Book Review

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Book review of Nersisyan, Y. and Wray, L.R. (eds): *The Elgar Companion to Modern Money Theory*

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European Journal of Economics and Economic Policies: Intervention has a symposium in Volume 20(1) that showcases the Drumetz and Pfister (2021) critique of modern money theory (MMT). In their rejoinder, Drumetz and Pfister (2023) argue that the responses did not address several remarks they made, including the applicability of MMT in the context of open economies and developing countries. They argue that foreign currency borrowing and exchange rate pegs in developing countries constrain macroeconomic policy autonomy. Such countries must worry about the cost of servicing foreign debt, importing necessary food, energy and capital, and potential capital flight.

The issue of the applicability of MMT to developing countries is not new and has been raised by many, including Vernengo and Caldentey (2020) and Bonizzi et al. (2020). I find this issue more interesting than the academic debates on the origins of money or the simplifying assumption of consolidating the government and central bank. In his critique of MMT, Palley (2015) also relegates the issue of the origin of money to the appendix. This is why the compilation of 35 articles by the editors Nersisyan and Wray (2024) is relevant, as it contains several articles that address the applicability of MMT, given external sector constraints and developing countries. While the compilation is extensive in its list of topics, the focus in this review is on articles that address issues pertaining to open economies and developing countries.

In his contribution to the compilation, Mitchell (2024) states that according to MMT, exports are a cost and imports a benefit; trade deficits allow for a higher living standard, and trade surpluses are based on underconsumption, working too hard and being underpaid. This flips the standard narrative on its head that prizes exports over imports, which allows earning foreign exchange and accumulating foreign assets. Based on the sectoral balance identity, he adds that a balanced budget with trade deficits is restrictive and likely results in recessions. However, Sylla (2024) notes that countries with trade surpluses can afford balanced budgets, whilst qualifying that export-led growth cannot be universalized. Thus, it is noted that countries that run current account deficits, as their export earnings are not enough to cover the cost of necessary imports, will not run fiscal balances.

Mitchell (2024) states that under the Bretton Woods system, the central bank had to maintain currency stability by contracting the money supply, increasing the interest rate and raising unemployment. This means that there is an external constraint to expansionary fiscal policy under fixed exchange rates. Fixed exchange rates are also problematic, as

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speculators target currencies of governments with limited foreign currency, fiscal deficits or trade deficits. Although floating exchange rates are also problematic when expansionary fiscal policy results in depreciation that causes inflation due to energy and food imports. Thus, Mitchell (2024) acknowledges that MMT is criticized for not recognizing external constraints on fiscal policy.

However, instead of the external constraint, he argues that, according to MMT, the issue is that developing countries are unable to find sufficient demand for their exports and thus earn sufficient foreign currency. In terms of solutions, he highlights that MMT proposes banning financial market speculation on food and essential commodities and supports industrial policy, as industrial good prices are stable compared to volatile primary good prices. It proposes capital controls that free monetary policy from maintaining the exchange rate and fiscal policy to target full employment. Additionally, it supports capital controls that allow governments to restrict speculative financial flows, curb real estate investment that worsens housing affordability, and ban political campaign funding and media ownership that undermine democracy.

In his article, Hudson (2024) states that balance-of-payment deficits incentivize governments to acquire foreign currency loans, which necessitates raising the interest rate. However, when foreign creditors stop lending, the government prints domestic currency, which results in depreciation and hyperinflation. He adds that borrowing in foreign currency and failure to repay expose debtor countries to austerity, privatization of public assets and anti-labour policies. This often has to do with the conditions imposed by institutions like the IMF through their structural adjustment programs (SAPs). Therefore, Hudson proposes to nullify foreign loans that undermine citizen welfare for foreign creditors, reject austerity and privatization of public assets, make creditors bear the risk if loans cannot be paid from export earnings, ban interest compounding on loans and cancel foreign debt if creditors lend with unrealistic repayment demands.

In his article, Sylla (2024) argues that colonialism came with the imposition of taxes that created demand for colonial currency. The idea was for colonialism to pay for itself so that colonial powers imposed balanced budgets in the colonies, which resulted in underinvestment in local capacity. Sylla notes the structural extraction of profit, dividends and interest from African countries to repay foreign currency debt. He adds that such countries have an incentive towards fixed exchange rates to maintain food and energy prices and to stabilize foreign debt repayments. However, fixed exchange rates often reflect domestic unemployment. Thus, he emphasizes that MMT rejects foreign currency loans for projects that use domestic real resources and supports policies to reduce technological dependency and increase domestic scientific capacity.

Finally, Tymoigne has several articles in the compilation, which essentially reflect his working paper (Tymoigne 2021). Tymoigne (2024) acknowledges that critics argue that MMT only applies to the USA, as its world reserve currency allows it to run persistent trade deficits without depreciation. In contrast, other countries running fiscal deficits face trade deficits that lead to depreciation. These countries lose foreign reserves when they service foreign debt, and therefore, they cannot have floating exchange rates, which means they cannot institute MMT policies. He also notes that fiscal surpluses lead towards currency crisis, as in the case of the East Asian currency crisis of 1997. This is because fiscal surpluses drain income from the private sector, which makes it difficult for the latter to meet its debt obligations. Overall, while Tymoigne (2024) responds to various criticisms, concrete solutions seemingly emerge from Mitchell (2024), Sylla (2024) and Hudson (2024).

Various authors in the compilation provide perspectives that provide a primer on MMT, respond to criticisms and highlight various topics, including trade deficits, fiscal

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deficits, interest rates, exchange rates, origins of money and monetary policy. What is commendable is the presence of articles that specifically address issues pertaining to open economies and developing countries that are the strongest focal point for MMT critics. The articles reviewed above make it clear that MMT authors shift the framing of the external constraint and highlight solutions like capital controls, restricting speculative financial flows, curbing real estate investment, cancelling fraudulent foreign loans, making foreign creditors bear the loan risk and rejecting foreign loans when domestic real resources are available. Overall, the compiled articles may or may not convince critics, but they provide substantial material for educators to bring pluralist perspectives and debate to the classroom.

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