real-world economics review, issue no. 89
subscribe for free

What is modern about MMT? A concise note

Paul Davidson [Founding Editor, *Journal of Post Keynesian Economics*; University of Tennessee]

This paper explains why modern monetary theory (MMT) fails to be a relevant modern theory of money because MMT completely neglects (1) the need to hold money for contractual liquidity purposes, and also neglects (2) the need for orderly price movements in financial markets.

Medievalism or Chartalism?

In my view, the "modern" thing about the modern monetary theory approach is its attempt to put a medieval *political* spin on the monetary theory developed by John Maynard Keynes in his *Treatise on Money* and *The General Theory of Employment Interest and Money*. The MMT problem is that this "modern" view of Keynes' theory of money results in significant errors in its implications of Keynes's theoretical approach to money and liquidity and its implication for deficit fiscal policy.

In Keynes's monetary theory the thing we call money is based on the concept of Chartalism where the State decrees, under the civil law of contracts, that the thing that is money is what discharges all legal contractual obligations. In his *Treatise on Money* (1930, 1, p. 4) Keynes noted "Today all civilized money is beyond the possibility of dispute Chartalist".

Yet, MMT disputes Keynes claim that all money in civilized, modern market-oriented economies is Chartalist. Instead MMT insists that money be defined, in medieval terms, as that thing which the sovereign (government) requires the private sector to use for the payment of taxes.

Nevertheless, implicit in MMT's support regarding the need for deficit spending to reduce unemployment is that private sector entrepreneurs and households will *accept any additional money government creates and spends* to employ resources owned by the private sector, even if no additional taxes are levied.

MMT argues that the government can create jobs merely by spending more money, which government creates without increasing taxes, i.e., by deficit spending. We should then ask of MMT advocates why should the private sector be willing to work to obtain possession of additional government money if this additional sum of money will not be needed, since no additional taxes will be imposed on the private sector?

I would suggest that what is missing from MMT's attempt to provide a modern version of Keynes's argument is the concept of liquidity as the motive for holding money.[1]

[1] For context regarding the work of Keynes, see Davidson (2017; 2009).

Money, money contracts and liquidity

Keynes's revolutionary theory requires that the analyst recognize that a monetary economy operates quite differently from the classical theory's operation of a non-monetary ("real") system. Accordingly, in Keynes's theory of a modern, money-using, market-oriented economic system, in the short as well as the long run, money is *never* neutral.

Time is a device which prevents everything from happening at once. Spot and forward money contracts and the civil law of contracts are human institutions created to organize all market-oriented production and exchange transactions that will be operative over an uncertain (not statistically predictable) future time period. A spot contract is one that specifies that delivery and payment is to be made "on the spot", i.e., delivery and payment is required the moment after the spot contract is agreed upon by the contracting parties. A forward contract, on the other hand, is one that specifies specific future date(s) for delivery of goods and/or services by the seller and money payment by the buyer. Accordingly, in all real-world market-oriented economies, all market transactions involve contracts specifying a calendar dated time when the buyer must meet his/her contractual payment obligation (liability) with the delivery of money to the seller who must deliver the "goods" at a specified date. An economy that utilizes spot and forward money contracts to organize production and exchange activities is an entrepreneurial economy.

In our world of experience, that thing that the State declares will legally discharge any contractual obligation under the civil law of contracts is money. In an entrepreneurial economic system, this concept of money requires a necessary property. The necessary characteristic of money in an entrepreneurial economy was spelled out by Keynes as early as the very beginning of his *Treatise on Money*: "Money [is] that by delivery of which debt-contracts and price-contracts are discharged, and in the shape of which a store of General Purchasing Power is held" (1930, p. 3). In other words, that thing that we call money has two specific functions:

1. Money is the *means of contractual settlement*;
2. Money is *a store of value*, i.e., a vehicle for moving purchasing power over time – "a time machine".

This "time machine" function indicates that money possesses the property of *liquidity*. The possession of liquidity means that the holder has sufficient money (or other liquid assets that can be readily resold for money in an orderly, organized financial market) to meet his/her contractual obligations as they come due. In a world of uncertainty, a decision maker cannot know what spot and forward contracts, either already entered into, or to be entered into in the future, will either (1) be defaulted by the buyer when the decision maker is the seller, or (2) will come due for which there will be a need for money to discharge these contractual obligations when the decision maker is the buyer. Accordingly, the more uncertainty the decision maker feels about future economic events, the more liquidity he/she will desire to hold to meet such unforeseen contingencies.

This characteristic of liquidity can be possessed in various degrees by some, but not all, durables. Since any durable besides money cannot, *by definition*, settle a contractual obligation, then for durables other than money to possess in some degree the characteristic of a liquidity time machine they must be resalable in well-organized, orderly markets for that thing (money) that the civil law of contracts declares can discharge a contractual liability.

Money, therefore, is the liquid asset *par excellence*, for it can always settle any contractual obligation as long as the residents of the economy are law abiding and recognize the ability of the State to enforce the civil law of contracts.

The degree of liquidity of any durable asset other than money depends on its prompt and easy re-salability in well organized *and orderly* financial markets. By orderly we mean that if the market price changes over time, these changes move in an orderly process by small amounts from the previous market price. For any financial market to be assured orderliness over time, there must be a "market maker", i.e., an institution that stands ready to:

1. Sell the durable whenever those who want to buy (the bulls) are overwhelming those who want to sell (the bears), or:
2. To buy when the bears are overpowering the bulls.

By making the market, the market maker assures all market participants that no matter what happens the market price of the asset in terms of money will move in orderly small amounts.
In sum, my point is that MMT fails as a theory to explain the need for contractual liquidity and the need for orderly financial markets.

Conclusion

In sum, MMT cannot be a theory of money operating in modern-market oriented economies for it fails to provide money with the property of contractual liquidity or the explanation of why other financial assets have some degree of liquidity because of the existence of orderly financial markets.

References

Davidson, P. (2017) *Who's Afraid of John Maynard Keynes?* Basingstoke: Palgrave Macmillan.

Davidson, P. (2009) *The Keynes Solution: The path to global economic prosperity.* Basingstoke: Palgrave Macmillan.

Keynes, J. M. (1936) *The General Theory of Employment Interest and Money*. London: Macmillan.

Keynes, J. M. (1930) *Treatise on Money*. London: Macmillan.

Author contact: pdavidso@utk.edu

SUGGESTED CITATION:
Davidson, Paul (2019) "What is modern about MMT? A concise note." *real-world economics review*, issue no. 89, 1 October, pp. 72-74, http://www.paecon.net/PAEReview/issue89/Davidson89.pdf

You may post and read comments on this paper at https://rwer.wordpress.com/comments-on-rwer-issue-no-89/