



**Centre of Full Employment and Equity**

**Working Paper No. 20-05**

**Debt and Deficits – an MMT perspective**

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October 2020

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I have thought it important, not only to explain my own point of view, but also to show in what respects it departs from the prevailing theory. Those, who are strongly wedded to what I shall call “the classical theory”, will fluctuate, I expect, between a belief that I am quite wrong and a belief that I am saying nothing new ... The matters at issue are of an importance which cannot be exaggerated. But, if my explanations are right, it is my fellow economists, not the general public, whom I must first convince. At this stage of the argument the general public, though welcome at the debate, are only eavesdroppers at an attempt by an economist to bring to an issue the deep divergences of opinion between fellow economists which have for the time being almost destroyed the practical influence of economic theory, and will, until they are resolved, continue to do so.

John Maynard Keynes, Preface to English Edition, *The General Theory of Employment, Interest and Money*, December 13, 1935.

## **1. Introduction**

The pandemic has triggered the most severe economic crisis since the Great Depression, and perhaps, the worst ever. This is one of the major tragedies in human history. From another perspective, it has further exposed the inadequacies of the mainstream macroeconomic consensus that has dominated for several decades. We argue the mainstream approach does not provide a convincing understanding of contemporary problems nor reliable guidance for policy making.

World economies were languishing before the pandemic as a result of poor economic policy interventions. The reliance on monetary policy with fiscal drag created slower growth in output and productivity, elevated levels of labour wastage, flat wages growth and a poor investment climate for savers. This policy bias arose because the dominant view among economists has been that fiscal deficits and rising public debt should be avoided. However, the predictive accuracy of the mainstream consensus has been appalling, which casts doubt on the underlying theory.

Capitalism is now on life support with fiscal policy dominant. We conjecture that significantly larger and sustained fiscal deficits will be required indefinitely and that we should be comfortable with that. Focusing on the size of the deficits is to focus on the wrong problem. The way out of the crisis requires an orthogonal shift in policy thinking and new theoretical understandings.

The usual narratives about the dangers of deficits and public debt are giving way to a new understanding. The IMF indicated that “we face a new Bretton Woods ‘moment’” (IMF, 2020a) and acknowledged that “Central banks ... have facilitated the fiscal response by ... financing large portions of their country’s debt buildup” (IMF, 2020b: 1), which has “helped keep interest rates at historic lows ... the fiscal response to the crisis has been massive” (IMF, 2020c). Journalist Alan Kohler (2020) wrote that “the IMF and World Bank, have given the green light to uncapped government spending and borrowing without later austerity”.

This policy shift is diametric to what mainstream macroeconomists have been advocating for decades and their analytical framework cannot provide an understanding of the fiscal space available to governments nor the consequences of these policy extremes.

In this paper, we highlight the mainstream failure and introduce Modern Monetary Theory (MMT), which is gaining traction in the public debate and arguably provides a better basis for designing a pathway to recovery. We argue that MMT has consistently advocated a return to fiscal dominance and disabuses us of the claims that deficits and debt are to be avoided. MMT defines fiscal space in functional terms, in relation to the available real resources that can be brought back into productive use, rather than focusing on irrelevant questions of government insolvency.

Section 2 examines the state of play in the Australian economy. Section 3 documents the shift to fiscal dominance. Sections 4 and 5 introduce core MMT ideas and considers the dissonance between mainstream predictions and reality. Section 6 compares two buffer stock approaches to price stability, which highlights the differences between MMT and mainstream NAIRU orthodoxy. Concluding remarks follow.

## 2. The State of Play

Before the pandemic, economic growth in Australia was languishing well below trend. The broad labour underutilisation rate was 14 per cent in March 2020. Wages growth was at record lows, and, despite low inflation, real wages growth was flat or negative and lagging well behind productivity growth.

