2022

BDO'S CONSIDERING MODERN MONETARY THEORY EBOOK (MMT)

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INTRODUCTION

A widely debated economic theory has been gaining popularity, and it could fundamentally change the way our governments manage economic policy.

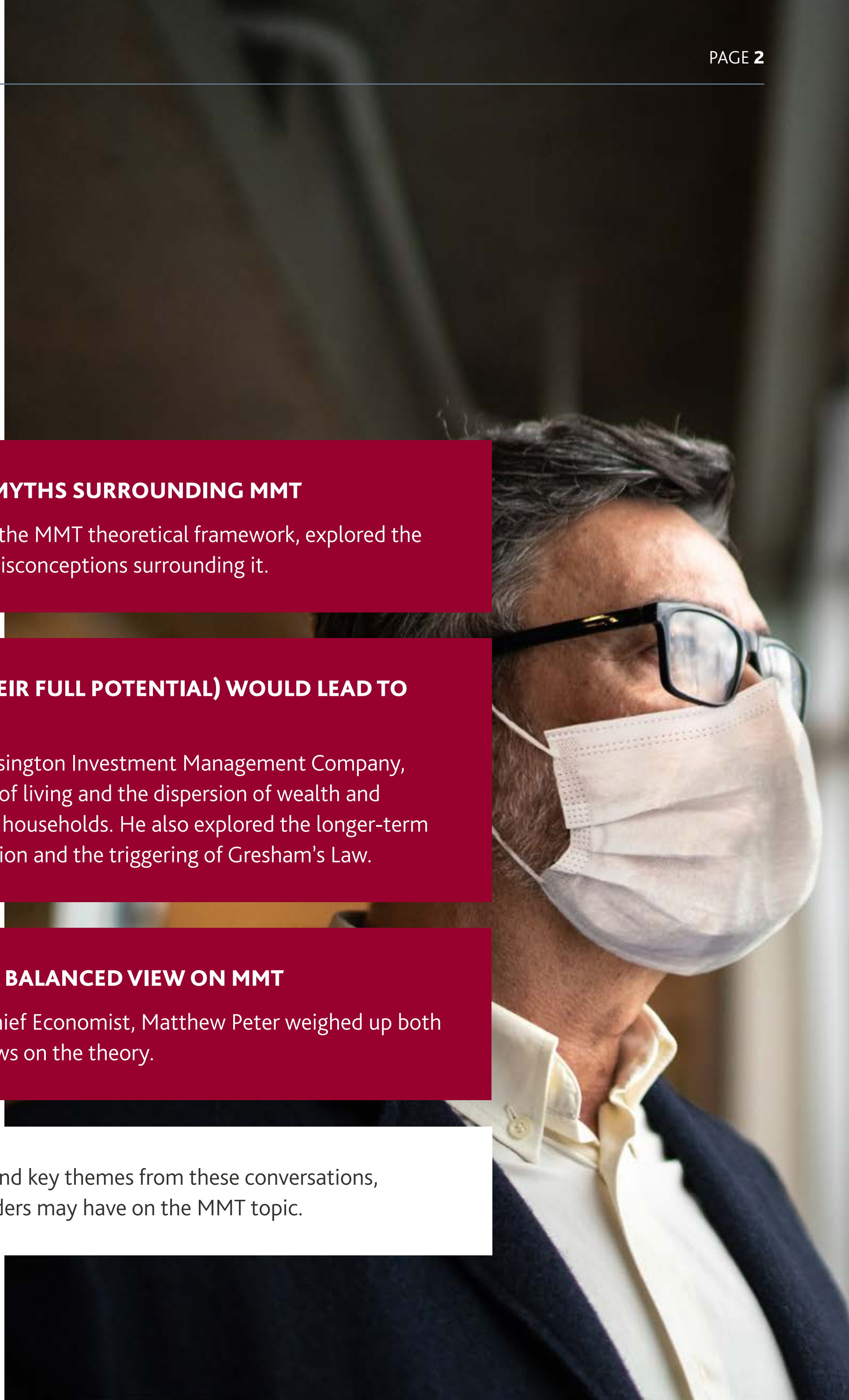
Modern Monetary Theory (MMT) directly challenges the established thinking on how governments should create and spend money.

