MACROECONOMY MANAGEMENT AND MODERN MONETARY THEORY: IS IT THE NEXT BIG IDEA?

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ABSTRACT

The role of the government and the central bank of a country in managing its economy has been one unending topic of debate among the economists and policymakers for many decades now. They are generally classified into the 'Keynesian' or the "monetarist' school of thought. While the former school believes in the inflation unemployment trade-off, the latter believes it doesn't hold true in the long run. However, in recent times another school of thought has been gaining some importance, known the Modern Monetary Theorists, who are in favor of a Keynesian style stimulation that is funded by freshly printed currency circulated by the central bank. This article makes an attempt to look deeper into the new approach and examine if such a proposal can really be the next big idea in the field of macroeconomic management.

Keywords: Modern Monetary Theory (MMT), Macroeconomic Management, Fiscal Policy, Monetary Policy, Inflation, Unemployment.

INTRODUCTION

Prior to the ear of great depression in the 30s, the predominant macroeconomic philosophy was of 'laissez faire'. A policy stance based on omnipotence of market forces that ensures full employment of the economy, at least in the long run. Powered by Say's law (supply creates its own demand) and 'classical double defense' of flexible wage and interest rate; the govt and the central bank across the western world pursued policy of minimum intervention in ensuring a stable rate of growth, unemployment and inflation rate.

The great depression of the 30s forced the policy makers to relook at the existing macroeconomic management as the classical double defense against involuntary unemployment seem to had broken down in face persistent slow growth, high unemployment and uncontrolled inflation. John Maynard Keynes provided them with an alternative approach that focuses on government activism in face of slowdown of the economy through massive spending. The fiscal stimulation became the new mantra for macroeconomic management from the late 30s till early 60s throughout the capitalist world.

However, the validity of such approach was seriously questions by Economists like Milton Friedman and Phelps, who theorized in their 'rational expectation' model, that any attempt by the govt. to stimulate the economy through massive spending is ineffective in the long run in maintaining low unemployment rate. If anything, it will cause an out of control inflation. Rational expectation theorists (Monetarist) therefore, advised a greater role for the central bank and money supply growth and accept the Non Accelerating Inflationary Rate of Unemployment (NAIRU). The focus was shifted from stimulation by the govt. to central bank controlling the inflation rate.

Late 80s saw a revival of the Keynesian approach and the approach of inflation control and lowering govt. intervention seem to have not worked in the economies that followed the Friedman approach and the second great depression in the 2007-08 seems bring the big govt.

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back to the forefront once again. However, the debate has not been settled yet as both schools of thoughts have produced their alternative explanations of the policies that were pursued by policy makers during and after the recessionary pressures were abetted.

Around 25 years ago, a new idea with respect to the mechanics of government finance and the limits on government spending, was propounded by Warren Mosler who deserves credit for "*coming out with*" Modern Monetary Theory (MMT), although the MMT label came many years later. The basic tenet of MMT is that it recognizes that the Government and its agents are the sole supplier of that which it demands for payment of taxes (money). The government and its agents, from inception, could spend (or lend) first, and only then can taxes be paid or govt. treasury securities purchased. The so called crowding out of private spending or private borrowing, driving up interest rates, federal funding requirements and solvency issues are not applicable for a government. In this article, the author shall explore a deeper understanding of the MMT theory, look at their basic premises from the fundamental macroeconomic framework and aim to find out if this approach requires greater attention from the policy makers and the macroeconomic theorists.