The Government's surplus obsession directly contributed to this slowdown. Successive governments relied on private debt increasing to sustain household consumption expenditure in an environment of flat real wages growth, which then gave them cover to cut net spending. The Howard government pursued this strategy after 1996, and household debt went from 85.8 per cent of disposable income in early 1996 to 184.1 per cent in 2007 (ABS, 2020). The household saving ratio also fell dramatically and was regularly negative after 1999 until the Global Financial Crisis (GFC) (Table 1). The current government has deployed the same strategy but with household debt so high, the private desire for ever increasing levels of debt has waned.

Table 1 Macroeconomic aggregates - averages by decade

| Decade | Annual GDP growth | Annual labour productivity growth - persons | Average unemployment rate | Average Household Saving Ratio |
|--------|-------------------|---|---------------------------|--------------------------------|
|        | Per cent          | Per cent                                    | Per cent                  | Per cent of disposable income  |
| 1960s  | 5.52              | 2.81  | 1.92                      | 14.3                           |
| 1970s  | 3.78              | 1.77  | 3.71                      | 16.1                           |
| 1980s  | 3.56              | 1.17  | 6.95                      | 12.0                           |
| 1990s  | 3.23              | 2.03  | 8.01                      | 5.4                            |
| 2000s  | 3.17              | 1.06  | 5.16                      | 2.2                            |
| 2010s  | 2.67              | 0.95  | 5.18                      | 6.4                            |
| 2020-  | -2.29             | -1.43                                       | 5.70                      | 12.9                           |

Source: Australian Bureau of Statistics, Modellers' Database and National Accounts, Table 1. Key National Accounts Aggregates.

We have been conditioned to think that the surplus period (1996-2007) represents the norm. In fact, it was abnormal because it relied on unsustainable increases in private debt to maintain growth to generate the necessary tax revenue. Without the private dissaving, Australia would have entered recession before the turn of the century. Historically, the federal government has run deficits of varying magnitudes - 76 per cent of the time since 1953-54, averaging 1.2 per cent of GDP - to support the non-government desire to save (Australian Treasury, 2020).

The surplus obsession began in the 1980s, when governments abandoned their full employment commitment, focused on microeconomic policy, and prioritised monetary policy over discretionary fiscal policy, as the principle counter-stabilisation tool. The Non-Accelerating-Rate-of-Unemployment (NAIRU) became a key organising framework for policy makers, which meant that unemployment ceased to be a policy target, and, instead, became a policy tool to keep inflation low (Mitchell and Muysken, 2008). The policy shift from full employment to full employability, resulted in reduced output and productivity growth and elevated levels of labour underutilisation (Table 1).

The pandemic has fundamentally changed this landscape. The government's V-shaped (hibernation) presumption, no longer reflects reality. This will be a long-drawn out crisis and many companies will fail to 'get to the other side', leaving a residual of high unemployment and idle capacity.

The Federal government significantly increased its deficit for 2020-21 to 11.8 per cent of GDP, with spending rising from 24.5 per cent of GDP in 2018-19 to 27.7 per cent in 2019-20 and to 34.8 per cent of GDP in 2020-21. Revenue will decline from 23.7 per cent of GDP in 2019-20 to 22.5 per cent in 2021-22 (Australian Treasury, 2020).

The government eschewed large-scale job creation programs and infrastructure investments and biased net spending towards tax cuts and wage subsidies. The Government's supply-side bias remains. There are no plans to accomplish longer term goals such as fast-tracking the shift to a non-carbon economy or addressing the massive social housing shortage.

Given the higher deficits and the convention of matching debt-issuance, federal debt will rise sharply, although with borrowing rates so low, net interest payments are projected to decline over the forecast period (Australian Treasury, 2020).

We conjecture that the deficit will have to rise further than projected. The Government forecasts official unemployment at 6.5 per cent in 2021-22 (around 888 thousand workers). In addition, by 2021-22 participation is assumed to be well below its August 2019 peak, leaving an additional 135 thousand workers as hidden unemployed (Australian Treasury, 2020).