In the wake of COVID-19, this debate is more prominent than ever as we tackle the new macro-economic problems facing the world today.

Given the amount of government debt which has been created, seemingly to some without adverse consequences, questions are being asked if this can continue or if this is simply delaying greater catastrophes or creating more subtle issues - such as sapping the growth of tomorrow.

BDO recently had the pleasure of sitting down with three well-credentialed economists for the three-part 'MMT challenging the economic establishment' webinar series.

The series explored all sides of this increasingly important debate including:



EXPLORING THE BASIC PRINCIPLES OF MYTHS SURROUNDING MMT

Professor Bill Mitchell, a leading advocate for the MMT theoretical framework, explored the basics of MMT and his view of the common misconceptions surrounding it.

WHY MMT POLICIES (FOLLOWED TO THEIR FULL POTENTIAL) WOULD LEAD TO HYPERINFLATION

Dr Lacy Hunt, Executive Vice President of Hoisington Investment Management Company, explored the short-term risks to the standard of living and the dispersion of wealth and income between the upper and lower income households. He also explored the longer-term risks MMT could lead to, including hyperinflation and the triggering of Gresham's Law.

WEIGHING UP THE PROS AND CONS – A BALANCED VIEW ON MMT

Queensland Investment Corporation (QIC) Chief Economist, Matthew Peter weighed up both sides of the MMT debate and provided his views on the theory.

BDO's *Considering MMT* eBook will share scenes and key themes from these conversations, designed to challenge any preconceived ideas readers may have on the MMT topic.

THE BASICS OF MMT

Professor Bill Mitchell developed the concepts and coined the phrase Modern Monetary Theory.

"We have to ask ourselves, given all the challenges of today: Is our policy narrative and our understanding of economics up to the task? The problem is the state of mainstream macroeconomics and our understanding of the capacities and consequences of governments -doing things with our currency is ill-equipped," Professor Mitchell said.

MMT calls for a fundamental reframing of the relationship between governments and currency. It is a lens through which to perceive the operations of the monetary system with a view to the true capacities of currency-issuing governments.

Unlike conventional neoclassical economic theory, integral to MMT is that the government does not function in the way an income-constrained household does. It has no constraints. Professor Mitchell uses a metaphor to illustrate.

"To say governments can run out of money is like saying that three minutes into the second half of a rugby union game, the game has to stop because the scoreboard has run out of points. That's an absurd proposition."

Professor Mitchell suggests any currency-issuing government can buy whatever it likes, whenever it likes. It will never run out of money.

