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MMT and the Santa Claus principle

To many economists, MMT stands for «Modern Monetary Theory». To investors on the other hand, MMT stands for «Magical Money Tree». The intentions behind such redistributive ideas are often good. However, good intentions and outcome are often very different.

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Deutsche Version

In 1961, during the Soviet's nuclear testing at the North Pole, a little girl wrote a letter to John F. Kennedy asking if Santa Claus was okay.

Kennedy wrote back to her saying that he spoke with Santa and that he was okay. Santa is a matter of belief. Some grownups believe in him, too. While economics is the study of the allocation of scarce resources, the Santa Clause principle implies that there is something for free.

To many an economist, MMT stands for *Modern Monetary Theory*. To many an investor, MMT stands for *Magical Money Tree*. To parts of the economics profession, the MMT idea means that an economy can borrow an infinite amount of money in its own fiat currency without facing negative consequences. To parts of the investment community, the idea resembles the Santa Claus principle. (Another group thinks it's just nuts.)

The wishful thinking around unlimited government largesse is called the *Santa Claus principle*. The term *Santa Claus principle* was coined by Ludwig von Mises in relation to the interventionalist argument of Keynes, and the redistributive idea is kept alive by all those who expect personal or political advantage from government spending:

An essential point in the social philosophy of interventionism is the existence of the inexhaustible fund which can be squeezed forever. The whole system of interventionism collapses when this fountain is drained off: The Santa Claus principle liquidates itself.[1]

—Ludwig von Mises (1881-1973), Austrian School economist

Many investors, practitioners by definition, are often surprised about the continuous supply of interventionist ideas coming from academia. The fall of the Berlin Wall should have put an end to all that, they say. The tooted «ideas» are often old, have failed in practice, and reappear as new wine in old wineskins. Here's one explanation:

Like every other group, academics like to exert influence and feel important. Few scholars in the social sciences and humanities are content just to observe, describe, and explain society; most want to improve society and are naïve enough to believe that they could do so if only they had enough influence. The existence of a huge government offers academics the real possibility of living out their reformist fantasies.[2]

– Dwight Lee (b. 1941), American economist

It is often the investor's «gut» or «intuition» or sense of history, that hisses the proverbial red flag from the social scientist's reformist fantasies.

Investors are trained to think in cost-benefit terms and are generally sceptical of fiscal-policy pies in the sky and monetary-policy induced nirvanas. The investor sees the first order effect as a vote-winner (the benefit) but also the second and third order effects that are socio-economically negative (the cost). Some investors might even go as far and associate excess government interventionism to Neil Diamond music:

Socialism is like Neil Diamond music. It's not good and belongs in the past, yet there's a group of people who think that it will eventually catch on if only they keep playing it.[3]

– Jeffrey Evan Brooks (b. 1976), American author

Some American authors avoid the term *socialism* and call it *campus liberalism* instead. This is in relation as to how education in the U.S. is organized and a reference to what is thought and taught there. Campus liberalism is like Neil Diamond music too, of course.

The road to hell is paved with good intentions

The intentions behind redistributive ideas are often good. However, good intentions and outcome are often very different:

What has always made the state a hell on earth has been precisely that man has tried to make it his heaven.[4]

— Friedrich Hölderlin (1770-1843), German poet

The first stage of a new policy is what makes the policy initiator look good. The problem is, though, that the policy initiator is not responsible for the ripple effects, the later stages. The negative consequences are socialized. Harry Browne found one way of putting it:

The free market punishes irresponsibility. Government rewards it.[5]

– Harry Browne (1933-2006), American libertarian writer and politician

While MMT proponents argue that the government coffers cannot be compared with household budgets, there is an element of fear that excess debt is associated with the road to serfdom, i.e., less freedom and fewer options for future generations. Herbert Hoover put it well:

Blessed are the young for they shall inherit the national debt.[6]

– Herbert Hoover (1874-1964), 31st President of the United States

Some of the Founding Fathers of the United States, somewhat ironically, since the main source of the MMT rhetoric stems from the U.S., warned against excess debt. This is just one example:

When you run in debt; you give to another power over your liberty.[7]

– Benjamin Franklin (1706-1790), American polymath

The relationship between debt and the road to serfdom is much older than just a couple of hundred years:

Debt is the slavery of the free.[8]

– Publilius Syrus (85-43 BC), Syrian slave and Latin writer

Given the enslaving nature of excess debt throughout history makes the unwisdom of the MMT crowd even more remarkable. The reformist fantasies and wishful thinking behind the old wine in new wineskins from U.S. campuses, i.e., the Santa Claus principle, can be debunked with a simple two-liner:

«Dad, I want to be a socialist, when I grow up.»
«You can't do both, son.»

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Alexander M. Ineichen is the founder of Ineichen Research and Management AG, and has been a CAIA Association member since 2003. He started his financial career in origination of risk management products at Swiss Bank Corporation in 1988. From 1991 to 2005, he had various research functions within UBS Investment Bank in Zurich and London related to equity derivatives, indices, capital flows, and alternative investments. Mr. Ineichen has written extensively on investment topics. He is the author of the two popular UBS research publications, «In Search of Alpha-Investing in Hedge Funds» (October 2000) and «The Search for Alpha Continues-Do Fund of Hedge Funds Add Value?» (September 2001), as well as two books, Absolute Returns-The Risk and Opportunities of Hedge Fund Investing (Wiley Finance, 2002) and Asymmetric Returns-The Future of Active Asset Management (Wiley Finance, 2006). He is also the author of AIMA's «Roadmap to Hedge Funds» that has been published in 2008 and updated in 2012. Mr. Ineichen holds the Chartered Financial Analyst (CFA) and the FRM designations.

[1] Von Mises, Ludwig (1949, 1996) “Human Action—A Treatise on Economics,” 4th edition. San Francisco: Fox & Wilkes, p. 858. First published 1949 by Yale University.

[2] “Go to Harvard and Turn Left: The Rise of Socialist Ideology in Higher Education" in T. William Boxx and Gary M. Quinlivan (ed.) The Cultural Context of Economics and Politics (Lanham, Mayland: University Press of America, Inc. 1994), pp. 15-26.

[3] "Socialism: The Next Social Revolution," Alternate History Discussion Board, 12 October 2013.

[4] From Hayek, F.A. (1944, 2006) “The Road to Serfdom,” New York: Routledge Classics, p. 24. First published 1944 by George Routledge Sons.

[5] Advocates for Self-Government (2004), p. 76.

[6] Address to the Nebraska Republican Conference, Lincoln, Nebraska, 16 January 1936.

[7] Poor Richard's Almanack, 1758.

[8] Sententiae, Maxim 14.