The bias towards tax cuts reveals that the government has not learned from the July 2019 tax cuts which barely moved retail sales. Tax cuts are typically less expansionary than equivalent spending injections because some of the increased disposable income is saved. Moreover, with household balance sheets so precarious and the economic outlook so uncertain, the propensity to consume is likely to have declined. Further the cuts are heavily biased to higher income earners who have lower consumption propensities.

The RBA has also changed tack by tweaking its 'long-dated outright transactions' program, which involved quarterly purchases of government debt (for open market operations). Since March 2020, they are buying government debt in secondary markets "to achieve a target for the yield on 3-year Australian Government bonds of around

0.25 per cent, as well as to address market dislocations” (RBA, 2020a). By the end of September, the RBA had purchased federal debt worth \$52,250 billion, and state/territories debt worth \$11,098 billion (RBA, 2020b). Despite RBA denials, it is now funding significant proportions of the government deficit.

The RBA has been very conservative relative to other central banks, who have been providing significant funding to government deficits via secondary bond market purchases over many years. The Bank of Japan has led the way for two decades and now holds close to 45 per cent of all government debt (Bank of Japan, 2020). The US Federal Reserve, the Bank of England and the European Central Bank have also expanded their balance sheets dramatically since the GFC through various bond purchase programs (IMF, 2020b).

Despite large fiscal deficits and rising government debt levels, long-term bond yields have mostly remained close to zero and inflation rates are subdued. In some nations, investors have extended long term loans to governments at negative yields.

These fiscal and monetary policy developments would have been unthinkable in the past. The successive crises (GFC, pandemic) and the government responses to them have confounded the consensus among mainstream macroeconomists, which was predicated on a view that high deficits and public debt levels are to be avoided.

We argue that with policies now being pushed to relative extremes, the predictive capacity of the New Keynesian mainstream has been so poor that it is unlikely to provide any meaningful guidance to dealing with the required policy trajectory.

A new normal is emerging and fiscal dominance is the only viable way forward. This is anathema to the New Keynesian approach. Only MMT economists have provided a body of work that is consistent with this new normal (Mitchell, 2020).

### **3. The shift to fiscal dominance**

Central bankers are increasingly expressing concern that reliance on monetary policy with passive fiscal policy, has undermined policy flexibility and delivered poor socio-economic outcomes. Further, the low and negative interest rates and yields on long-term bonds, and the stifled public infrastructure development has restricted low-risk opportunities for investment funds.

The RBA governor has regularly urged government to use fiscal policy more aggressively because “monetary policy can't drive long-term growth” (Lowe, 2019). In August 2020, the US Federal Reserve Bank redefined the bank’s policy position to prioritise “maximum employment and price stability” and admitted the inflation first approach had reduced long-run growth rates, stifled productivity growth and maintained elevated levels of unemployment. Their new approach would prioritise employment growth even if inflation rose above their 2 per cent stability target (Federal Reserve, 2020). Reuters commented: “One of the fundamental theories of modern economics may have finally been put to rest” in reference to the Fed’s new disregard for the NAIRU (Reuters, 2020).

Paul Keating recently accused the RBA of being “high priests of the incremental” who should abandon its taboos on purchasing government debt and “help the Government ... shoulder the load ... funding fiscal policy. Mountainous sums of it” (Hutchens, 2020).

Even the Australian Treasurer acknowledged that an increasing deficit will increase employment, stimulate private confidence, profits and productive investment, which is a far cry from textbook predictions of crowding out, Ricardian equivalence, and more (Frydenberg, 2020).

We are now at a turning point in macroeconomics.

## **4. The modern money era**

### **4.1 The point of departure**

The abandonment of US dollar gold convertibility in August 1971 signalled the start of the fiat money era. The options available to currency-issuing governments changed dramatically although that shift has not been reflected in mainstream macroeconomics pedagogy or policy analysis (Mitchell *et al.* 2019). The shift, however, provides a point of departure for MMT. We do not provide a comprehensive account of MMT here (see Mitchell *et al.*, 2019). The aim is to introduce some core ideas and explain some key departures from the New Keynesian consensus. Most of the recent attacks on MMT from high-profile New Keynesian economists (for example, Summers, 2019; Rogoff, 2019) and financial journalists are based on crude renditions ('money printing') and only serve as misinformation.

