning the taxpayer's money myth. Kelton's book is a great step in that direction as it provides the public with a reliable guide to Modern Monetary Theory and how to build a people's economy.

Reference

Keynes, J.M (2010 [1936]) *The General Theory of Employment Interest and Money*, Martino Publishing, Mansfield Centre, CT.

Note

1 https://twitter.com/POTUS/status/1454208491783081985.

Reviewed by Zdravka K. Todorova

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In Fall 2020 I used *The Deficit Myth* as a supplementary book in Intermediate Macroeconomics at Wright State University in Dayton, Ohio – a public university with primarily a regional focus. In this short note, I will discuss the book's role in my class along with general impressions of student reception.

I designed and developed the Intermediate Macroeconomics for asynchronous online delivery and took an applied approach. I used Kevin Hoover's *Applied Intermediate Macroeconomics* (Hoover, 2011) for structure and background. I supplemented each syllabus topic with a contemporary policy note, or a measurement/issue report from a government agency or a research institute. The course was designated as writing intensive. Specifically, I designed it so students practice different forms of writing in economics: a short descriptive report, discussions of data trends and measurement exercises; a reflection on economics in the news; storytelling with data; portfolio editing, including revisions and reflection on assignments; as well as the most informal type of writing – journaling. Students journaled on each chapter of *The Deficit Myth* and shared their entries only with me. They also had an opportunity to share reflections in their final portfolios.

The overall goal of the intermediate course was to deepen macroeconomic knowledge through a structured, applied, exploratory learning experience, focusing on practical skills, data exploration, varieties of writing in the discipline, and reflections on the topics, as well as on the learning process. The course focused on developing and practicing skills and was designed around the objectives of navigating macroeconomic data (e.g., FRED – Federal Reserve Economic Data); applying measurements, reflecting on data trends; deepening understanding of macroeconomic concepts and issues at the intermediate level; and practicing forms of economic macroeconomic writing.

To implement this more applied and reflective approach, I decided to leave out completely the introduction to the IS-LM model. The model takes too much time and, I think, there is no pay-off for intermediate macro students. My view is that students benefit from more time to explore trends and developments in the economy and to practice writing in the discipline, including reflective and informal journaling. Coming from Post Keynesian and Institutional Economics, I find that it is best to introduce the IS-LM model in a proper theoretical and historical discussion. However, that would require even more time and would change the direction of the class. I doubt if it is worth dedicating the necessary time to this impractical model at the intermediate level, unless perhaps the class takes a heavy theory approach. Instead, we had more time for contemporary reports from agencies on pressing issues like COVID, inflation measurements, inequality, and for practical writing and working with data. Those were engaging and useful, and students appreciated the currency of topics.

Also, instead of a final exam, the course culminated with editing a portfolio, where students had an opportunity to reflect on their learning, on the material, and to revise assignments. Moving away from exams shifted the nature of the class towards students, the current economy, and practicing skills. Assignments were designed to practice the following skills: familiarity with macroeconomic data sources and trends; application of macroeconomic measurements; intermediate ability to discuss macroeconomic news and issues in connection to concepts and basic theoretical debates; practicing storytelling with macroeconomic data and visualisation in Excel; writing concise descriptions of complex macroeconomic topics; and compiling and editing a portfolio with reflection. Dropping the IS-LM model and the 'no final exam' approach allowed me to structure the course around a variety of writing assignments (including journaling on the book). I gave detailed instructions and criteria for each writing assignment, stressing the difference in purpose, audience, tone, and degrees of formality. Students formulated their own topics in discussion with me, and this was part of the scaffolding of exploration and skills.

