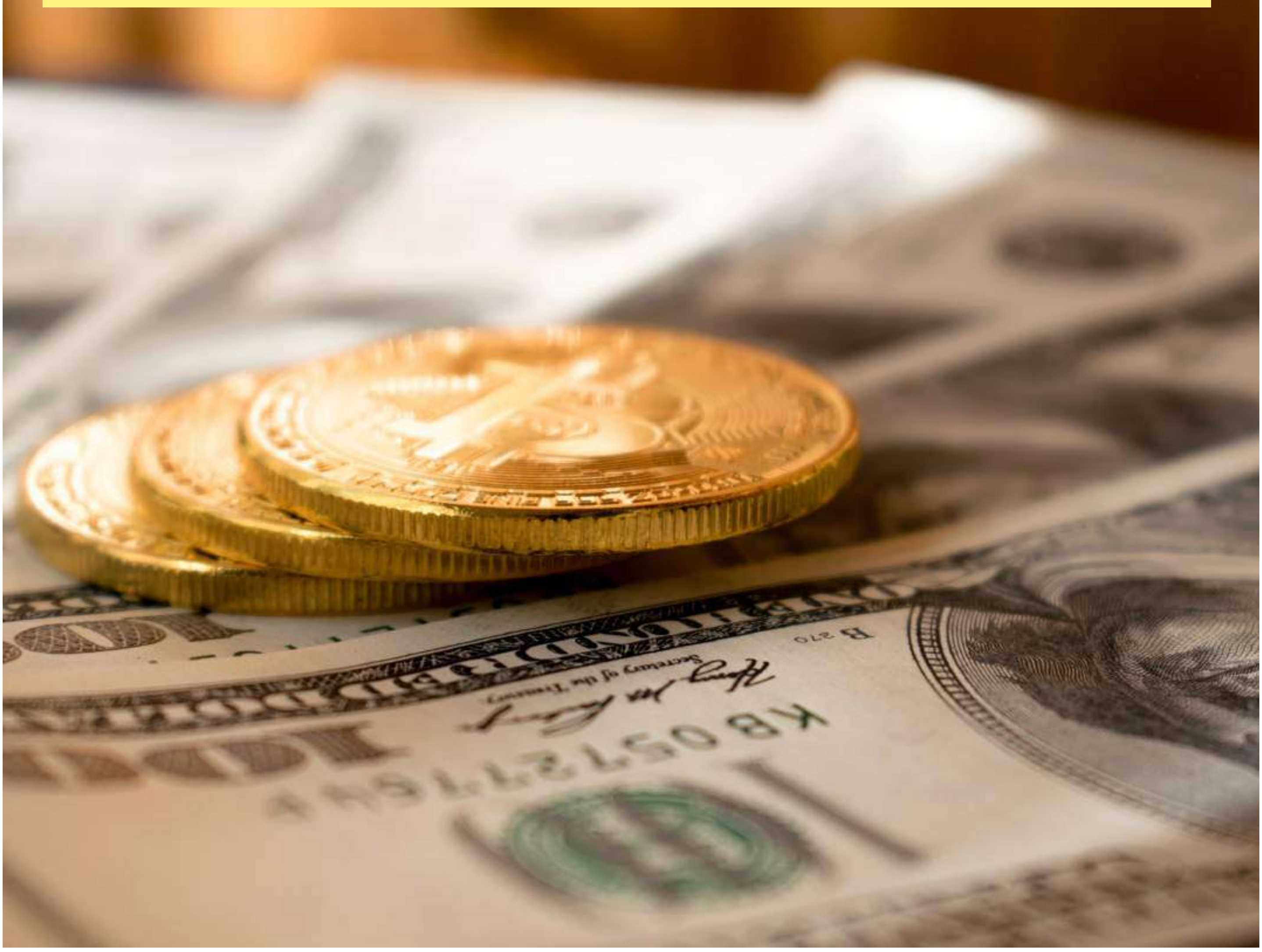
Exploring Economics

MODERN MONETARY THEORY

AN OVERVIEW AND DEVELOPING COUNTRIES CASE STUDIES



THE ONLINE SUMMER ACADEMY FOR PLURALIST ECONOMICS// 2021

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INTRODUCTION

Are We Living in an MMT World?

In the pandemic, the U.S. government has spent money on a scale not seen since World War II—without worrying too much about how it would pay the bills. That looked to some people like the triumph of Modern Monetary Theory.

