



Why We Need To Take Modern Monetary Theory Seriously

Its appeal is powerful whether it works or not.

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KEY INSIGHTS

- Modern monetary theory (MMT) has been seized upon by populists to argue for huge spending on universal health care, job guarantee schemes, and climate policies.
- MMT will probably not work in practice because politics is always likely to get in the way.
- However, it does not ultimately matter whether MMT works or not—its appeal to voters means that it is likely to be influential for some time to come.

The idea that governments can use large-scale money-printing to finance ambitious social and environmental spending programs is gaining traction. Modern monetary theory (MMT) has been seized on by populists, particularly those on the left, to justify ambitious spending programs aimed to redress the balance between the “people” and the elite. Critics have lined up to dismiss MMT as unworkable, but whether it works is not particularly important—the important question is whether enough people can be persuaded to *believe* that it works.

It is easy to understand why people might *want* to believe in MMT. One of its key contentions is that a country with its own currency can always fund new initiatives by printing money and, therefore, that a government’s spending power is not constrained by its ability to raise revenues or a requirement to balance the budget. MMT advocates argue that the true constraint on fiscal spending is inflation.

If there are underutilized resources in the country, they say, the government should increase spending to expand the economy to the point at which all resources are employed. If inflation becomes a threat, governments can simply raise taxes to remove the excess demand and money from the system.

The prospect of financing universal health care, job guarantee schemes, and climate policies through money-printing is clearly an enticing one. In the U.S., left-wing Democrats, including Alexandria Ocasio-Cortez, have argued that MMT can be used to fund the Green New Deal, a far-reaching proposed stimulus package that aims to address climate change and economic inequality. In the eurozone, although individual countries are prevented from printing money to finance fiscal expansions, the key ideas of MMT are being used by left-wing populists to push back against the bloc’s fiscal orthodoxy. It is likely that aspects of MMT will be adopted by more



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populist movements across the world over the next few years.

Lack of Clarity Hampers Debate

It is difficult to evaluate the merits of MMT as its advocates have not provided a unified framework to illustrate how it works. On the one hand, MMT suggests that there is no level of debt that is too large for a government to manage provided that debt is issued in the local currency and that governments, therefore, have limitless potential to initiate social good by printing money. On the other hand, most MMT enthusiasts claim that they do not advocate out-of-control fiscal spending and emphasize the need to manage demand to keep the economy on an even keel.

Critics argue that MMT advocates are deliberately vague about how MMT works precisely because it cannot work. MMT enthusiasts have responded by accusing the critics of not taking the trouble to properly understand the theory. The absence of an agreed-upon framework has meant that debates of the merits of MMT rarely lead anywhere, with both sides often accusing each other of acting in bad faith. Economist Paul Krugman, a strong critic of MMT, wrote: “MMTers...tend to be unclear about what exactly their differences with conventional views are, and also have a strong habit of dismissing out of hand any attempt to make sense of what they’re saying.” MMT supporter Stephanie Kelton, an economist and former advisor to 2016 U.S. presidential campaigner Bernie Sanders, has accused Krugman of getting “some of the basic ideas wrong” and of being “led astray” by working within a crude macroeconomic framework.

Economic Theory vs. Political Reality

In my view, MMT could probably work in theory but would be difficult to implement in practice because politics is likely to get in the way. MMT supporters argue that economic policy

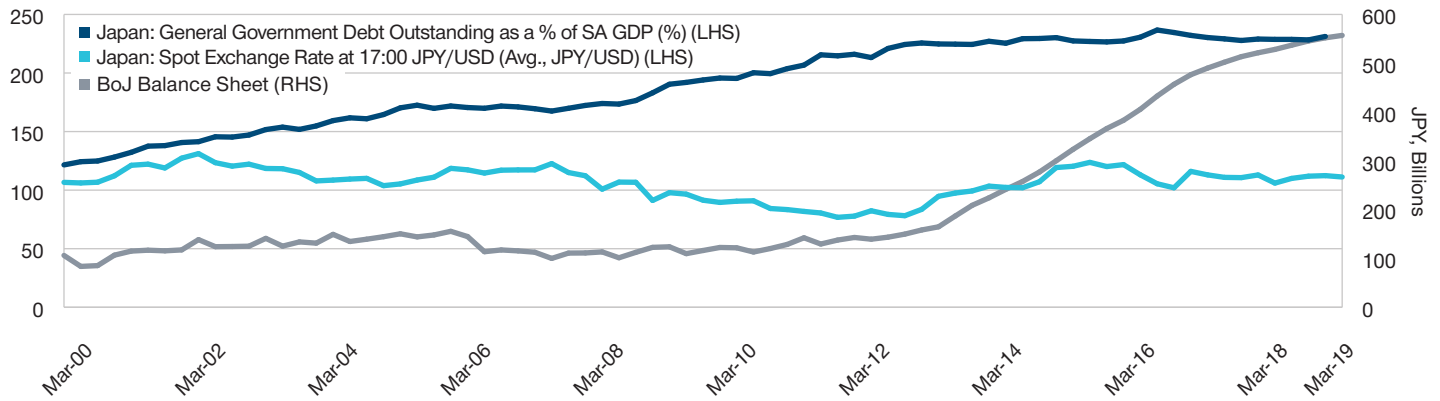
should be set to keep the economy on an even keel: The fact that the fiscal deficit can be monetized does not imply that fiscal policy should be imprudent. Consequently, they argue, fiscal expansions under MMT should never reach the point at which a rising debt load leads to unstable money demand, capital flight, currency depreciation, and inflationary spirals. Provided that fiscal (and other economic) policy is set responsibly, MMT slots easily into well-established theoretical frameworks—in other words, it is nothing new.

