# Does Modern Monitory Theory (MMT) give Lousy Politicians the Right to Print Money?

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Printing money has been a hot topic due to the huge amounts of money printed by the Central Bank of Sri Lanka (SBSL) following the Covid-19 outbreak in the country. The process of money printing leads to two sides of arguments based on conventional monetarist views and Modern Money Theory (MMT). Since MMT is an unfamiliar concept among the majority of Uuniversity students, Professionals and AL students, they were confused by the statement "Monies printed did not enter the system, so there was no impact on domestic price inflation". Printing large quantities of money contradicts the established economic theory of Milton Friedman. Hence, the purpose of this article is to examine the validity of both theories based on real facts from the world.

## The Modern Monitory Theory

Modern Monetary Theory (MMT) is a heterodox macroeconomic framework that says monetarily sovereign countries like the U.S., U.K., Japan and Canada, which spend, tax, and borrow in a fiat currency that they fully control, are not operationally constrained by revenues when it comes to federal government spending.Put simply, such governments do not rely on taxes or borrowing for spending since they can print as much as they need and are the monopoly issuers of the currency. Since their budgets aren't like a regular household's, their policies should not be shaped by fears of rising national debt.

MMT challenges conventional beliefs about how the government interacts with the economy, the nature of money, the use of taxes and the significance of budget deficits. These beliefs, critics say, are a hangover from the gold standard era and are no longer accurate, useful or

necessary.The central idea of MMT is that governments with a fiat currency system under their control can and should print as much money as they need to spend.

The simple view of MMT is that a sovereign government that prints its own fiat currency does not have to be concerned about fiscal deficits as long as there is excess capacity in the economy so that increased government spending does not contribute to inflation. Since the government can effectively borrow money from the Central Bank and may indeed never be required to pay back the money it borrows, financing considerations should not be a constraint on government spending.

**Monetarist Theory of Inflation**

Monetarists argue that if the Money Supply rises faster than the rate of growth of national income, then there will be inflation. If the money supply increases in line with real output then there will be no inflation. Friedman had stated that: "Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output".

Monetarists believe that in the short-term velocity (V) is fixed this is because the rate at which money circulates is determined by institutional factors, e.g. how often workers are paid does not change very much. Milton Friedman admitted it might vary a little but not very much so it can be treated as fixed Monetarists also believe output Y is fixed. They state it may vary in the short run but not in the long run (because LRAS is inelastic and determined by supply-side factors.) Therefore, an increase in the Money Supply will lead to an increase in inflation.

**Does history support to the Monetarist View?**

The link between the money supply and inflation can be seen in many historical cases. US Confederacy 1962-65. During the Civil war, the Confederacy of Southern states found itself short of finance (it could only raise 46% of the cost of war from taxes and bonds) so it increased the printing of money to pay for materials and soldiers. However, with economic output falling, this caused inflation of 700% in the first two years of war and reaching a peak of over 5000% by the end.German Hyperinflation 1923.

In the aftermath of the First World War, Germany faced high reparation payments. To meet these demands, the government started printing more money - so that firms could continue to pay workers. This led to an explosion in the inflation rate. By the end of 1923, printing money had got out of hand, and the economy experienced hyperinflation. Zimbabwe 2008. Zimbabwe found itself in a similar situation. High government debt, Falling output and a need to print money to stave off a short-term crisis. This printing of money led to hyperinflation of an estimated 79,600,000,000% in Nov 2008. A daily inflation rate of 98%

**Can Money Print under Monitories?**

It is possible to increase the money supply without causing inflation under monitories. There are a few possible reasons. The growth of real output same as growth of money supply. Suppose the

money supply increased by 4%. In a simplified model, this would lead to an increase in Aggregate Demand (AD) of 4%. If AS (productive capacity) also increased by 4%, then the price level would be unaffected. In other words, the growth of money supply is absorbed in the increase in real output. Sometimes the money supply is hard to calculate and is constantly changing. Large increases in the money supply are often just due to changes in the way people hold money. For example, an increase in credit card use may cause an increase in the broad money supply.

**Keynesian view - Liquidity Trap**

In a recession, there is spare capacity in the economy. Therefore, an increase in the money supply merely helps to get unemployed resources used in the general economy. Therefore, in the case of a recession, increased money supply is unlikely to cause inflation. In a liquidity trap, interest rates fall to zero but this doesn't prevent people saving. In this situation, there is a fall in the velocity of circulation and this can cause deflation. In this situation, increasing the money supply will not necessarily cause inflation.

**Is the Corona virus lead to printing Money?**

Many countries around the world have been printed the money during the year 2021, especially after the Covid-19 pandemic that has compelled respective economies into recession. As economists say, in a recession, there is spare capacity in the economy. Therefore, an increase in the money supply helps to get unemployed resources used in the general economy. Therefore, in the case of a recession, and increased money supply is unlikely to cause inflation. The Sri Lankan economy is depressed due to the Covid-19 pandemic and Central Bank can increase the money supply without causing inflation.

Money printing is nothing new and has to be done by all Central Banks in the world to facilitate asset growth and liquidity in the banking system as and when required depending on the prevailing business cycle. "What we have seen is that many Central Banks have resorted to monetary stimulus when the economy is facing recession or is in a trough and such actions are evident in the balance sheet expansion or contraction of Central Banks. In an expansionary situation Central Bank buys already issued treasurybills and bonds or corporate bonds and infuses money into the system in order to stimulate economic growth and real sector production expansion" (Dr. Kenneth de Zilwa).

Some economist argued that"Many countries including UK, US and India have substantially printed the money during Covid-19 pandemic period and why we cannot? Those economies are in top 10 and comparison of their money printing with that of Sri Lanka is irrational justification. Economists have maintained that if a country prints a certain sum of money that could match their real output, money printing could be healthy for an economy. Policy makers could justify money printing under both monetarist theory and MMT. However, justification would be more rational under monetarist views rather than MMT.

**MMT: Is it a Policy Model for Funding Government Spending?**

MMT attempts, unsuccessfully in my opinion, to repackage and resurrect the empirically and theoretically discredited Keynesian policies of the 1960s and 70s. A 2019 survey of leading economists showed a unanimous rejection of MMT's assertions that (1) "Countries that borrow in their currency should not worry about government deficits because they can always create money to finance their debt" and (2) "Countries that borrow in their currency can finance as much real government spending as they want by creating money" (Chicago Booth 2019). MMT is an effort to justify more government spending on programs with claims of fiscal space that can be liberated by printing money. Its arguments do not add up (Palley 2019). Both the excitement and motivation for MMT seem to reflect the desire to promote a political agenda, without the hard analysis of its pros and cons - its costs and benefits. Politicians are more towards and love the MMT since they would have more chances to enhance welfare expenditure during the election period. However, the impact could be seen within next year.

Whether government has the political will and technical ability to raise taxes and/or cut spending in response to rising risks of faster inflation is an open question. Hence, while the risk of MMT igniting a sustained and relatively fast rate of general price increases is uncertain, there has been relatively recent historical experience in Latin America and Greece where the implementation of MMT did, indeed, result in runaway inflation and a significant decline in the standards of living in the relevant countries. This experience is cautionary tale for those proposing adoption of the MMT framework.

Finally, I courted the statement drawn by former Central Bank of Sri Lanka Deputy Governor Dr. W.A. Wijewardena "Following MMT by the Central Bank in the present juncture is like holding a tiger by the tail. If the grip is loosened for whatever reason, the chances are that the tiger will turn around and attack. In the case of the economy, that attack will take the form of setting it on inflation, on the one hand, and causing the exchange rate to fall further, a situation which even Keynes had admitted".

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