### **4.2 A new lens**

MMT is not a regime nor a set of policies. Rather, it is a lens which provides a superior understanding of our monetary system. By linking institutional reality with behavioural theories, MMT allows us to understand the capacities of the currency-issuing government and the consequences of different policy choices. To operationalise an MMT understanding into policy one has to overlay a set of values (ideology). MMT is politically agnostic. Most policy choices that are couched in terms of 'budgets' and 'financial constraints' are, in fact, just political or ideological choices.

MMT cuts through the fictions that mainstream economists use to obscure reality. These fictions deliberately restrict fiscal space and distort the political choices that citizens make. Paul Samuelson likened fictions about the dangers of fiscal deficits and debt to "old fashioned religion ... [which] ... was to scare people by sometimes what might be regarded as myths into behaving in a way that long-run civilised life requires" (Blaug, 1988). Wolf (2020) wrote of MMT that "It is right, because there is no simple budget constraint. It is wrong, because it will prove impossible to manage an economy sensibly once politicians believe there is no budget constraint."

While MMT exposes these fictions many economists still think it is better to keep the public in a state of ignorance.

## **5. Dissonance in Macroeconomics**

Lucas (2003: 1) summarised the mainstream macro consensus:

macroeconomics in this original sense has succeeded: Its central problem of depression-prevention has been solved, for all practical purposes, and has in fact been solved for many decades.

The 'Great Moderation' (Bernanke, 2004) and the Washington-Frankfurt Consensus (Williamson, 1989) were expressions of the view that the policy assignment should focus on monetary policy settings with passive fiscal policy, biased towards surplus.

However, their confidence that the macroeconomic problem had been ‘solved’ was unjustified, given the inferior macroeconomic aggregates since the 1980s (Table 1) and then the GFC.

Mainstream economists justify their antipathy towards fiscal deficits and public debt in a number of ways. The ‘government budget constraint’ (Christ, 1968) provides the standard analytical framework for assessing fiscal policy, often in an IS-LM context. The micro foundations draw an analogy between government and households. Barro (1993: 367) asserted: “We can think of the government’s saving and dissaving just as we thought of households’ saving and dissaving”.

Accordingly, the GBC framework asserts that governments are financially constrained, *a priori*, and have to fund spending via taxation, bond issuance, or ‘money printing’, which all have negative consequences (taxes distort behaviour, bonds drive up interest rates (crowding out), and money finance is inflationary). As a result, fiscal deficits are largely eschewed.

MMT rejects the household analogy. Households are currency users and are financially constrained. Conversely, a currency-issuing government faces no intrinsic financial constraints, which means it can buy anything for sale in that currency, including all idle labour. Mass unemployment becomes a political choice.

Government spending is constrained, however, by the ‘inflationary ceiling’, which binds when all productive resources are fully employed. We must traverse from a focus on erroneous financial constraints to an appraisal of real resource constraints.

The perennial question: How are we going to pay for it? – can only have meaning in the context that the cost of government programs are the real resources consumed not the dollars outlaid.

Mainstream economists will respond that they knew this all along because governments can always ‘print money’, but, should not, because it is inflationary. MMT demonstrates how this reasoning is erroneous.

First, government spending is facilitated by central banks typing in numbers to bank accounts. New currency is digitally spent into existence (Bernanke, 2009). There is no spending out of taxes or bond sales. The elaborate accounting and institutional processes, which make it look as though tax revenue and/or debt sales fund spending, are voluntary arrangements with no real economic consequence. They are designed to impose political discipline on government spending.

Second, all government and non-government spending carries an inflation risk. If nominal spending growth outstrips the economy’s productive capacity, then inflationary pressures emerge.