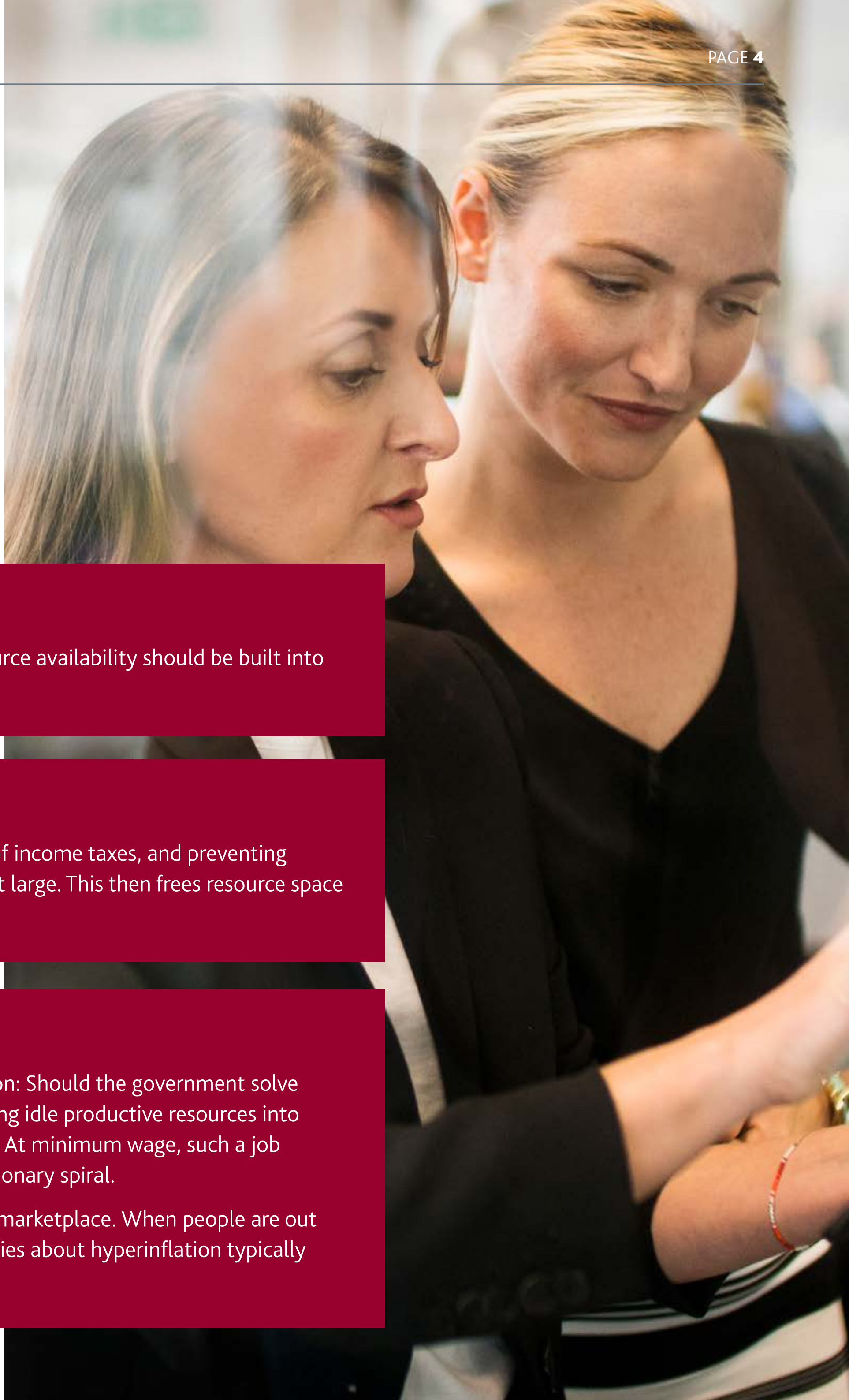
Scaffolding on this framework, MMT reconsiders the capacities and implications of this situation, rethinking concerns such as inflation, deficits and failed states.

RETHINKING KEY ECONOMIC QUESTIONS

MMT is not a political theory but does seek to provide a knowledge basis that can inform the policy suite in Australia and abroad.

This theory is also not a far-off idea, particularly when considering quantitative easing programs are presently employed in many countries.

It can also prompt a real reconsideration of pressing questions such as:



WHAT CONSTRAINS GOVERNMENTS?

Governments are not financially constrained but are resource-constrained. Professor Mitchell suggests real resource availability should be built into all fiscal policy analysis — as opposed to the size of the deficit.

WHY DO WE PAY TAXES?

According to MMT, taxes achieve two aims: Perpetuating use of local currency, as it is required for the payment of income taxes, and preventing inflation by way of reducing individual purchasing power and thus removing money from the general economy at large. This then frees resource space for the government to spend into, without creating inflationary pressures.

CAN THE GOVERNMENT 'SOLVE' UNEMPLOYMENT?

Proponents of MMT will say yes, noting of course the answer to this question begs a moral, humanitarian question: Should the government solve unemployment? If the answer is yes, then it's possible to conceive of many steps the government can take to bring idle productive resources into productive use and minimise recessions. Many MMT proponents advocate a job guarantee for any willing citizen. At minimum wage, such a job guarantee would help increase price stability by way of preventing continual wage raises that can cause an inflationary spiral.

At present, raising taxes can be seen to lead to a contraction in economic activity by way of reducing jobs in the marketplace. When people are out of work, their purchasing power is lessened and there exists a check on demand that in turn limits inflation. Worries about hyperinflation typically prevent greater political support for a job guarantee.

