

Perspectives on Modern Monetary Theory (MMT)

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A few questions

- ▶ What is MMT?
 - ▶ Is it new?
 - ▶ Is it a theory?
 - ▶ Is it about money?
- ▶ What is right and what is wrong about MMT?
- ▶ Is MMT relevant for the Euro zone?
- ▶ Which side of the political spectrum is MMT?

Sources: Lavoie, 2014, Palley, 2015, Epstein, 2020, Blogs MMT, The New Yorker

What is MMT?

- ▶ Founding parents: Randall Wray (1998, 2012b), Stephanie Kelton (2000), Mathew Forstater and financier Warren Mosler (Forstater & Mosler, 2005).
- ▶ **Bottom line: Sovereign fiat money changes the nature of the financial constraint on government.**
- ▶ Fiat money implies that a government cannot become insolvent as they can issue their own currency
 - ⇒ Public spending can be financed in advance of taxes by having the central bank 'print' money
 - ⇒ There is no need for government to raise taxes in advance of spending
 - ⇒ The constraint on government spending should not be debt but inflation

Flow-stock accounting

$G - T = \theta + \beta$, with G government spending, T net tax revenues after transfers and interest payments, θ sovereign money, and β government bonds

$T = 0$ and $\beta = 0 \rightarrow G = \theta$, government spending financed by money issuing

This budget-flow identity is in neo-keynesian analysis (Blinder and Solow, 1973, Tobin and Buiter, 1976).

Implication 1: the political economy of Central Banks

- ▶ MMT raises the question of the institutional arrangement between fiscal and monetary authorities
- ▶ A Central Bank likely to accommodate budget deficit ($G = \theta$) is not independent → consolidation of fiscal and monetary authorities
→ back to the old days **without the external constraint implied by commodity money**
- ▶ Today CBs are highly independent from the government with more or less parliamentary control about their objectives (Kydland and Prescott, 1977)
- ▶ What is the political economy of consolidated fiscal and monetary authorities? (quite overlooked by MMT)

1a- Political business cycle à la Nordhaus (1975)



Remember Kydland and Prescott (1977)

1b- Immunity from popular pressure



No government is happy to remove the punch-bowl before the end of the party

2- Euro-Zone specific constraint: Germany

In Europe, the way to bring Germany in was to design the European Central Bank on Bundesbank's template

Who holds sufficient political capital to convince Germans to reduce independence?

Is is efficient use of political capital?



Nein

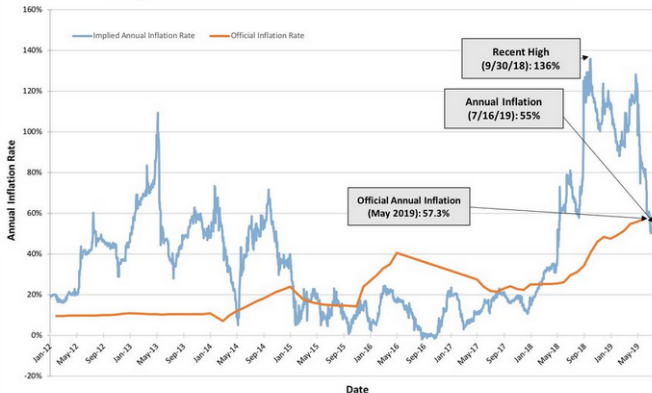
Implication 2: Macroeconomic Consequences

- ▶ In MMT, government uses money financed deficit spending to cover employer of last resort and other spending to increase aggregate demand
- ▶ The critical question is what are the macroeconomic consequences of financing deficits without taxes?
- ▶ Money supply $\uparrow \rightarrow$ prices \uparrow
- ▶ Self-correction: prices $\uparrow \rightarrow \downarrow$ real balances (savings) \rightarrow interest rate $\uparrow \rightarrow$ prices \downarrow
A classical Pigou effect then moves the economy to full employment
- ▶ If you believe in the self-correcting effect of inflation on real balances then it is realistic to say that it takes a lot of time!
- ▶ In the meanwhile, a lot can happen

What level of inflation is acceptable?

- ▶ "Inflation below 40% is costless"... ask Argentinian

Argentina's Annual Inflation Rate: 2012-Present



Sources: Ambito.com, Instituto Nacional de Estadística y Censos, República Argentina (INDEC), U.S. Bureau of Labor Statistics
Calculations by Professor Steve H. Hanke, The Johns Hopkins University

Note A: These inflation rates are implied from the black-market ARS/USD exchange rate using PPP; values under 25% should be considered unreliable.