Consider two scenarios. At full employment, inflationary pressures will arise if government competes at market prices with non-government spending for productive resources. To increase its use of productive resources, but avoid inflationary pressures, the government has to ‘free up’ resources. Taxation is one option because it reduces non-government purchasing power and creates the real resource space to accommodate non-inflationary government spending. Importantly, the taxes do not provide any extra spending capacity for government. In the second scenario, idle productive resources can be brought back into productive use with higher deficits. There are no constraints – financial or resource – on such government spending.

Fiscal space is thus much broader than mainstream economists suggest and is defined in terms of available real resources rather than numbers in fiscal statements. Following Lerner's functional finance (Lerner, 1943, 1951), MMT focuses on how policy advances desired functional outcomes, rather than what the state of the deficit might be. To maximise efficiency and minimise Okun losses, the responsibility of government is to spend up to full employment. The fiscal outcome will be whatever is required to achieve that functional goal and will be largely determined by non-government saving decisions (via automatic stabilisers).

## 5.2 Does debt issuance reduce inflation risk?

The GBC framework asserts that bond sales reduce the inflation risk of public spending. Students learn that if central banks credit bank accounts on behalf of governments (erroneously called 'money printing') without bond issuance, then accelerating inflation follows. The risk is lower with bond issuance because, allegedly, rising interest rates 'crowd out' private spending (Mankiw, 2018). However, these conclusions are not ground in the foundations of a fiat monetary system nor banking reality.

Classical loanable funds theory, which remains a central organising concept in mainstream pedagogy (Mankiw, 2018), leads to the assertion that competition for finite savings from government bond sales, drives up interest rates and reduces interest-sensitive non-government spending. Keynes (1936) demolished this theory by showing that saving is a function of income, which rises with net government spending. MMT takes this insight further by providing a forensic understanding of the impacts of government deficits on the banking system. It also exposes the flaws in mainstream inflation theory.

First, students are taught that bank lending is reserve constrained. However, real world banks extend loans to any credit worthy customer and deal with reserve implications afterwards. They know that if all other sources of reserves are insufficient to satisfy regulative requirements, then the central bank will supply them. Loans create deposits, which generate reserves, exactly the opposite to what student rote learn in their banking courses. There is no scarcity of 'savings' squeezed by government debt auctions.

Second, fiscal deficits generate excess reserves, which places downward pressure on interest rates and influences central bank liquidity management. To maintain a positive policy rate, the central bank can (a) drain excess reserves (open market operations); or (b) pay a return on excess reserves. The two are functionally equivalent. If it does neither, then it loses control of its policy target as commercial banks try to offload their excess reserves in the interbank market, which drives the short-term rate down to zero. This allows us to understand how Japan has been able to maintain near zero interest rates for nearly 3 decades. The Bank of Japan does not drain all excess reserves created by on-going fiscal deficits.

Third, when government bonds are issued to match deficits, the central bank effectively just marks down reserve accounts and marks up a 'treasury debt' account. There is no reduction in bank deposits that were created by the deficits and the bond sales do not alter the net financial worth in the non-government sector. Only the composition of the non-government asset portfolio changes. Why would that alter the inflation risk inherent in the spending? The funds used to purchase the bonds were not currently being 'spent'. Thus, bond sales do not ordinarily reduce non-government spending. While it is beyond the scope of this paper, MMT economists see no need to issue debt to match deficits.

### 5.3 Quantitative Easing and inflation

QE involves the central bank swapping reserves for financial assets (bonds) held by the non-government sector. A maturity substitution occurs within non-government financial wealth portfolios, which reduces interest rates at the maturity segment targeted by the central bank. This might increase aggregate demand because investment funds become cheaper. But during recessions, investment and consumer durable spending is typically interest-inelastic. The lower rates also reduce the income of savers.

But mainstream economists saw QE differently. They initially justified it as a way of stimulating private borrowing through the provision of more bank reserves. It was based on the (false) claim that bank lending was reserve constrained. However, bank lending was weak during the GFC because there was a dearth of borrowers given the endemic uncertainty.

