Modern Monetary Madness

By John Mauldin | February 15, 2019

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More than 10 years ago some Australian readers begin regaling me with the ideas of economist Bill Mitchell of the University of Newcastle in New South Wales. He was teaching about something he called (and he coined the term) Modern Monetary Theory. I looked into it and fairly quickly dismissed it as silly. Actually printing money as an economic policy? Get serious.

MMT is a revival of an early 1900s idea called chartalism. Now it is influencing the thinking of new socialist-like movements in the US and other places and cited by politicians. MMT is increasingly appearing in mainstream media like this sobering *Financial Times* article. Since it is increasingly discussed in more public venues, you should know more about it and that will be today's topic.

Before we go into that, I want to remind you that Priority Pricing for the Strategic Investment Conference ends on Monday, February 18. You can save up to $1,000 over the final registration price. On Tuesday, the price goes up substantially.

It's the best lineup of speakers I've ever had. If I have room at the end of this letter I'll mention them for you but you can look on the link and see the speakers yourself. Twenty-nine speakers plus yours truly, not including some well-known names as panel moderators. By popular request, there will be more panels and speaker interaction this year than ever.

Attendees all mentioned how much they enjoy discussing the conference with fellow attendees and making new friends, and especially that the speakers make themselves available to attendees as much as possible. Frankly, many of the speakers will attend most if not all of the conference. It is simply that good.

So don't procrastinate, save yourself some money by clicking on the link and registering today. And make sure that we don't have to tell you we sold out again. Registrations are ahead of schedule so there is a real chance even with the larger venue that that could happen.

Here is a quick video in which I tell you more. I hope you catch my enthusiasm!

Join me in Dallas. Now, on with our letter.

Modern Monetary Madness

Essentially, MMT espouses that the public through the government owns the process of money creation, and that in addition to borrowing and taxing, should simply issue currency as payment for its obligations. This is not the sleight-of-hand that quantitative easing was. This is direct monetization in lieu of borrowing.

If that sounds like printing money, that's because it is. Upfront and in-your-face as a serious economic proposal. Most of the time when I am talking with my fellow writers and economists, when somebody mentions MMT, everybody smiles, maybe chuckles, and shakes their heads. The problem is, what seems like a joke is actually getting traction.

Let’s get the official definition of MMT from Wikipedia. My comments inserted are in brackets.

I*n MMT, “vertical” money (money created by the government and spent in the private sector) enters circulation through government spending. Taxation and its legal tender enable power to discharge debt and establish the fiat money as currency, giving it value by creating demand for it in the form of a private tax obligation that must be met.* [And thus higher taxes create more demand for the currency and help to maintain the value thereof.]

In addition, fines, fees and licenses create demand for the currency. An ongoing tax obligation, in concert with private confidence and acceptance of the currency, maintains its value. Because the government can issue its own currency at will, MMT maintains that the level of taxation relative to government spending (the government’s deficit spending or budget surplus) is in reality a policy tool that regulates inflation and unemployment, and not a means of funding the government’s activities by itself. [The more you want the government to spend, the higher the taxes have to be in order to keep from creating inflation, or so the theory goes.]

Proponents argue that unemployment is caused by lack of demand and lack of demand is caused by insufficient money entering the private sector, a problem the government can solve by creating money and spending it in the private sector. Voilà, demand is created and unemployment goes down. Inflation? That can be controlled by higher taxes. Hey, it’s their theory. Don’t ask me to explain it.

Economists advising major presidential and congressional candidates on the progressive and even “moderate” left are more and more openly talking about MMT and its practical applications.

Pet Economists

I have said before that economists are the modern-day equivalent of shamans and priests. Rather than looking at sheep entrails, economists look at “data” and tell the politician (king, emperor, or chief…) what they want to hear. I have been in more than one meeting where a politician is clearly shopping for a rationale for something that they would like to propose and do. Any serious politician is going to have more than a few economic advisors attached in one form or another to their campaign.

Let me quickly state that I am not disparaging the role of economists when they act as political advisors. I have done that myself. It is actually one of the rationales for the discipline. Indeed, it would be strange if that were *not* the case.

Can This Really Be a Thing?

90% of readers may wonder why we are even talking about this in a serious letter. The rest of you may tell me how I'm wrong and it really will work. Let me hasten to say that 10 years ago it was much less than 1%. And it is beginning to come from readers that I recognize to be fairly serious.

There are multiple and growing motivations and rationales for adopting MMT into your own philosophical base.

Why should this be on your radar? Let me give you just a few scenarios…

Politicians are increasingly talking about "free stuff." Free college, guaranteed basic income, more total healthcare paid for by the public, basic housing, and more. It is almost like there will be an auction to see who can promise the most free benefits, paid for by taxes on the rich. They will cite economic advisors who say it is completely doable and even necessary for the general welfare.