In reality, however, handing control of the money-printing presses to politicians is likely to lead to imprudent economic policies because sensible fiscal policies tend to fall victim to the electoral cycle. In the more severe cases, this can bring about currency depreciation and a risk that the monetary authority loses control over inflation. Money demand becomes unstable.

We do not know the levels of debt at which the adverse effects of excessive deficits come into play. The experience of Japan, where public debt is large but inflation and interest rates have been low for decades, suggests that the limit could be quite high (see Figure 1). By contrast, past events in Argentina suggest that the economic blowup could occur at much lower levels of debt (see Figure 2). However, we do know from experience that when we hit the threshold, economic prospects can turn ugly very quickly. In practice, the implementation of MMT likely requires the existence of a “benevolent social planner” who is willing to apply the fiscal brake when required to do so regardless of the electoral cycle. In the absence of such a figure, MMT supporters advocate that fiscal spending should be coded into laws and legislations in the form of automatic stabilizers (i.e., a call on politicians to relinquish the power over the purse to technocrats). I harbor sincere doubts that any politician would willingly do this though.

(Fig. 1) Rising Debt, Stable Currency

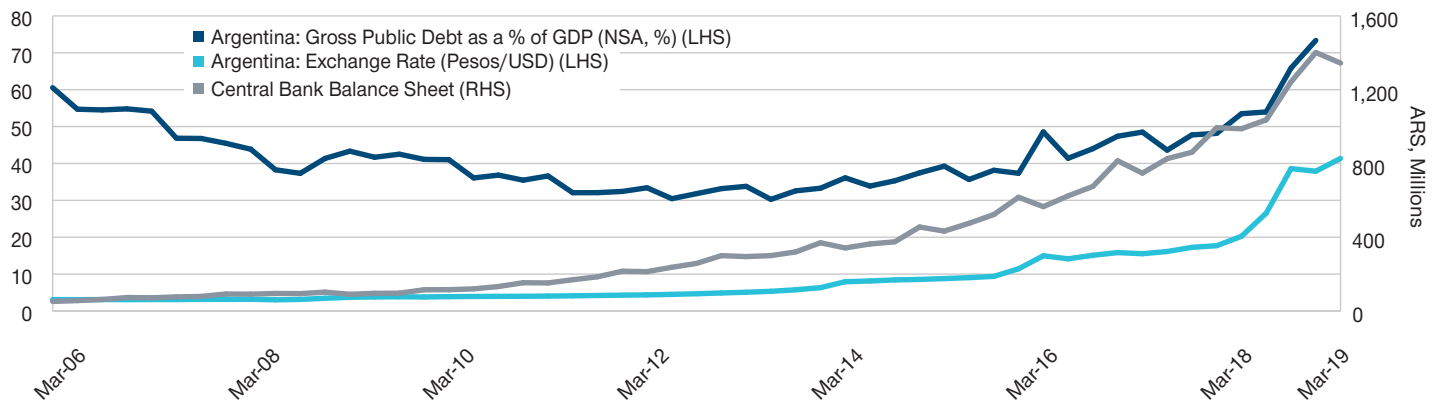
Japanese debt-to-GDP, exchange rate and central bank balance sheet, March 2000 to March 2019
As of March 31, 2019



Sources: Bank of Japan and Cabinet Office of Japan.

(Fig. 2) Peso Crisis

Argentine debt-to-GDP, exchange rate and central bank balance sheet, March 2006 to March 2019
As of March 31, 2019



Sources: Instituto Nacional de Estadística y Censos and Banco Central de la República Argentina.

The Eternal Allure of a Better Future

Ultimately, however, it does not matter too much whether MMT works or not—at least not yet. What’s more important is that MMT’s influence is growing, particularly among voters who traditionally support populist politicians. Many middle- and working-class people across the world believe that mainstream political parties offer them no hope of a better future. MMT’s core

argument—that governments can print money to substantially improve the lives of ordinary people—will win popular support, and it is popular support that wins elections, not economic reality. In fact, the more criticism is heaped on MMT by the political establishment and traditional economists with model frameworks, the more attractive MMT becomes for many people who feel left behind in a world of rising inequality.

Populists understand this and are well-placed to gain from it over the next few years.

I have argued elsewhere why I believe that the economic and financial market implications of populism are negative. In the absence of a benevolent social planner, MMT is likely to become just another arrow in the populist politicians' quiver. The temptation to keep printing money to finance extravagant electoral promises will be strong, and at some point this results in an excessively loose fiscal policy. Ultimately, this brings higher inflation, weaker currencies, and

higher interest rates, all of which make it harder, not easier, to deliver the kind of social and environmental benefits that political supporters of MMT seek.

For the time being, MMT is likely to retain its potent appeal to voters frustrated by a lack of economic progress and rising inequality—and it will, therefore, continue to be trumpeted by populist politicians seeking power. Analysts and economists may continue to dismiss MMT as unworkable, but the opinion of the establishment may ultimately prove to be irrelevant; the broader political impact of MMT is much more important.



WHAT WE'RE WATCHING NEXT

As long as populist parties continue to threaten the status quo, MMT is likely to remain a hotly debated issue. The theory will almost certainly feature as a major topic of discussion during the 2020 U.S. presidential race, particularly if Bernie Sanders becomes the Democratic candidate. In the meantime, we will be closely following elections in other countries where populists are in the ascendancy and aspects of MMT may feature in the election campaign.

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