More recently, they justified QE as a way to boost inflation that has been systematically below central bank price stability targets. Drawing on the mainstream money multiplier and quantity theory of money, central bankers claimed they could increase broad money and stimulate inflation by increasing bank reserves (Mitchell et al., 2019). Some economists viewed the predicted increase in inflation favourably (Krugman, 2010).

But, despite the significant build up in bank reserves, broad money and inflation did not rise as predicted. The money multiplier went missing! McLeay *et al* (2014) note a “common misconception is that the central bank determines the quantity of loans and deposits in the economy by controlling the quantity of central bank money – the so-called ‘money multiplier’ approach ... In reality, neither are reserves a binding constraint on lending, nor does the central bank fix the amount of reserves that are available” (p.15), which means that the money multiplier “it is not an accurate description of how money is created in reality” (p.15). In reality, bank reserves accommodate broad money growth, which is driven by borrowers seeking funds (Lavoie, 1984).

While these bond-buying programs have effectively funded fiscal deficits, there were no inflationary consequences, because the increase in fiscal spending was not sufficient to push the economy beyond the real resource constraints.

### 5.4 What Japan and the GFC has taught us

The experience of Japan since 1990 provides us with long-term evidence of what happens when fiscal parameters are pushed beyond typical settings. Japan endured a massive commercial property collapse in 1991 after the debt-fuelled boom ended. Government responded by running continuously large fiscal deficits and the public debt ratio is now the highest in the advanced world. The Bank of Japan has bought most of the new debt issued since 2000.

Japan has maintained low inflation or deflation, near zero interest rates and strong demand for government debt with low or negative yields since the 1990s defying predictions from mainstream economists to the contrary (for example, Doi, Hoshi, and Okimoto, 2011; Reinhart and Rogoff, 2009; Tokuoka, 2012). It has also enjoyed very low unemployment, by comparison with most other nations. Economists failed to understand that a currency-issuing government can meet all liabilities issued in its own currency and never faces insolvency. Further, the Bank of Japan can maintain yields and interest rates at very low levels indefinitely to suit its policy purposes. Bond

markets can never overpower the financial capacity of government and can only determine yields if governments allow them to.

The GFC further exposed the shortcomings of mainstream macroeconomics. First, the standard New Keynesian framework excluded a financial sector such was the confidence in ‘efficient markets’ theorem, which denied that financial markets could misallocate funds in any systematic way. Mainstream economists did not foresee the GFC and continued to urge further financial deregulation even as the signs of crisis were evident (see Mishkin and Herbertsson, 2006).

The GFC was a balance sheet recession, beginning in financial markets as a result of excessive private debt levels and lax regulative oversight (Koo, 2003). Extended fiscal support was indicated to support private balance sheet restructuring. The rising debt and deficits attracted the usual mainstream warnings of doom. Governments were pressured by economists to withdraw fiscal stimulus too early and rely on monetary policy (Krugman, 2010). The strategy resulted in slow recoveries and the Eurozone nations suffered massive economic hardship as a result of the austerity. None of the mainstream predictions were realised.

Buiter (2009) was scathing of the New Keynesian orthodoxy:

Most mainstream macroeconomic theoretical innovations since the 1970s ... have turned out to be self-referential, inward-looking distractions at best ... the Dynamic Stochastic General Equilibrium approach ... excludes everything relevant to the pursuit of financial stability.

## 5.5 A government deficit is a non-government surplus

MMT also highlights another misperception about deficits and debt. While the public is continually told that fiscal surpluses are desirable and allow government to pay down debt, the reality is different.

The national accounts show that a government deficit (surplus) is, dollar-for-dollar, equal to a non-government surplus (deficit). When the non-government sector is in deficit it is also accumulating ever increasing debt levels. The only way that the Costello surpluses were possible, without the fiscal drag causing recession, was because households accumulated record and unsustainable levels of debt.