A newish school of thought, MMT proposes that a country with its own currency, such as the U.S., doesn't have to worry about accumulating too much debt because it can always print more money to pay interest. So the only constraint on spending is inflation, which can break out if the public and private sectors spend too much at the same time. As long as there are enough workers and equipment to meet growing demand without igniting inflation, the government can spend what it needs to maintain employment and achieve goals such as halting climate change.

Put simply, such governments do not rely on taxes or borrowing for spending since they can print as much as they need and are the monopoly issuers of the currency. Since their budgets aren't like a regular household's, their policies should not be shaped by fears of rising national debt.

MMT challenges conventional beliefs about how the government interacts with the economy, the nature of money, the use of taxes, and the significance of budget deficits. These beliefs, critics say, are a hangover from the gold standard era and are no longer accurate, useful, or necessary.

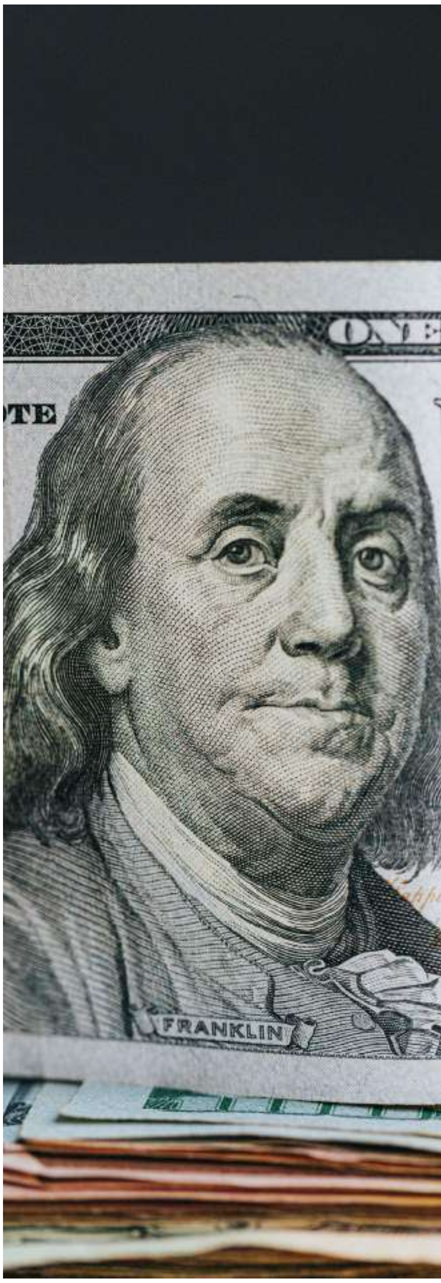
BUT, What about No Currency Issuer ?

Are we talking just about the USA, or dollars, or developed countries? How do we understand MMT on the regional level? This is the starting point of this course.

Modern Monetary Theory has a developed approach around fiscal and monetary policies, has thought and rethought the state, money, debt, deficit, unemployment, and inflation concepts. Nevertheless, MMT requires some basic or necessary economic conditions to desenvolve its ideas, an aspect that strikes with developing regions or countries, which likely do not accomplish them.

So, what Modern Monetary Theory can do to improve the economic landscape of developing countries? So far, how MMT could contribute to the strengthening of the Global South.

ORIGINS OF MMT



MMT was developed by Mosler and bears similarities to older schools of thought like functional finance and chartalism. Mosler first began thinking about some of the concepts that form the theory in the 1970s, when he worked as a Wall Street trader. He eventually used his ideas to place some smart bets at the hedge fund he founded.

In the early 1990s, when investors were afraid Italy would default, Mosler understood this wasn't a possibility. His firm and his clients became the largest holders of Italian lira-denominated bonds outside of Italy. Italy did not default, and they made $100 million in profits.

Mosler, who has a B.A. in Economics from the University of Connecticut, was largely ignored by the academic world when he tried to communicate his theories. In 1993, he published a seminal essay called "Soft Currency Economics" and shared it on a post-Keynesian listserv, which is where he found others like Australian economist Bill Mitchell, who agreed with him.