"The richest country in the history of rich countries can easily afford to spend more on its citizens ensuring basic income and wealth equality." More or less a direct quote from several interviews. Forget mere income taxes. The new political ante will be a wealth tax.

That means these ideas will be increasingly promoted in the public space. More politicians will argue for increased spending and/or at least different spending priorities. Guns and butter.

Over the next few years this will enter the national mindset. An increasingly large group of voters, especially younger voters, will feel a natural affinity with the idealism. Why shouldn't a rich nation help those who are less advantaged?

Then somewhere, while we are having this conversation, there will be a recession. Unemployment will rise and deficits increase until we are on our way to a $30-trillion debt in just a few years. This will crowd out private investment, slowing whatever recovery there might be and making us vulnerable to a quick second recession, not unlike the recessions of 1980 and 1982.

But it will also produce the potential for a true "change" election. The frustration noted among Trump voters will still be there, but it will also be shared by many on the left who will see the promises as a way to change things. It is hard to argue in the middle of financial crisis and recession that we don't need change.

There won't be a President Warren Harding who essentially decided to do nothing in one of the deepest recessions/depressions in American history in the early 1920s. In that case, severe austerity allowed markets to clear but the recovery gave us the Roaring 1920s. Cause and effect? Numerous scholarly books have been written to suggest that.

But that will not be the case 100 years later as we face the 2020s. There will be an increasing drumbeat for "doing something." Change will be the mantra.

It is not far-fetched to imagine a White House and Congress beginning to work around the principles of MMT, if not adopt it outright with sharply higher taxes and spending.

Now here's where it gets a little bit murkier. The Federal Reserve, even if a new president could pack the board with members philosophically attuned to a new president's desire to increase public spending through monetary creation, does not have the legal authority to directly create money. That is a right reserved strictly for the federal government and specifically the US Treasury. The Treasury can issue all the debt into the private sector it wants. The Federal Reserve can then go into the private market and buy all the debt it wants, adding that debt to its balance sheet. This is called quantitative easing. It is technically not the same thing.

Congress has tried to create agencies which would use the Federal Reserve to directly create money. These agencies and methods have all been ruled overwhelmingly unconstitutional by the Supreme Court. For the Federal Reserve to create money as MMT advocates want, you would have to amend the Federal Reserve Act. Certainly a possibility, but not easy.

Sound Bite Economics

Proponents of MMT point to how successful Japan has been in implementing what essentially looks to be the same policy. They have moved 140% of their GDP under the balance sheet of the Bank of Japan—essentially buying every bond available in the private markets. Their balance sheet is growing because they are buying stocks and carrying Japan's entire annual deficit, which is large.

Why can't we do the same? Japan and the US are both modern countries and economies. Europe, though not to the extent of Japan, also engaged in a large amount of quantitative easing. If it didn't cause problems the last time, why not try it again on a larger scale? Especially if there is a crisis?

The explanation for Japan not having inflation or hyperinflation doesn't fit into a sound bite and MMT proponents can answer it with dismissive sound bites that will be readily consumed and believed by a public wanting change, coupled with automation increasingly taking jobs and depressing wages. It will be a firestorm of political backlash and calls for change.

Do Deficits Matter?

The only way to really tackle the increasing deficits is to:

1. Reduce Medicare and Medicaid benefits, means-test Social Security and at the same time raise the age of eligibility. But few politicians will run on a platform of cutting Medicare and Social Security, because no matter how they propose it, that will be what it means.

2. Raise Medicare and Social Security taxes, or simply increase taxes on everyone or at least “the rich.” A lot. The definition of “the rich” would have to be lower than you might think. Most of my readers will be seen as the rich. Whether you *feel* rich is beside the point. That will still not balance the budget but there’s a high probability that it will send us into yet another recession, bringing calls for more direct spending and some form of money creation as the answer. That’s what MMT says we should do.

Any politician who proposes to limit entitlement spending to balance the budget will be accused of forcing austerity on those least able to afford it. That is not a winning platform. There will be no Clinton/Gingrich compromise. Austerity has no fun and simple sound bites. It requires a certain amount of pain, which is generally not politically popular.

Oh, a segment of the population will embrace such, but we must remember that elections are won on the margin. President Trump won by razor-thin margins in a few Midwest states. A change election in the middle of a recession or its aftermath could not only see those margins evaporate, but bring a wave of progressive and socialist politicians to join AOC and her friends.

Think 1932. The country was in true turmoil and there was a huge shift to the left. FDR didn’t get every policy he wanted, but he got a lot of them. It was truly transformational and has impacted the US for the last 100 years.