THE CASE AGAINST MMT

While proponents of MMT say rampant inflation is an unlikely direct outcome of putting it into practice, those who prefer a more mainstream economic view argue that MMT, implemented to its logical conclusion, would lead to catastrophic outcomes.

Invoking present-day case studies as well as historical examples from Mesopotamia to the Bourbon empire, Dr Lacy Hunt, Executive Vice President of Hoisington Investment Management Company, says MMT is capable of causing the harmful effects of massive indebtedness.

"MMT has already been tried, tested and failed." Dr Hunt said.

Concern abounds among MMT critics regarding the casual approach the theory seems to take toward debt and inflation. Excessive use of debt slows the velocity of money and can be seen as triggering the law of diminishing returns — a basic law of economics. Debt burdens can also prompt economies to lapse into deterioration, especially when monetary and fiscal policy are too closely intertwined, Dr Hunt added — citing 17 scholarly studies.

The economies most heavily indebted are underperforming relative to those which are less heavily indebted, he said, citing the US, Japan and Europe. The ratio of real per capita growth in Japan is at present more than 10 per cent below that of the US, with the Euro economy 38 per cent below that of the US.

CONCERNS ABOUT DEBT

If MMT is a rejection of overreliance on monetary policy — particularly the setting of interest rates and quantitative easing — a mainstream approach to economics would call for monetary and fiscal policy to continue acting independently so as to check each other.

Both have work to do, Dr Hunt says, noting current American policies limit the economic growth rate as measured in real per capita GDP — which was historically 2.2 per cent and dropped by 40 per cent by 2019.

"If we remain on a high debt path, the growth rate may whimper away. But if we take experimentation further and make central banks liabilities mediums of exchange, we will end with a bang of hyperinflation," Dr Hunt said.

Concerns about merging fiscal and monetary policy direct many critics' paths away from MMT. Additional government involvement can be seen as a misstep toward a command and control economy. It is austerity, Dr Hunt says, which has historically resolved debt issues.

Dr Hunt credited post-war austerity in the UK when England, heavily burdened by debt, had to continue rationing into 1956, limiting the income people could spend and ultimately resolving the debt to a level where other countries agreed to lend money to the UK.

There are no easy answers to current government debt levels and, as appealing as MMT may be, in Dr Hunt's view, it's not the answer.

A ZOOMED-OUT VIEW OF MMT

Rare is a conversation in the field without the phrase 'on the other hand' appearing. The topic of MMT brings many other hands into the conversation.

Dr Matthew Peter, Chief Economist at QIC Global Economic Forecasting and Research, discussed some of the views within the fields of economics and finance regarding MMT. Dr Peter noted the theory's proliferation after the Global Financial Crisis, or GFC, as part of a search for alternative paradigms.

After re-summarising — noting governments can't go 'notionally' insolvent as they can always issue currency to pay off their debts, so long as the debt is denominated in their own currency — Dr Peter highlighted some aspects of MMT:

The limitation to government spending arrives when spending causes an imbalance in supply and demand in the market for goods and services, particularly when that imbalance causes demand in the economy to exceed its productive capacity — resulting in inflation.

As a fiscal policy, MMT is more effective than conventional monetary policy of raising and lowering interest rates to stimulate the economy. When there is excess productive capacity — as in a slowdown or recession — tightening fiscal policy is more effective than raising interest rates to control inflation during times of excess demand.

IS MMT ALREADY IN PLAY?

It's not impossible to argue MMT is already in play both globally and in Australia. Central banks such as the Reserve Bank of Australia regularly buy government debt in secondary bond markets, driving up the demand for that debt and driving the yield downward — in alignment with MMT. In Europe, the European Central Bank does the same, buying national debts on the bond market.

Dr Peter raised more hard questions than made conclusions about MMT:

What happens if the government decides to offset its expenditures with a tax increase to keep a balanced budget? What would this look like?

Why hasn't there been more empirical evidence gathered? It seems there's no real experiment with MMT to test it.

How would a full transition to MMT be managed that wouldn't cause mayhem in financial markets?

