Knitted in our Economies: MMT in a Practical Sense

Student Research Internship Report

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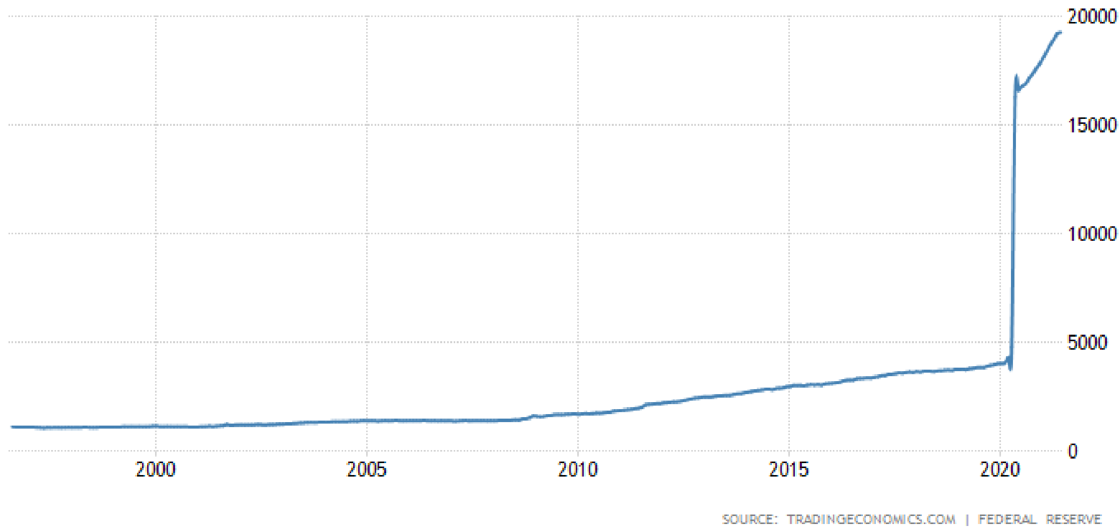
The modern monetary theory (MMT) is new age, heterodoxic theory which explores money from a different vantage point where it is considered as a public monopoly and which could be used to fund public debt and accelerate economic prosperity in mostly developed nations with sound economic structure.

Even though this theory seems to be very abstract and challenges the role of fiscal policy and monetary policy and brings a shift in the way we perceive money there are some practical examples as to how it is woven subtly in the American economy especially due to the pandemic.

Over the last few years, USA has "printed "more money than it ever has, in fact 40% of the money circulating at this moment were printed over the last year.



Money Supply M1 in the United States increased to 19268.10 USD Billion in June from 19221.70 USD Billion in May of 2021. source: Federal Reserve

[1] I, Sowbarnickha.S, hereby declare that the contents of this article are not plagiarized and reflect my own views. This article was written as part of a research internship at FAIR India, under the guidance of Dr. Sashi Sivramkrishna.

It is by now common knowledge that “printing more money” would lead to more inflation. If it is not understood they bring the age-old example of Germany until the discussion turns into how it ultimately led to the Holocaust. Hence, it is understood that there are some clear harrowing ramifications following a case of a hyperinflation diagnosis.

There are often parallels drawn between the rate at which the US fed is feeding the economy with cash and the crisis Germany faced after its fall during the world war I. But there is a question to be asked at this moment:

Is it wise to compare the US at this point of time and Germany in the 1940s?

The answer would be that we have come a long way since humankind believed that the world war was a way to end all wars.

The short answer is no, we are far more evolved at this point.

The longer answer however examines the history and the challenges, the taunts and the torment the Germany was facing during the war and after the war.

During this WWI, Germany was solely dependent on imports and were going through a nationwide food crisis. Its economy was barely afloat and by the end of the war, Germany was forced to sign the Treaty of Versailles where it was stripped of its assets and had to shell out large amounts of money to the British Government as a form of a punishment for siding with their enemies. However, the disturbing factor was that, Germany could not have paid in the form of their currency but, only in British Pounds, which resulted their currency to deplete, as they scoured around to pay back millions.