What would this look like? How do we get there? We are going to have several sessions at the Strategic Investment Conference to specifically address these issues. Is all this going to happen next year? No, but something along the above line is my base case for the 1920s. That means you need to begin structuring your life and your portfolios to avoid being in a tunnel with an oncoming train.

These are not simple changes, like simple buy and sell instructions, but will require much deeper structural change in not just your portfolios but perhaps your lives. It is something you want to think very seriously about while you have the luxury of time and not wait to the last minute. Waiting too long may mean you won’t be as prepared as you will wish.

Think about how you would deal with taxes 20 or 30% higher (or more!) than today’s, and potentially more. How would that change your lifestyle? What can you do today to deal with whatever may come? It may mean adjusting your lifestyle, saving more and getting out of debt, which takes time. For most families these are not quick decisions. But I think they will become necessary ones, especially if the first wave of a change election happens in 2020. Bluntly, Shane and I have already begun our own changes.

If somehow there is eventually a change back to austerity? Or a crisis forces it? That will mean even more change you need to be prepared for. And unfortunately, it’s not clear what will happen. We will have to get much closer to the actual events and elections to get a feel for the way actual events may develop.

Strategic Investment and Life Planning

This year's SIC has perhaps the widest range of topics and speakers I have ever assembled. Every speaker is designed to help you plan for 2020 and beyond. What should you do today? What should you do to begin to get ready for change? What might those changes look like? Where are we currently in the investment cycle? Bull or bear market? I have numerous cycle and market experts presenting.

There will be several panels focused specifically on government debt and deficits and more than a few sessions on China and Europe. The speakers on China and the panels will be eye-opening. The China panel will be explosive. There are experts you may not be familiar with who have much different viewpoints. It is a bit of a personal coup to get them all on the same stage.

While they will be making separate presentations, I'm going to have Bill White and Lacy Hunt on the same panel talking about central banking and debt. Bill White, for those not aware, was the chief economist for the Bank of International Settlements and my favorite central banker. Housing and interest rates are critical to the US economy and I have invited John Burns and Barry Habib, my go-to guys when it comes to housing and mortgages, to open up that world to us. Who better than Jeffrey Sherman from DoubleLine to talk about interest rates? (I am technically not allowed to say he might be a better speaker than his boss Jeff Gundlach.) Mark Yusko, Grant Williams, Louis Gave? Of course George Friedman will be there. David Rosenberg will once again be my lead-off hitter and will be one of the speakers staying and mingling for the entire conference. And of course, you have to deal with energy in a serious way you're in Texas.

A final closing morning with Howard Marks, Carmen Reinhart and Bill White talking about central banks, government debt and how we deal with it? I am really looking forward to the final panel. Seriously, can it get any better?

We're going to do a special session with Pat Caddell and Neil Howe talking about the elections of 2020 and the political climate of the 2020s. Caddell was predicting a populist like Trump to win years before 2016. Neil was talking about the generational angst that is developing. These are the two guys who got it right and have been getting it right for a long time. I want to know what they're thinking now and so do you. And they will also be there for the entire conference so you can access them in a break or even sit with them at one of the many dinners and lunches.

I am more excited about this conference than any other for the last 16 years. You are simply not going to want to miss this. Register today and save $1,000. Don't procrastinate. Join me for three power-packed days and frankly, a lot of fun. I look forward to meeting you personally.

Dallas, Houston, Cleveland a lot, New York, back to Puerto Rico, Austin and Dallas

Shane and I will be traveling to Dallas at the end of this week to begin to get ready to move the rest of our furnishings to Puerto Rico or to a new, smaller apartment that will be our Dallas base. Right now, it appears my Dallas high-rise home will sell within a few weeks. After an Ashford, Inc, board meeting in Athens, Texas I make a quick dash to Houston to meet with my SMH friends and then a meeting with an economics council at Rice University, my alma mater. Then it's back to Dallas for a few days and then on to Puerto Rico.

Starting in the middle of March, I will be staying in the Cleveland area where I will have two separate cataract surgeries over a few weeks, maybe get a quick visit to New York, eventually back to Puerto Rico and then in early April I have dinners with clients and potential clients in Austin and Dallas. And then thankfully the rest of April looks mostly free of travel.

When I write to you about the potential for needs for lifestyle changes, I am also talking to myself. And taking action. If there is any interest, maybe I will do a private session on what changes I am making at the SIC. But everyone's life and reality is different. I am still thinking through and making those changes,

It's time to hit the send button. This has been an interesting letter to write. More speculation than economic rationale, but I can guarantee you this is something I worry about. And I think you should consider what it might mean for you. Have a great week!

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