Support for MMT grew in large part thanks to the Internet, where economists explained the theory on popular personal and group blogs, the idea of a trillion-dollar coin was widely discussed, and supporters shared a clip of former Federal Reserve Chairman Alan Greenspan saying pay-as-you-go benefits aren't insecure because "there's nothing to prevent the federal government from creating as much money as it wants and paying it to somebody."

Political leaders like Alexandria Ocasio-Cortez and Bernie Sanders have espoused MMT, and economist Stephanie Kelton, who first came across Mosler's ideas on the listserv and is now arguably the face of the theory, served as chief economic adviser to Sanders during his 2016 presidential campaign.

UNEMPLOYMENT AND INFLATION

Money is a creation of the State and taxes "drive money": a certain currency is accepted as a means of payment even when is not "backed up" by precious metals, like in modern fiat currency systems because citizens know themselves, or other fellow citizens, can pay taxes with it.

Two of the most important requirements for qualifying a currency as sovereign are:

1. The liabilities of the government must all be denominated in that currency (e.g., government bonds cannot be denominated in a foreign currency, such as the US dollar if the government in question is not the United States);
2. The government must adopt a floating exchange rate regime (e.g., its central bank should not promise to redeem the local currency for a fixed quantity of foreign currency).

General Theory:
"When a further increase in the quantity of effective demand produces no further increase in output and entirely spends itself on an increase in the cost-unit fully proportionate to the increase in effective demand, we have reached a condition which might be appropriately designated as one of true inflation."

MMT would call "demand pull" inflation what Keynes called "true inflation." It occurs when the system reaches the point of full utilization of its productive capacity, both in terms of capital utilization and in terms of availability of workers.

At this point, the government should curb inflation forces cooling down the effective demand.

This is another fundamental task of taxes. We have already seen that from an MMT perspective taxes "drive the money," in other words they make the money of account chosen by the state accepted for payments. The second reason to have taxes (once a currency is established and widely adopted) is to reduce aggregate demand to keep inflation in control. In this way taxes create real resources space in which the government can spend to fulfill its socio-economic mandate. Taxes reduce the non-government sector's purchasing power and hence its ability to command real resources, leaving real resources for the government to command its spending.

UNEMPLOYMENT AND INFLATION

MMTers reject the law of diminishing returns, therefore the increase in costs and prices that can follow an increase in production before the point of full capacity utilization should not be explained through a decrease in productivity. Instead, MMTers endorse Kalecki's vision of inflation as the result of the distributional struggle over the respective shares of income between different sectors, or classes, of society. A higher level of employment, or a lower level of unemployment, can encourage workers to claim higher nominal wages, triggering a wage-price spiral.

Given the fact that for MMTers the achievement of full employment should be among the main duties of a government, instruments are required to manage in an orderly way the fundamental trade-off between inflation and employment that has been at the center of macroeconomic debate since Phillips's famous paper published in 1958.

A first tool is given by income policy: the Scandinavian model based on the distinction between a competitive sector (where wages can only grow in line with productivity gains and foreign inflation) and sheltered sector (where wages should be aligned with the ones of the competitive sectors, is described in the MMT handbook as a good example of this approach's utilization.

Yet the main idea put forward by MMTers is the use of the so-called buffer employment ratio (BER). A job guarantee (JG) program should ensure that workers that cannot find a job and would swell the ranks of the unemployed could receive a job offer from the government at a national minimum wage. The BER is defined as the ratio between people employed by the JG program over the total employment in the economy. Evidently, the BER would be higher in a time of recession and lower in a time of expansion, as people tend to move to non-JG positions where the wages are higher when there is the possibility to do so. However, the BER could also be "actively" used to manage inflation pressures in the same way the unemployment buffer stock has been traditionally used under inflation-targeting monetary policy regimes. If the economy is getting closer to full capacity utilization, the government could increase taxes (or cut expenditure) in order to diminish aggregate demand, raise the BER, and cool inflation.