The current state of United States is vastly different.

Yes, we are going through a world-wide outbreak of a pandemic and pandemics have historically and consistently proved that it could take a huge toll on an economy.

But US is not facing a debilitating inflation problem despite the decrease in consumption due to the pandemic. Why?

while expanding money supply might be a part of increasing inflation other factors might also come to play such as employment (where an economy nearing full employment could spiral into an inflation) or the rate at which the money is circulating in the economy which is very much on the lower end.

And other than a toilet paper and a sanitizer shortage the US was undergoing supply chain problems at the most. They were not stripped of resources.

The existence of the current system:

During The financial crisis of 2007–2008, the US Federal reserve System opted to use quantitative easing measures to curb the problems the financial crisis brought in temporarily by buying $600 billion worth of government bonds. Bringing more liquidity in the economy.

This was the same strategy Japan used earlier in 2001 to combat the deflation crisis it was facing.

However, on 2013, the US fed announced its intentions to reduce its investments to buy the government bonds or "tapering". The fallout of that decision is what resulted in a phenomenon called the "Taper tantrum".

when there is an expansionary QE policy announced, the markets become bullish and stock prices begin to go up. On the other hand, QE tapering contracts the economy, then the markets become bearish and stocks tend to go down in value.

The bond market responded aggressively to that news and it resulted in a lot of the market participants sell the bonds thus, increasing the US treasury yields. However, this only had a tremendous impact on the bond market.

Recently the Fed has expressed its interest in tapering again either towards the end of this year or the beginning of 2022. Their statement also made it clear that this was not going to be as intense as the 2013 tapering.

It is also undeniable that the financial participants place more trust in the US economy than themselves. Which is reason why it is ineffective to

With all these considerations which should also consider the "spill over" effect or the multiplier effect this excess cash flow has brought with something as simple as the Indian stock market, where even with a global pandemic and low confidence in the Indian market. The index Nifty 50 (which is the top 50 stocks traded in the NSE) reached all-time highs even when there were strict nation-wide lockdowns.

But there are some hidden discrepancies which is a popular debate about how these changes are only going to help the top 5 % who own about 70% of the assets. Wealth inequality is also a subject that should be considered in when we are addressing this considering that there are inequalities in that very 5%. This becomes a way for them to accumulate and hoard wealth in forms of assets and America's Taxation system very much allows the rich to get away with hoarding huge amounts of cash.

One other interesting thing to note is that whenever there is spike in US inflations it coincides with a war or calamity causing greater economic damage like World War 2.

The implementation:

Quantitative easing which is arguably a huge factor the Fed is using to curb the crisis. Fed launched **quantitative easing** (**QE**), ultimately buying trillions of dollars of government bonds and mortgage-backed securities. Between 2008 and 2015, the Fed's balance sheet, its total assets, ballooned from $900 billion to $4.5 trillion.

The newly created money therefore went directly into the financial markets, boosting bond and stock markets nearly to their highest level in history. Risky assets became favorites. Asset bubbles emerged. It had spillover effects on emerging markets, India included. Stagflation was also witnessed in some countries. Many research studies showed significant impact on Indian Stock Markets. And additionally, the Biden administration introduced Stimulus checks as a way curb this crisis.

However, there are other Challenges as well for one. The intention of tapering the markets now will truly show the state of the economy, and the stimulus checks were used to buy “meme” stocks such as Game stop and cryptocurrency as people lost jobs and chose to rather invest in stocks than pay their expenses.

Cryptocurrency is very much in the realm of limitations in MMT as it is not controlled by the government.

With these in mind we do have to realize this is an uncharted territory and we are supposed to tend to matters with caution but, with prudent policies this theory can very much achieve its purpose of its existence.