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# Modern monetary theory for conservatives

- **MMT would support Fed-accommodated tax cuts as readily as the conventional spending version**
- **Whether the economics will work remains uncertain**
- **Equity and FX outcomes from the tax-cut version could be much friendlier, but quite likely unsustainable**

## Symmetry is brutal

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A conservative version of Modern Monetary Theory (MMT) could arguably work just as well as the standard progressive version and would probably support asset prices initially. This conservative version sounds like the Fed-accommodated tax cut regime that the Trump Administration seems to be supporting. The economic outcomes from the lower-tax version of MMT would likely be indistinguishable from the higher-spending version, but the asset-market reaction to a wider deficit driven by lower tax rates would likely be more positive than if the wider deficit were driven by higher spending (this note extends *Modern monetary theory and asset markets)*.

According to MMT advocates, the money supply is increased by *government deficits* that are financed by the central bank. This principle is often stated as central-bank accommodated *government spending* increases the money supply, but advocates are explicit in stating that spending creates money and taxation destroys it. In other words, the money-printing is the same if spending is 15% of GDP and taxes 10% as when spending is 50% of GDP and taxes 45%. The stimulus from changing deficits from each of these starting points would be similar – and could come from cutting taxes as easily as raising spending.

In the first case, the private sector is expected to do the spending, in the second, the government. One can even argue, contrary to the standard MMT perspective, that if it looks as if the economy is overheating, government spending should be cut to keep the economy in equilibrium. We are not advocating this version of MMT, merely pointing out that the same principles could be used to justify a very different agenda than is commonly associated with MMT. The core idea that central-bank-financed deficits drive activity and inflation remains the same.

Asset-market consequences are likely to be very different. The alternative form of MMT that we describe here is likely to be equity-market-positive initially. This could spill over into a stronger currency initially, but this is not certain. It seems more likely that it will attract capital than the conventional version, which could be strongly currency-positive initially. By contrast we do not see why the fixed-income outcomes would be much different between the two approaches.

We emphasise ‘initially’ because we are sceptical that asset-market outcomes will be sustainable. As we noted in our earlier discussion of MMT, success depends on enough discipline to raise taxes or cut spending as needed to keep inflation at target. The political processes in the US and elsewhere suggest that this would be a clumsy, slow-moving process. When policy makers run into inflation difficulties, it is rarely because they do not realise that they should be raising taxes or cutting spending.

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Three final considerations:

1) The low-tax version resembles the supply-side agenda that President Trump explicitly is advocating. He claims that the Fed should have been expanding not contracting its balance sheet while the tax cuts (and higher deficits) were working their way through the economy. One can debate his economics, but he may be an MMT-theorist manqué.

2) Either version of MMT would require major institutional change. MMT theorists argue that spending and taxation could largely be put on automatic pilot. It seems more likely that spending would have to be changed roughly as often as central banks alter policy. The US Congress and other legislatures are not very flexible in terms of tax and spending policy. They may have to create a fiscal authority to which they can delegate some degree of taxation and spending policy. This would raise constitutional questions in the US.

3) Many advocates of MMT see an open-ended government job guarantee to workers who cannot find work as an essential part of the MMT framework. Advocates argue that such a programme provides an automatic stabiliser in that the deficit and monetary creation increase when the economy slows. To us it seems that this guarantee is grafted onto the basic MMT framework. If the inflation and employment targets are consistent, then taxation, spending and (residually) monetary policy should suffice to hit the target.



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