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What Modern Monetary Theory (MMT) has to say about freebies

Critics of MMT have portrayed it as a supporters of unrestrained government spending. In reality, though, MMT has always placed emphasis on the opportunity cost of government expenditure, which diverts resources from other sectors

SASHI SIVRAMKRISHNA

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MMT not only raises concerns over unproductive freebies but is, more importantly, apprehensive of situations where real resources remain unutilised or underutilised.

From a purely economic and public policy angle, it is difficult for Modern Monetary Theory (MMT) to be kept out of the present debate on freebies, simply because if there is any economic perspective that has been closely associated with advocating governments to dole out free lunches, it is MMT. Popular media propagated this opinion: **Top IMF Economist Says No Free Lunch From Modern Monetary Theory** and **Beware the free lunch of modern monetary theory**. Nonetheless, when the US government ran a 15% of GDP fiscal deficit to rescue the US economy from total disaster unleashed by the Covid-19 pandemic, the media was compelled to change its stance: **Op-ed: Pandemic moves Modern Monetary Theory from the fringes to actual US policy** and **Modern monetary theory: the rise of economists who say huge government debt is not a problem**.

Keeping the US debate on MMT aside, what are some of the implications that can be drawn from MMT in the Indian context, in particular, in the ongoing freebie debate that has already taken on contentious political overtones? The fundamental tenet of MMT is that economically sovereign states which issue their own fiat currency do not face a monetary constraint *in their own currency,* and can therefore draw real resources from the private sector against issue of their currency or promissory notes. Given that all obligations due to the state including taxes, fines and penalties can be settled in these promissory notes, *and in these only*, they come to be generally acceptable.

What is key here is that the state does not 'earn' and spend like the private sector – households and businesses. It must first spend by issuing its promissory notes (say, rupees) into existence and then collect these back as 'revenue' by way of taxes or against issue of bonds. While the ability to create money lies only with the central government in India, state governments depend on the backing of the central government against debt-default, so that they are not reduced to the risk level of the private sector.

However, something commonly overlooked by mainstream critics is MMT's emphasis on the real resources constraint faced by an economy. The government – both central and state governments – through their spending are essentially drawing resources away from their market-based allocations to those that they deem necessary to meet broader economic, social and political objectives. This may include the building of schools, hospitals, courts, roads, defence or whatever else it deems necessary. Although the monetary cost *per se* is not of essential significance to the government, there is a real opportunity cost in reallocating resources. This is what happened in times of war: governments across the world used factories and labour to build tanks and guns instead of cars and buses. Economies boomed with full employment but there was scarcity in availability of day-to-day necessities resulting in supply shortages and high rates of inflation. The excessive money created by way of government spending had to be subsequently sucked out of circulation through issue of war bonds even as raging inflation was controlled though strictly enforced price controls.

When a government decides to build a school there is an opportunity cost in doing so. Resources like cement, water, steel, an educated work force, are allocated away from building homes, a road or a bus depot. The only justification to build the school must be that it will contribute more to a country's growth potential by way of increases in productivity than other alternatives. Ideally, a ranking of all projects (and combinations thereof) in enhancing productivity should guide the government's rationale for spending.

A freebie, from an MMT perspective, would constitute a good which does not lead to a positive increase in productivity or even worse, has a negative impact on productivity. The recently launched 'Sake Viva' competition by the Japanese government to actually encourage alcohol consumption would be a case-in-point of the latter. According to MMT, the objective of earning revenue for the government is unequivocally an unsound basis in guiding the (re)allocation of resources within an economy.

The closest MMTers have come to debating about freebies is to argue against a universal basic income (UBI) scheme, favouring a universal job guarantee (UJG) programme instead. Except for crisis situations like the pandemic and for aged or challenged individuals, a UJG is preferred because it can contribute to enhancing aggregate supply through productivity increases and capacity building while also increasing aggregate demand. On the other hand, a UBI scheme would only contribute to raising aggregate demand but may make matters worse by reducing the labour force participation rate, adversely affecting aggregate supply in the longer term and inducing inflationary pressures. A well-planned and administered UJG programme may not only raise productivity and aggregate supply but also stimulate private sector investment given greater stability in aggregate demand.

To sum up, MMT not only raises concerns over unproductive freebies but is, more importantly, apprehensive of situations where real resources remain unutilised or underutilised. Speaking on John Maynard Keynes – from whose work MMT draws upon – the renowned heterodox economist Josef Steindl argued: 'Keynes … had no respect for financial orthodoxy – the gold standard, balanced budgets, sound finance – in so far as they merely hindered a rational use of available material resources.'

Sashi Sivramkrishna studies macroeconomics from a Modern Money Theory (MMT) perspective.

Views are personal and do not represent the stand of this publication.

SASHI SIVRAMKRISHNA *is an economist, economic and environmental historian, and documentary filmmaker. Twitter: @Sashi31363.*