As part of engagement activities (20% of the grade) students journaled on each chapter of *The Deficit Myth*, which represented 10% of their grade.[1] Students engaged in a completely independent reading of the book, i.e., no lecturing about the book from me. I provided limited individual feedback to journal entries – only to point out an obvious mistake or factual confusion, to answer a question, or provide further reading, if a student expressed interest. I explained to students that the journal entries were entirely for their own purposes of learning (and the grade points were low stake). There are several worthy benefits of this approach:

- Students understand that reading and reflecting are the beginnings of writing.
- Students are given the freedom to read a text without the instructor's framing of the text and are free to form their own reflections.
- Students realise that we read not simply to gain knowledge, but also to raise new questions, which is the beginning of research and writing. I explained that journal entries could include questions and interest points for future research.
- Students appreciated the freedom and flexibility I gave in their reading schedules.

Given the controversial topic, and the many stresses students experienced during pandemic times, that degree of freedom worked well. Many students started with scepticism and were either won over by the book's arguments (without lecturing and guided discussion) or were intrigued and interested to learn more about the monetary system and policymaking. Many students remarked how they were drawn into the book once they started, and that they were engaged by the chapters.

Thinking about students' demanding schedules, I decided to offer flexibility to submit journal entries for each chapter, or at the end of November (after Thanksgiving). In retrospect that meant that some students started reading the book later in the semester, even as I encouraged gradual reading. Perhaps it would be better to require regular submissions of journal entries. Yet, this would take away from the point about the benefit of informal writing for one's own learning (and pace).

Reading journal entries and portfolio reflections, I found that this approach of unguided reading is appreciated and effective, especially when the book is intriguing, well written, and timely. It gives students more space (structured) and respects them as independent readers and thinkers.

What were the features, points, and topics in the book that impressed most students? One, the effective visualisation with drawings of buckets illustrating sectoral accounting and balances. Two, the examples from the arena of policymaking, and that the author was inside the process and shared her experience. Three, students related to the writing style, imagery, and examples, which made them think, and even change their mind about how they look at the economy.

Major concepts of *The Deficit Myth* that impacted students were 'currency issuers vs. currency user', 'the sovereign federal government cannot run out of money', 'government is not like a household', 'government surpluses were followed by depressions and recessions', 'austerity is a failure of imagination', and 'the role of political and social willpower', Warren Mosler's taxation and chores example, and 'their red ink is our black ink' – regarding sectoral balances of the public and private sectors.

It seems that Chapter 1 – 'Don't think of a household' and Chapter 4, 'Their red ink is our black ink' were the most revealing 'aha' moments for students. Most controversial were Chapters 7 and 8 – on issues (the deficits that matter) and the suggested policies – 'building the economy for the people', which is the subtitle of the book. Some noted that the author took a political view and said she should have not done so. I think one of the biggest challenges for students in economics is to understand that economics is political because it has to do with distribution and resource creation (or simply allocation). NAIRU is political. The supply and demand apparatus is political. Economic education overall should enable students to understand that, without relativism that usually is deployed to support the status quo.

Student engagement with supplementary texts, speaking about current anxieties and realities, should be appreciated in times of multiple crises. This book was read in Fall 2020 in a super-charged political climate and rampant demagoguery. Students are learning under such conditions, adding to their everyday challenges of work, family, and financial obligations, and building their own skillset, knowledge, and social positions. Some students voiced concerns about particular political consequences of the arguments, yet noted that they were engaged and challenged. Many students said that they had a better understanding, and wanted to learn more. At the end, this is our goal as educators. All students mentioned that either they found the book a good read, or it was informative in some way, and appreciated that they were challenged.

I hoped that students would engage in discussions with friends and family members. Being interested in intergenerational communication of economic ideas beyond the classroom, I was pleased to see that some students noted such conversations in their reflections, without me prompting that. Students are eager to share what they learn, and it is plausible that an accessible informative book like *The Deficit Myth*, may spark enthusiasm and cross-generational conversations about the economy beyond the curriculum.