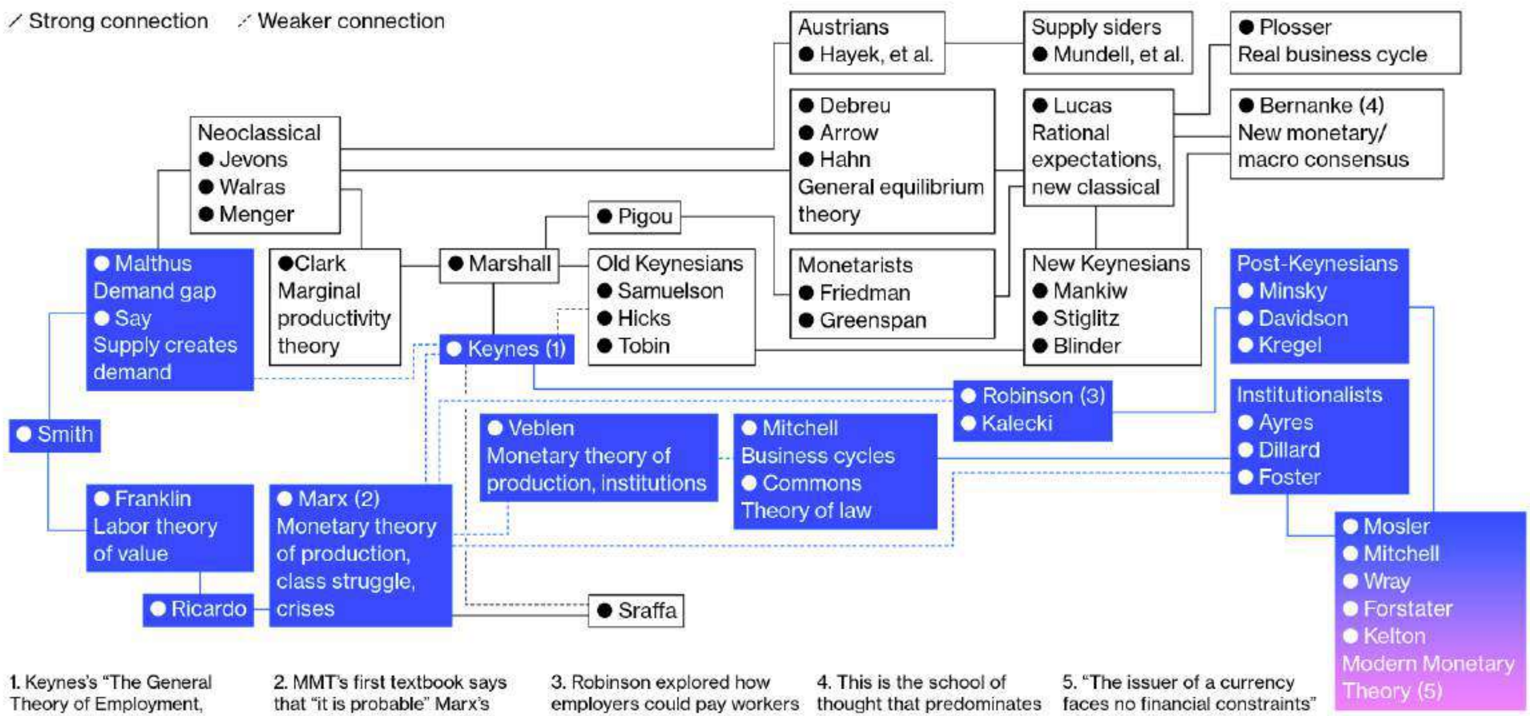
UNEMPLOYMENT AND INFLATION

Traditional (Keynesian) fiscal policies could still play a crucial role in case of severe recessions to avoid deep slumps, or more generally when the system is far from its full potential. Yet when the economy is in relatively good health only the JG, according to MMTers, can reach full employment without triggering an inflation spiral. Indeed, Keynesian policies focused on public expenditure attempted to maintain full capacity utilization by 'hiring off the top' (that is, making purchases at market prices and competing for resources with all other sources of spending in the economy). In practice, these policies often focused spending on the most advanced sectors employing higher-skilled (usually unionized) workers in the defense sector, for example.

By contrast, the JG program buys labor off the bottom, and doing so does not contribute to the reinforcement of the distributional conflict and the related inflation tendency. MMT theorists think of the JG program as part of a broader strategy carried out by the government to honor its social duties. This strategy harkens back to Abba Lerner's concept of functional finance: The first financial responsibility of the government (since nobody else can undertake that responsibility) is to keep the total rate of spending in the country on goods and services neither greater nor less than the rate which at the current prices would buy all the goods that is possible to produce.

Through the combination of traditional Keynesian fiscal policies and a JG program, MMT claims to have overcome the once unavoidable trade-off between inflation and unemployment. The Phillips curve in an MMT world still exists, but it can be "flattened" on the left-hand side at virtually any point, depending on the level of the BER.