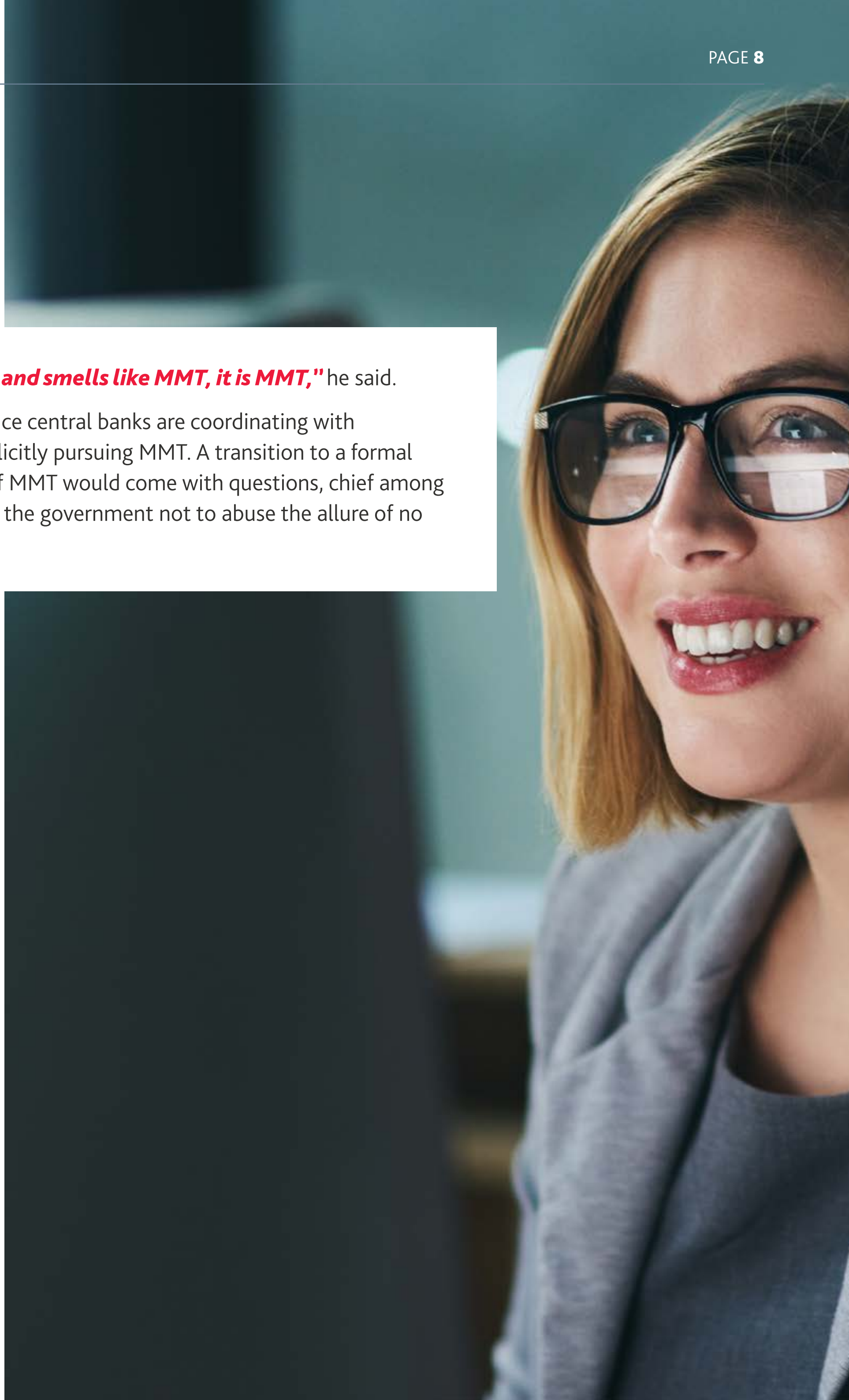
What happens if governments abuse the allure of no budget constraint?

What happens to our currency if we adopt MMT, particularly in Australia?

The debate about MMT will persist well into the future. But Dr Peter added he does see MMT at work in the world today in the case of central banks and quantitative easing.

"If it looks like MMT and smells like MMT, it is MMT," he said.

Still, there's no evidence central banks are coordinating with governments and explicitly pursuing MMT. A transition to a formal wholesale adoption of MMT would come with questions, chief among them the reliability of the government not to abuse the allure of no budget constraint.