LITERATURE REVIEW

(Kelton, 2020), in in her book, The Deficit Myth, offered a simple pneumonic to describe the conventional model: (TAB)S. this reflects what most economists brought up to think of taxes and borrowing as two competing ways for the government to gets its hands on the money it needs to finance its spending. Taxing And Borrowing came first. Spending came last. Many of the core tenets of MMT came from Warren Mosler's book, titled Soft Currency Economics about 25 years ago (Mosler,1995). In this book one of the most fascinating arguments Warren proposed had to do with the sequencing of the government's taxing, borrowing, and spending. Mosler flipped all of that on its head. In fact, he proposes the reverse that to S (TAB). He explained that not only did everyone have the sequencing backwards but that we were thinking about taxes and bond sales the wrong way as well. However, some economists believe that MMT is a restatement of established Keynesian monetary macroeconomics and so there is nothing new warranting a separate nomenclature. MMT over-simplifies the challenges of attaining non-inflationary full employment by ignoring dilemmas posed by the Phillips curve, maintaining real and financial sector stability, and an open economy (Palley, 2018). On the other hand, (Juniper et al., 2014) identifies that over the past decade or so, a number of post Keynesians have been critical of modern monetary theory despite MMT being a part of the post Keynesian tradition (Juniper et al., 2014). The present time it has been highlighted by Chohan (2020) that MMT's interesting outlook on inflation, interest rates, government spending, deficits, and debt require the careful attention of a wider public. It also observes that MMT has gained an even larger audience since the spread of the Covid19 pandemic, with massive liquidity being pumped into monetary systems of the First World to grapple with the global health crisis. Andrew Baker and Richard Murphy on the other hand highlight that the MMT fundamentally change the way we treat taxation policy and go to state that the insights on the money removal, or cancellation function of taxes, derived from MMT, demonstrate how this also creates possibilities for using tax to achieve social objectives such as mitigating income and wealth inequality, increasing access to housing, or funding a Green New Deal. Mankiw, (2020) the Harvard economists concludes in his recent article that while MMT contains some kernels of truth, its most novel policy prescriptions do not follow cogently from its premises (Mankiw, 2020).

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Nesiba (2013) in his paper explores the degree to which this Post Keynesian Institutionalism convergence extends, or fails to extend, to the historical, theoretical, and policy issues surrounding MMT and delineate where scholars from these traditions agree, where they specifically disagree, and to explore whether or how these disagreements may be ameliorated with respect to MMT (Nesiba, 2013). The basic tenet of the modern monetary theory, which states that it is possible to use expansive monetary policy (printing new currency notes) to fund ever increasing govt. expenditure (hence fiscal deficit) and create jobs requires greater attention in context of economic slowdown imposed by covid-19 restrictions. The followers are convinced this approach (large fiscal deficit financed by QEs) will neither create 'crowding out' nor inflation; two of the major limitations of fiscal stimulations as highlighted by monetarists and neo-liberal economists coats, criticizes the MMT on the ground that this theory essentially undone years of work that has separated monetary policy decision from the fiscal decisions as it proposes taxation policy as a monetary instrument (Coats, 2019).

CONCLUSION

One of the common misunderstandings that have been perpetuated by the critics of MMT is that this theory does not offer anything novel; instead it oversimplifies the expansionist Keynesian theory and ignores the glaring evidence of inflation-unemployment trade off. They go on to classify MMT and proponents of Quantitative Easing (QE) in the same category. However, there are several ways in which MMT could be shown to be different from mere QE advocacy. The MMT has offered a descriptive framework, which is a superior one, since it explains the actual mechanics of government finance. It was never a proposal to "*print money*" or to encourage central banks to engage in large-scale asset purchases (LSAPs). In fact, many of the MMT scholars were earliest skeptics of Quantitative Easing (QE) as an effective tools to deal with economic slowdown and job losses. The idea is, unlike the private sector, govt. never has to check the balance in its bank account to figure out whether it can afford to spend more. As the issuer of the currency, it doesn't have to worry about running out of money. It can afford to buy whatever is available and for sale in its own currency. That might involve spending on roads and bridges, or hospitals and schools. Whenever govt. agrees to spend more, the government's bank—the central bank—works with the rest of the financial system to get that money into our accounts. Everything happens electronically, so there's no physical printing of money involved. No taxpayers needed to be involved in the process. It all can be done using nothing more than a computer keyboard. The MMT experiment involves not just an embrace of substantial fiscal support (and large deficits) to fight economic slowdown—but also monetary support in the form of central bank bond-buying (QE) to keep the spending affordable. When the government spends more than it takes away (in form of higher taxes), it makes a financial contribution to some other part of the economy. So the fiscal deficit in reality is a surplus for the private sector. When one looks at it this way, it becomes clear that every deficit is good for someone! The question is, for whom it is surplus? And what are those deficits being used to accomplish? It matters how the money is spent and who ends up with the resulting surplus. Tax cuts that create huge windfalls for those at the top without spurring investment and opportunities for the rest of the population don't make good use of deficits. On the other hand, spending trillions to support our economy during the recession put the deficit to good use.

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