MODERN MONETARY THEORY'S LINEAGE



1. Keynes's "The General Theory of Employment, Interest and Money" created the field of macroeconomics

2. MMT's first textbook says that "it is probable" Marx's theories influenced Keynes

3. Robinson explored how employers could pay workers less than they're worth

4. This is the school of thought that predominates in central banks and leading universities

5. "The issuer of a currency faces no financial constraints"

DEVELOPED AND DEVELOPING COUNTRIES CONTRASTING REALITIES

It is important to know that MMT doesn't advocate for money printing. To borrow from L Randall Wray, a pioneer of the field, MMT argues that a sovereign government that issues its own "nonconvertible" currency cannot become insolvent (in terms of its own currency). It cannot be forced into involuntary default on its obligations denominated in its own currency. It can "afford" to buy anything for sale that is priced in its own currency. Here sovereignty is defined in monetary terms in that a state has monetary sovereignty when it issues its own currency, taxes its people in that currency, accepts that currency in payment of the imposed obligations, and issues debt in its own currency.

MMTers argue that their descriptions and prescriptions equally hold for the developing nations as for the developed nations.

MMT describes how economies work but does not prescribe the policy choices that they should make, whilst admittedly showing the way to full employment. So, MMT is wholly relevant to developing countries precisely because it can say what the focus of economic policy should be if these countries want to take control of their macroeconomies is for the benefit of the people who live within them.

MMT explains how an economy and its relationship with the money that it creates and the tax system that it has all work so modern monetary theory isn't a policy it isn't a choice it's a description of a reality and there is a reality about modern monetary theory in developing countries, therefore the question that's been asked is relevant. It is that there are aspects of what one would desire in those economies that do not exist which however modern monetary theory makes clear.

Modern Monetary Theory says that if a country has its own central bank and its own currency and it only borrows in that currency then it can at least in theory never become insolvent. The government cannot become insolvent because it can always simply create more money to settle its liabilities.

Two things apply developing countries, one is that they don't always use their own currencies in their own economies in fact there's a very dangerous situation with regard to macro economic control of many of these countries economies in that they let a second currency circulate which is often preferred the local one and that second currency is most commonly the us dollar and secondly they borrow in that other currency again usually the us dollar a situation which is not helped by the world bank the IMF and other international organizations frequently making loans in dollars and then insisting that the country has to repay in US dollars which does necessarily mean it's got to generate those dollars by export sales to service the loans which are often used for domestic purposes creating an enormous imbalance and stress within the economy which means it can never meet the demand for loan repayment out of the activity that is generated by the loan funds creating eventually an economic crisis which we are too familiar with but what MMT does is point out that these imbalances exist it says you should not make loans if you are the IMF or the world bank to a developing country in US dollars if the loan is to be for the purposes of local economic development in fact it says you shouldn't simply make loans to that country in any other currency than that which it wishes to use for itself and the IMF and the world bank should assume the exchange risk as a consequence it also says that a country should not tolerate the circulation of a second currency as a common performance of settlement within it and it can do that by having a strong and effective tax system that demands that its own currency is in use for the purposes of settlement of tax.

Unfortunately let's be clear, we know this the tax systems of many developing countries are quite simply too weak for that enforcement to take place it isn't uncommon for half of tax revenues in developing countries to simply not be collected because of the weakness of enforcement in those tax systems and with that comes an effective failure of macro economic control on the behalf of the government so what we're seeing is MMT saying something very clearly which is not about a policy prescription but about an economic management system that should be put in place to ensure that the conditions in which a government can put in place its own economic policy decisions must arise so MMT says that a country should not borrow in a foreign currency and it is time for the international financial institutions to recognize this issue.

The government in question should be accountable for the budgets that it sets for the management of its economy, the measurement of its tax revenues, the control of its tax cap, and the reporting on that issue to its parliament.