Note B: INDEC did not provide annual inflation statistics between April 2016 and April 2017

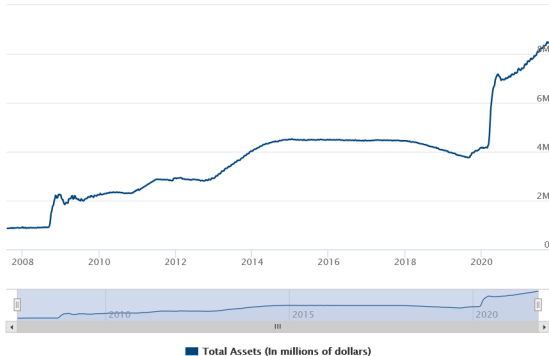
QE is a kind of natural experiment

Total Assets of the Federal Reserve

The Federal Reserve's balance sheet has expanded and contracted over time. During the 2007–08 financial crisis and subsequent recession, total assets increased significantly from \$870 billion in August 2007 to \$4.5 trillion in early 2015. Then, reflecting the FOMC's balance sheet normalization program that took place between October 2017 and August 2019, total assets declined to under \$3.8 trillion. Beginning in September 2019, total assets started to increase.

Zoom 1m 3m 6m YTD 1y All

Jul 30, 2007 — Oct 12, 2021



QE/ APP programs have monetized part of the budget deficit via government bond purchases.

The world has not become a big MMT experiment but CB use one leg

QE and asset prices



- ▶ Asset prices bubble (Darmouni et al. 2020)
 - financial instability
 - QE and income and wealth inequalities (Colciago, A. et al. 2019).

How relevant is MMT for the Euro Zone?

- ▶ MMT would imply consolidation of the ECB with EZ fiscal authorities
- ▶ However there is no central fiscal authority in the EZ
- ▶ Each EZ member remains sovereign (within budget rules/ programs)
- ▶ Fiscal-monetary consolidation in the EZ would need to take place at the member-state-level → Massive resistance from Northern member states
- ▶ The reason is that it would jeopardize the credibility of the single currency
- ▶ Can it be done at the level of the European Commission ?
- ▶ The European Commission issued debt with the NGEU program for the first time on the market but it is planned to be repaid by every single member states
- ▶ No democratic legitimacy of European Commission and European Parliament.

Debt cancellation, helicoptere money and MMT

- ▶ A part of French post-keynesian economists have argued to cancel the COVID debt held by the ECB (Le Monde, 2020, 2021)
- ▶ How does it square with MMT?
- ▶ For MMTers, debt cancellation is just an accounting trick not changing the capacity of governments to run deficits
- ▶ Debt cancellation is a wrong battle because debt ratio is never an issue.
- ▶ Deficit capacity is the real issue.
- ▶ Same reasoning for helicopter money proposals

Which political spectrum covers MMT?

- ▶ Stephanie Kelton was the Economic adviser of Bernie Sanders (who never endorsed MMT but used it in his platform)
- ▶ Alexandria Ocasio-Cortez publicly expressed interest in M.M.T.
- ▶ However, you can use MMT to argue that tax is useless
- ▶ Ideological background: Laffer "helped workshop [Warren's] ideas and directed him to a group of post-Keynesian economists " (NewYorker, 2019)
 - ▶ Laffer popularized the contentious notion that reducing taxes can actually increase tax revenues.
- ▶ "Mosler, who used to identify as a "Tea Party Democrat," told [...] that he speaks to Tea Party groups about M.M.T. and is received warmly. Kelton often exchanges ideas with John Carney, an economics columnist at Breitbart, who considers himself a "fellow-traveller" of the M.M.T. movement. "(NewYorker, 2019)

Conclusion

1. Why has MMT attracted so much attention?
 - ▶ Promise: Full employment and price stability at low cost!
 - ▶ Ingredients: over-simplification and controversial thoughts
→ New "RADICAL" theory
 - ▶ However MMT analysis uses an old framework (not new nor radical) but does not offer rigorous and compelling thinking of macroeconomic implications which can be very serious : inflation, financial instability, inequalities
2. Is it relevant for the Euro-zone?
 - ▶ The current political governance does not make it possible. If political capital can be used to reform the political governance, I would use it differently
3. Will MMT become popular in Europe?
 - ▶ Probably yes because Europe is facing a depressed time which make polemic policy attractive