Any economist/person interested in social justice should read Chapter 2 on inflation and unemployment to appreciate the potential contributions of Post Keynesian economics to understanding and addressing social justice problems. This chapter explains an important point regarding inflation and deficits: "Instead of accepting the presumption that we should always avoid adding to the deficit, MMT tells us to start by asking whether any of the proposed spending needs to be offset to mitigate inflation risk" (p.73). (This includes addressing asset and commodity inflation through structural, infrastructural, and regulatory changes). This chapter is also very useful to supplement teaching of the debates around the non-accelerating inflationary rate of unemployment (the NAIRU) and to show their political aspects.

Chapter 3 is one of my favourites because it challenges the demagogue scaremongering of the American people that each individual owes thousands and thousands of dollars to pay the public debt. Indeed, some students called out the misleading and panic-inducing artefact of the national debt clock on their own. I have a favourite title of a section in Chapter 3, 'The national deficit (that isn't)' – 'it's so, 000, 000, 000, 000 big' – so clever. Related, I appreciated the usage of some timely Mark Twain quotes; my favourite: "It's easier to fool people than to convince them that they have been fooled" (p.79).

Understanding the myths described in *The Deficit Myth*, and the basic facts about deficits and debt (e.g., Chapter 4 'Their red ink is our black ink') is needed in any transformative problem solving. The book discusses how deficits matter, and more precisely, the deficits that matter – in employment, care, environment, etc. Chapter 5 on trade, not only employs effectively the bucket visualisation for the national income accounts and sectoral balances, but also provides valuable political insights and connects to the structural change and geopolitical problems. One chapter title I would change, however, is Chapter 6, 'You are entitled!' perhaps to 'Entitled?'

The book emphasises the distinction between material resources and financial claims. The modern money strain of institutionalism offers the liberating understanding that material resources can be mobilised using the public institution of money as a permission to solve problems of livelihood. I call this getting out of the ceremonial encapsulation of artificial financial scarcity – to use institutional terminology. Hopefully *The Deficit Myth* will help more people to move beyond that painful self-encapsulation. The book and the MMT arguments including job guarantees (see Tcherneva, 2020) deserve the attention of all (heterodox) economists. As Randall Wray said, and as we all know: it is not a lack of things to do, that causes unemployment, it is a lack of paid work.[2] I expect most heterodox economists to agree. At least institutionalists know that this tension between monetary investment and needs is the dichotomy described by Veblen.

The Deficit Myth is a nice example of institutionalism available to the broader public (written in the manner of worldly philosophers and economists as public intellectuals). I highly recommend it to economists and non-economists alike. It opens up avenues to relate the political economy of debt and deficits to urgent discussions within economics and across disciplines about the environment, care, unemployment, and work, and the health problems that we face. The book can be used as a supplementary reading in all courses that take seriously economic reality, even outside of economics. Of course, *The Deficit Myth* could work especially well as a supplement to heterodox macroeconomic textbooks, such as Goodwin et al. (2019), Mitchell et al. (2019), Rochon and Rossi (2021), and Schneider (2022). Because it is well-written and timely, I encourage experimenting with using the book for informal journaling, and giving learners the space to process it outside of class lectures and discussions.

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Notes

1 For access to the syllabus, please see my website https://www.ztodorova.net/teaching.html.

2 Editor's note: the *IJPEE* reviewed Wray's latest book, *A Great Leap Forward – Heterodox Economic Policy for the 21st Century* (Academic Press, London, 2020) in the *IJPEE*, Vol. 12, No. 2.

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Using the Deficit Myth in a Mainstream Money, Banking, and Financial Institutions Course

1.1 My course

ECON 301 is a mainstream, money, banking, and financial institutions course at Augustana University. It relies primary on the textbook *Money, Banking and Financial Institutions* (Cecchetti and Schoenholz, 2021) (C&S), its accompanying online learning management system, and my lectures for most of its content.