COUNTRY CASE STUDIES IN THE DEVELOPING WORLD

BRAZIL

This session aims to provide an understanding of the current debate of MMT in Brazil while addressing common caveats to the MMT approach when analysing developing countries' realities. It is crucial to highlight the existence of a monetary spectrum in which developing countries can perform more or less monetary sovereignty depending on i) its own domestic characteristics and ii) its insertion into the international economy. As for the case of Brazil, austerity has been the rule and there was a spending ceiling until the beginning of the pandemic. However, COVID-19 consequences have shown the necessity of social spending and an emergency budget was approved by the parliament in tandem with the flexibilization of fiscalrules. “Miraculously” the money to pay social grants and manage an expansionary fiscal policy has appeared. MMT has much to explain in this regard and its framework can help to debunk some myths in public finance. Nevertheless, MMT’s underlying policy recommendations should be shaped to fit the developing countries' dilemmas.

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COLOMBIA AND ITS ROAD TO A MORE CRUCIAL STATE: INDUSTRIALIZATION & DEFICITS

In this session we will analyse the Colombian road to development, as we consider how this South American country has passed through different stages that have been supposed to achieve its way out from the "Developing country" category. Necessary conditions that would make MMT an adequate analytical lens to observe the Colombian economy. Since this country has today structural trade deficits, a high structural unemployment rate, import dependency of complex goods and services and, disadvantages in trade terms. All this behind the exaltation of a stable macroeconomic performance in the 20th century.

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INDIA

MMT as a concept is everywhere now-a-days. Everyone seems to be fascinated about the idea that a government which issues its own currency, can print the same out of varied economic problems like unemployment, debt, economic downturns, recessions,etc. But, most of it seems to be ideal for countries like the USA, UK, JAPAN, etc. as these countries enjoy strong currency sovereignty and have strong developed economies.

Now in this session, we analyse MMT through India's Perspective and raise the question, Is MMT relevant in a developing global south country like that of India which still has weak financials compared to many developed countries in the world. We will also assess if the Indian economy and its variables are strong enough to implement something like the MMT in the Indian Economic System. We will also try to analyze the relationship between the Indian central government and the central bank of India, RBI, in the context of MMT.

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- Why emerging markets like India are wary of using modern monetary theory to fix the economy https://theprint.in/economy/why-emerging-markets-like-india-are-wary-of-using-modern-monetary-theory-to-fix-the-economy/532893/
- The Inexplicable Allure of Modern-Monetary Theory https://www.livemint.com/opinion/columns/opinion-the-inexplicable-allure-of-modern-monetary-theory-11571676733717.html
- Covid-19 Response: Can Modern Monetary Theory Come To India's Rescue? https://www.bloombergquint.com/coronavirus-outbreak/covid-19-response-can-modern-monetary-theory-come-to-indias-rescue

MOROCCO

MMT isn't considered a political theory as everyone is assuming, it's a reality description of how money creation works. Many people went with the idea that modern monetary theory is only applicable to sovereign countries' currencies as US, UK, Canada and Japan without strict consideration of the impact on global south countries even if they're in continuous commercial transactions with most of the countries mentioned previously.
Developing countries are known for their borrowing character in currencies other than their own or having a second currency in use in their economies, or a weak and unenforced tax system.

Morocco isn't different!

By the end of the 1980s, the Moroccan economy became qualified as an administered debt economy which was financed by the banking sector. This one was placed under government control. Interest rates were, at all, administered and the role of capital markets was marginal.
Because of the limits of this financing mode to allow and allocate efficiently the resources, a new financing system, centered on the market mechanisms, market-driven system was set up gradually.
Our objective in this section will consist at first to examine main measures taken by Moroccan monetary authorities within the framework of MMT in addition to a detailed clarification of how MMT is wholly relevant to the Moroccan economy.

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SOUTH AFRICA

In this session we shall explore whether MMT policy frameworks can be implemented in the South African context as a viable option to aid in socio-economic development. Following the turn of democracy and the ushering in of a new constitutional dispensation, South Africa has been identified as a monetary sovereign emerging market within the African continent.

Favourable economic circumstances in the form of high domestic interest rates coupled with increasing demand for South African debt proves attractive to foreign investment due the long-term growth prospects both domestically and on a global scale. As attractive as these economic circumstances may appear, it must however be noted that it is not without its hindrances. High dependency on imports, a small taxpayer base, soaring inequality gap and high fiscal constraint due to extensive over-financing of state-owned-enterprises, proves an arduous challenge to policymakers.

The principal intention of this session is to delve into the theoretical application of the MMT policy framework in a South African context and whether South Africa has the capacity to successfully implement these policy framework recommendations.

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- "Maurice Höfgen
- https://mauricehoefgen.com/
- Book: The myth of a lack of money

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