Further, for a nation running an external deficit (such as Australia), a fiscal surplus squeezes liquidity in the private domestic sector. While Costello claimed the fiscal surpluses were about getting “the debt monkey off our backs” (Australian Treasury, 2006), in reality, the surpluses were paid for by wealth destruction in the private domestic sector and the falling interest payments destroyed private income flows.

Conversely, fiscal deficits add to net financial wealth in the non-government sector and support its desire to save overall. Any matching debt that is issued provides a portfolio choice to private savers. There is never a question of a currency-issuing government defaulting on its own debt for financial reasons.

## 6. Buffer stocks and price stability

The NAIRU concept has dominated policy practice since the mid-1970s (Modigliani and Papademos, 1975). MMT constructs the NAIRU approach as a costly unemployment buffer stock (Mitchell, 1998) and contrasts it with an employment buffer

stock approach (Job Guarantee), which can achieve both full employment and price stability (Mosler, 1997-98; Mitchell, 1998).

Under the NAIRU orthodoxy, tightening monetary and fiscal policy creates an unemployment buffer, which moderates wage demands and suppresses margin push by firms. Not only are the output and income losses huge, but, the social costs impact heavily on individuals and families. The wastage violates any notion of macroeconomic efficiency.

Conversely, under the Job Guarantee, the government uses its currency capacity to make an unconditional job offer at a socially-inclusive minimum wage to anyone who wants to work. The buffer stock of jobs fluctuates with the strength of private spending – that is, market forces determine the total quantity of government spending that would be required to sustain ‘loose’ full employment. The Job Guarantee thus becomes an additional automatic stabiliser.

Following the long tradition of commodity buffer stock schemes to maintain price stability, the Job Guarantee achieves price stability by buying labour at a fixed wage. This labour has a zero bid in the market. The government thus buys off the bottom. When the private sector is inflating, tightening fiscal and/or monetary policy shifts workers into the fixed-wage Job Guarantee sector to quell price pressures. The Job Guarantee thus flattens the Phillips curve (Mitchell et al., 2019).

MMT prioritises the creation of high skill, well-paid public sector jobs but considers the Job Guarantee to be superior to the NAIRU approach to shore up the bottom of the labour market.

## **7. Summation and the way forward**

The IMF (2016: 38-39) acknowledged that the policy bias “to reduce fiscal deficits and debt levels” over the last three decades has created a vicious cycle of slow growth and rising inequality. Rather than “deliberately running budgetary surpluses” (p.40), they argued that governments should foster growth to reduce public debt ratios. More economists are also shifting towards that position as the failure of the mainstream consensus becomes more obvious.

MMT economists have always held the view that a focus on deficits and debt aimed at assessing solvency thresholds and the like has never been justified and has underpinned destructive policy interventions that have undermined prosperity. Now, as never before, the scale of the socio-economic-ecological challenges before us requires a rejection of the deficit/debt scaremongering. Meeting these challenges will require significant fiscal support over an extended period.

Such fiscal support is necessary to sustain income growth to allow the non-government sector to reduce its debt levels and to provide for jobs growth. But it should also target longer-term challenges, such as restoring some self-sufficiency in manufacturing; reforming the gig economy that has exposed millions to poverty during the pandemic; supporting regions that have experienced a major loss of firms (for example, tourist destinations); address the housing crisis; and, importantly, accelerate the transition away from carbon-intensive production and consumption.

Even before the pandemic, the climate issue suggested large fiscal deficits would be required in the transition phase. The health crisis has added another dimension to that need.

We argue that the old orthodoxy does not provide a reliable framework for understanding these options and consequences. It is likely that relying on ‘business as usual’ will result in an inadequate level of fiscal support being provided and a premature withdrawal of that support as the old debt and deficit themes return.

MMT provides a comprehensive macroeconomic framework, which allows us to understand that the problem into the future will not be excessive deficits and/or public debt. Rather, the challenge is to generate productivity innovations derived from investment in public infrastructure, education and job creation. And while Paul Keating was part of the problem as Treasurer, he is correct in calling for the RBA to fund the required deficits as we deal with the pandemic. There is no need for privately-held debt to rise.

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