During the fall semesters of 2020 and 2021, I also supplemented the primary text with Stephanie Kelton's *The Deficit Myth*. That was a good decision. I'll explain why in a moment. A second distinctive part of this course is that this is a writing intensive course for our majors and counts as one of two 'W credits' – writing across the curriculum credits – toward graduation. As part of that process students do a multiple step, 10–12 page research paper related to money and banking and complete four or five other short (2–3 pages) writing assignments related to Kelton's book and the intersection of the two texts.

My goal for their term paper is for them to write their single best college paper. Students complete a library research seminar that includes a bibliography and parenthetical reference assignment related to their research topic. This is followed up with a one-page description assignment, which includes a clear thesis statement, outline, and preliminary bibliography. Students then use Turnitin and work with the writing centre to take the paper through two drafts. The second draft they submit to me, and we meet one-on-one and talk through their entire paper. They make additional corrections before submitting their final draft. The last week of class is reserved for student presentations. This year students prepared slides and did a 5–8 minute video recording that was then uploaded to our course folder. The class watched these presentations collectively over Zoom and students asked and answered questions about their recorded speeches.

Students were initially assigned five short writing assignments (SWAs) related to Kelton's book. The goal is that by assigning Kelton's book and doing these writing assignments, students are introduced to the basics of MMT. They are asked to compare these to the ideas in C&S. The hope is that this helps them not only understand MMT, but also enhances their understanding of the textbook logic regarding federal government spending and other issues.

1.2 Short writing assignments

Of the five assignments listed below, the most important is SWA #2, which I will focus on. It tries to get at how economists frame and talk about government spending – particularly deficit spending. What effect does deficit spending have on interest rates?

> SWA #1 – Summarize Ch. 1 of Kelton in two double-spaced pages or less. Be sure to explain why governments engage in taxation. Why is federal government spending fundamentally different from that of a state government, private business, or a household?
>
> Read Kelton, Ch. 1, 'Don't think of a household'.
>
> SWA #2 – What effect does deficit spending have on interest rates? Use words and diagrams to compare how C&S' bond market diagram (Figure 6.2 on page 141) explains the effects of government spending on interest rates with Kelton's discussion (pp.112–126).
>
> Read Kelton, Ch. 3, 'The national debt that isn't', Ch. 4, 'Their red ink is our black ink', and C&S, Ch. 6, 'Bonds, bond prices, and the determination of interest rates' (note: you can add a selection from C&S, Ch. 18, 'Monetary policy: stabilizing the domestic economy' around Figures 18.2 and 18.3 on the market for reserves).
>
> SWA #3 – What is the relationship between federal budget deficits and private sector surpluses? Be sure to define your terms and to explain how they are related to one another.
>
> Read Kelton, Ch. 4, 'Their red ink is our black ink'.
>
> SWA #4 – Explain Kelton's three-sector accounting identify and its implications for understanding the trade deficit. From Kelton's perspective, what policy issue primarily drives a nation's desire to run a trade surplus? Is there some other way to address this macroeconomic policy issue?
>
> Read Kelton, Ch. 5, ''Winning' at trade'.
>
> SWA #5 – Is social Security going to be around when you retire? What does Kelton see as the primary threat to entitlement programs? Explain.
>
> Read Kelton, Ch. 6, 'You're entitled'.

1.3 Discussion and response to SWA #2

Money and banking textbook authors and MMT theorists like Kelton are asking and answering the same question – *what effect does deficit spending have on interest rates?* However, the frameworks and logic are by necessity very different. By forcing students to confront this, my hope is that not only do they learn MMT but also, they deepen their understanding of mainstream interest rate theory. And as I'm certain all of us agree, economic pluralism – seeing competing ideas – is a powerful form of education. It changes the students' relationships to the textbook. The text is no longer viewed as just a repository of truth, like a dictionary or other reference book, but is instead seen as a set of ideas that one can think critically about and challenge.