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10 OFFICES

226 PARTNERS

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91,054+ PEOPLE

1,658 OFFICES

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FIGURES TAKEN AS AT 1 JULY 2021

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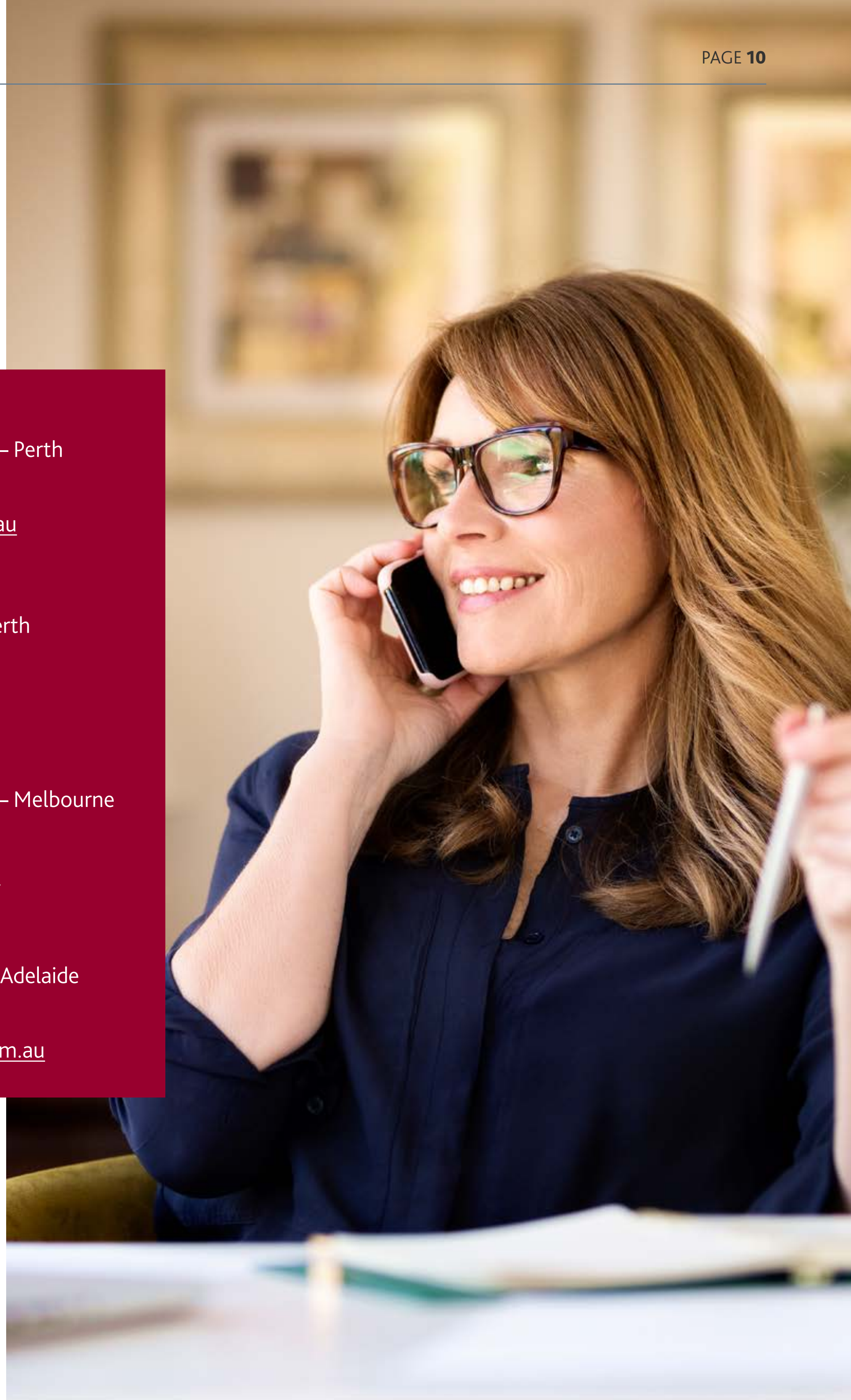

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