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Opinion | Why Modern Money Theory needs to be taken seriously

4 min read . Updated: 04 Nov 2019, 10:36 PM IST Sashi Sivramkrishna

We must question blind allegiance to mainstream paradigms rather than dismiss heterodox views without serious inquiry

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In just four minutes of reading time, Ajit Ranade's opinion piece, *The Inexplicable Allure Of Modern Monetary Theory*, published in Mint on 21 October, attempts to bring down Modern Money Theory (MMT), a school of thought that presents a cogent alternative to the mainstream neoliberal macroeconomic discourse by fundamentally reassessing the notion of money, the modern monetary system, and the role of the state in a free-market capitalist economy. Arguably, Ranade's article conveys an inadequate interpretation of its essential propositions, nuances and relevant policy implications.

MMT asserts that economically sovereign states decide the unit of account, or the "money", in which all private sector obligations to the state—primarily taxes—must be settled. In India, for example, tax obligations are settled in rupees and rupees only, either in the form of currency notes or through commercial banks which debit our accounts as well as their reserve accounts with the central bank. But how do we get these notes and how do commercial banks get positive balances of reserve money with the central bank in the first place? The answer is obvious; when the government spends rupees into existence. Theoretically and institutionally, an economically sovereign country issuing its own fiat currency cannot face a solvency crisis. The government can issue an unlimited quantum of money into existence through printing, or by means that would be more appropriate today, such as computer keystrokes, which, incidentally, is what former US Federal Reserve chief Ben Bernanke referred to when he was asked how he bailed out private banks with some $5 trillion after the 2008 US recession. However, and most importantly, “can" does not mean “should", and no MMT proponent has ever said that sovereign governments should issue unlimited amounts of money. Any critique of MMT must begin with a reading of scholars including Randall Wray, Warren Mosler, Stephanie Kelton and Bill Mitchell, among others.

When a government spends money into existence, it may cause inflation if the spending faces “real" physical and natural resource constraints, such as of labour, capital, technology and skills. The government must then drain out the “excess" money, say, through taxes, destroying the money spent into existence. Here, taxes are not a source of funds for government spending. Given their impact on incentives, governments could alternatively choose to issue and sell bonds to the private sector to drain excess money. Once again, the government sells its bonds only for rupees, though it doesn’t need its own promissory notes. Bond sales are not an instrument of raising revenue for the government. They serve as an instrument of controlling inflation (although not all inflation is due to government spending), while also providing safe assets to the private sector and an instrument for the central bank’s monetary policy operations.

Repayment of public debt is done through the issue of new debt, rather than imposing taxes on our grandchildren. As Mosler argues, some (if not all) grandchildren are twice blessed—they inherit the bonds and thus repayments on it, as well as the benefits of the physical assets built by government spending.

Dismantling erroneous and inconsistent assumptions of the Loanable Funds theory of market interest rates that has given rise to the crowding-out hypothesis, MMT argues that interest rates are not a market-clearing price, but an instrument of monetary policy operated by the central bank to achieve its final inflation target. It is possible that when a central bank anticipates higher inflation, it could raise rates, although this does not have to be based on a naïve correlation between the fiscal deficit and higher expected inflation.

MMT further postulates that fiscal deficit targets and public debt figures are meaningless, per se. Japan, with a debt-to-gross-domestic-product ratio of 250%, struggles to check deflation, while Zimbabwe, even with an average 75% debt-to-GDP ratio since the 1990s, is unable to tame hyperinflation. In India, inflation has remained in check and interest rates are falling despite the overall fiscal deficit of the Centre and states having supposedly touched 8-9% of GDP. The US fiscal deficit has increased substantially in the last few years due to significant tax cuts, but there is no sign of inflation and higher interest rates. The crisis in Europe, where MMT principles do not apply, sends a clear message to the world: that austerity has failed in alleviating unemployment, and since monetary policy is a spent force, recourse to fiscal policy is inevitable.

Repositioning the importance of fiscal policy in achieving full employment of a nation's resources (labour, in particular), MMT advances an unequivocal policy stance: a universal job guarantee (UJG) programme that neoliberal economists unilaterally dismiss without any study and reflection as an idea of the “leftist crowd". Contrary to intuition, MMT argues that a UJG programme will stabilize prices, aggregate demand, and consequently, private sector investment spending. As John Maynard Keynes put it, “Look after unemployment and the budget will look after itself."

It is important for macroeconomists today to rise to the challenges posed by unemployment and widening regional, income and wealth inequalities by questioning blind allegiance to mainstream paradigms, rather than dismissing heterodox views without serious inquiry. Popular economic commentators like Ajit Ranade could perhaps make this effort, too.

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