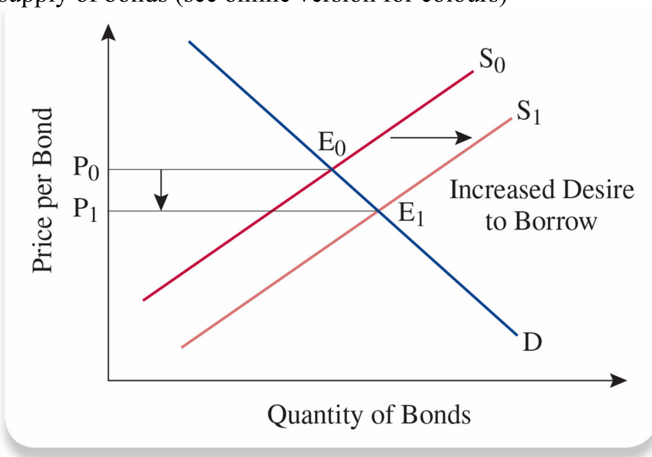
However, I find that students need some help to understand why textbook authors say deficit spending will raise interest rates while Kelton says deficits will decrease interest rates.

It is easy for heterodox economists to discuss loanable funds theory as Kelton does (p.113, pp.116–117). We understand what it means, and we have either a classical savings and investment diagram in our heads or perhaps a more sophisticated notion based on Wicksell. However, many textbooks do not use that precise language. There is no 'loanable funds theory' in C&S. Instead, in Ch. 6, they use a bond market – supply and demand of bonds determining bond prices and therefore interest rates – and that works as a mechanism to tell this story.

From the textbook perspective, if the federal government wants to spend more, and increase its budget deficit and therefore the level of national debt, that means there is an increase in the demand for loanable funds.

Using the bond market language, it would be similar (at least with respect to the effect on the interest rate) to say that government spending beyond government revenues will increase budget deficits. In the textbook context this means that the government is increasing its supply of bonds. Government spending is seen as a borrowing function financed by issuing more bonds as illustrated in the following figure taken directly from the textbook,

A shift in the supply of bonds (see online version for colours)



Note: When borrowers' desires for funds increases, the bond supply curve shifts to the right, lowering bond prices and raising interest rates.

An increase in the supply of bonds decreases the price of bonds and therefore necessarily raises interest rates. C&S also argue that rising interest rates decrease private investment. When interest rates are increasing, businesses will be less likely to borrow money to expand. This phenomenon is called 'crowding out' in the textbook because it is the federal government borrowing that raises interest rates and 'crowds out' private investment.

1.4 The MMT perspective says government budget deficits push interest rates to zero

Kelton takes an entirely different approach and reaches an opposite conclusion. She says that as budget deficits increase, there is also an increase in bank reserves. This is because government budget deficits mean private sector surpluses. An increase in the supply of bank reserves will push the Fed funds rate down below the Fed's target rate and without intervention by the Fed to zero (p.117). From an MMT perspective, bonds are issued after the fact – they are not a borrowing function. They are issued to absorb bank reserves and put upward pressure on the interest rate to nudge it back toward the Fed's target rate. Bond issues are not a fiscal policy borrowing function in MMT, instead being a monetary policy function to absorb reserves.

1.5 Why do these models present exactly opposite findings?

Here's how one of my students answered this question:

> "The core reason is that with the C&S bond diagram, the government finances the deficit with borrowing. In the bond diagram, the government needs more borrowing from the market. Increases in government borrowing increase the market interest rate. In contrast, from the MMT perspective, the government does not need to borrow. It spends money into existence. Further, the interest rate is not determined in a free market. It is instead set as a result of monetary policy decisions. These fundamentally different perspectives determine whether interest rates are going to increase or decrease with higher deficits. With C&S, a higher budget deficit means higher interest rates and less private investment. With Kelton, a higher budget deficit will lower interest rates and if left unadjusted will lead to more investment. These two theories explain what may happen to interest rates and investment when deficits increase, but they produce two deeply different results."

I was satisfied with his conclusion. He demonstrated both an understanding of the textbook bond market model as well as an understanding of Kelton's framework and contrary conclusion. Being able to hold contradictory ideas simultaneously is an important step in one's intellectual development and it allows a student to make up their own mind about the effects of deficits. Many realise that we are running multi-trillion dollar deficits and interest rates are at almost zero. This empirical fact also supports the MMT position.

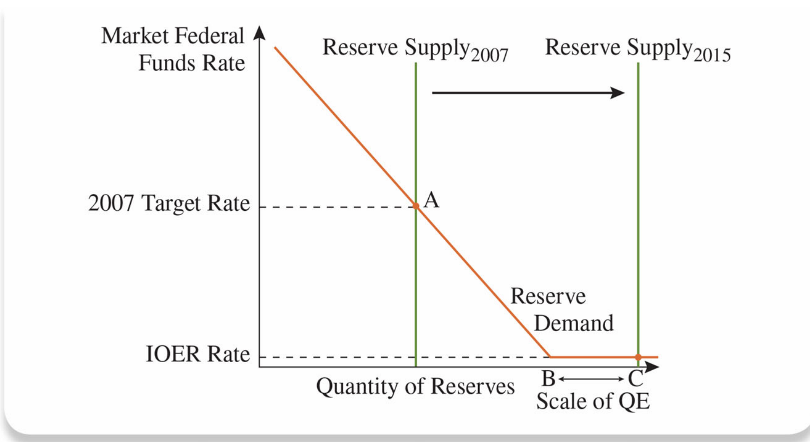
1.6 What did I learn about by giving this assignment?

First, students needed far more help on this than I initially expected. Although students could see the opposite conclusions, many could not carefully explain the logical steps of either the textbook bond market diagram or Kelton's argument. I had to spend some class time clarifying, and I asked them to take this assignment through another draft. To make this fit in the course I ended up cancelling one of the other assignments. Getting students in the habit of writing and revising is also a part of the term paper assignment used in this course.

Second, this assignment could have been made better by also assigning a few pages from C&S, Ch. 18, which provides the mainstream explanation on the market for reserves. This past semester I waited until the end of the semester to discuss this with respect to monetary policy. However, this fall I assigned it so they also have a market for reserves in their heads when they are reading Kelton.

In Figure 18.3 from C&S (p.485) one can see a downward sloping demand for reserves that becomes flat at the rate at which the Fed pays interest on excess reserves, the IOER. The vertical supply of reserves is assumed to be controlled by the Fed. One can easily translate Kelton's ideas onto this model. If one simply demonstrates that government budget deficits increase private sector surpluses and therefore, increase bank reserves, we can see why in the absence of an IOER, the interest rate would fall to zero. This is more persuasive, particularly considering the large budget deficit, low interest rate world we now inhabit.

Figure 18.3 The market for reserves with quantitative easing (Q) after September 2018 (see online version for colours)



From 2008 to 2014, through quantitative easing the Fed increased the supply of reserves by nearly \$3 trillion, shifting the supply far to the right along the horizontal portion of the reserve demand curve and moving the equilibrium from point A to point C (Figure 18.3 is not drawn to scale). Reserve demand is depicted as flat at the IOER rate because banks have no better alternative to holding reserves at that rate. Put differently, they will not make loans at a rate below the IOER rate.

And finally, although not directly related to this assignment, I had students record their final term paper presentations because of the pandemic. This ended up producing the best presentations I have ever had in this course. I will continue to require this recording of presentations post-pandemic. Students confessed that they rehearsed and went through multiple takes to create their final recorded presentation and to have them fit the 5–8 minute limit. Seeing themselves on the recording was an important learning experience and led them to make corrections to their presentations before turning them in and having them presented in class.

Reference

Cecchetti, S. and Schoenholz, K. (2021) *Money, Banking and Financial Institutions*, 6th ed. McGraw-Hill, New York.