

Is a paradigm shift in macroeconomics imminent?

While Modern Monetary Theory has been embraced by the public and by policymakers, mainstream economic theory remains in thrall to obsolete ideas

[SASHI SIVRAMKRISHNA](#)

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“... the question is since we are not funding the government with tax revenue, we have decided that Modern Monetary Theory [MMT] is real, because we could just print money, because we are the reserve currency. Why would you even consider raising taxes on families making 400 grand? Why do that at this point? You don’t need to. To punish you, obviously.”

This is what [Tucker Carlson](#) said – yes, Tucker Carlson – on Fox News, making explicit reference to MMT.

Carlson was, however, not the only one to highlight a key tenet of MMT – whatever may have been his objective in doing so – that taxes actually do not fund government spending. John Oliver who hosts the popular television program, Last Week Tonight, had a full episode recently on the US national debt. Here’s what he said: “amidst the current crisis that we are in, many experts are less concerned about us spending too much than spending too little and if it turns out that inflation or interest rates do start to rise we should absolutely start cutting deficits, although not by cutting government programs that people need but taxing people who can afford it.” With a strong dose of humour, Oliver ridiculed deeply ingrained fears that Americans have been led to believe about deficits and debt, propagated by 50 years of neoliberal macroeconomic theory. Interestingly, many of his comments were uncannily similar to what MMT has been repeatedly arguing for decades now.

Reeling under a crisis unleashed by the COVID pandemic, the US bailed out its financial system with an expansion in the Federal Reserve’s balance sheet by some \$7 trillion while the fiscal deficit hit a 75-year high of 18% of GDP in 2020. This was followed by a rescue plan of \$1.9 trillion that includes \$1400 relief cheques to the unemployed and poor, and just a few days later an even bigger package of a \$3 trillion infrastructure program spread over the next eight years. All this has made one fact unequivocally clear: the US government does not earn money or collect revenue before it spends. In common parlance, it simply “prints” money and spends.

Surprisingly, or perhaps unsurprisingly, the massive infrastructure plan proposed by President Biden has elicited more discussion on how the money will be spent rather than where the money for it is going to come from – something which even Carlson has seen through. The American Conservative, a magazine of “Main Street conservatives”, published an article, Modern Money Theory for Conservatives, with the deck, “It’s time to debate to what ends, not whether the government should spend.” Bloomberg too, in the deck to a recently published article announced that excepting inflation, “Economists are steadily ditching other cues to tighten policy. Deficit warnings fall flat ...”, and conceding in the article that “In some ways, the new approach aligns with the school of thought called Modern Monetary Theory.”

While the Global Financial Crisis of 2008 drew tentative attention to MMT, it is the COVID pandemic that has brought it into popular macroeconomic discourse in the US. The role of the state in alleviating the economic and humanitarian crisis is urgent and undeniable. And it is in times of deep crisis that new paradigms in economics begin to be taken seriously when they connect to economic, social and political realities. Biden must be aware that the neoliberal response to the 2008 crisis was far from adequate. When “top 1% incomes grew by 31.4% while bottom 99% incomes grew only by 0.4% from 2009 to 2012” (Emmanuel Saez) it is obvious in hindsight why rising discontent was rife in the United States. The urgency with which Biden is confronting this challenge shows that he cannot risk history being repeated. While Trump may have been defeated, Trump(ism) can make a comeback. The failure of fiscal conservatism and austerity policies around the world can no longer guide policy responses to crises especially when the capacity of the government to leverage its financial power is in the open.

The story in academia is, however, neither supportive nor promising. Macroeconomic theory taught at Ivy League universities and followed almost everywhere in the United States – and in the rest of the world – seems to have decoupled itself altogether from reality. Here is the conclusion to a recent paper on recursive macroeconomic theory: “I obtain the results in a complete-market two-agent economy with an aggregate endowment process that is specified as a geometric Brownian motion. The focus of this paper is primarily theoretical and the stochastic structure of the economy is kept deliberately simple to yield a sharp analytical characterization, sacrificing quantitative fit.” Incredible!

The rise of neoliberalism – as a counter to Keynesian macroeconomics – was after all due to the ability of its founders – be it Milton Friedman, James Buchanan or Paul Volcker – to communicate issues of the times with the larger world and the political class. Present-day macroeconomists seem to have lost this ability. No wonder the article in the American Conservative derides “a faulty and outdated *economic theory*.” Meanwhile, fence sitters like Olivier Blanchard will rather claim that “we have no explanation” as to why interest rates have been falling in spite of soaring public debt to GDP ratio. Paul Krugman had also raised the same question years ago on Italian and Japanese interest rates, ultimately relenting that “I actually don’t have a firm view. But it seems to be an important puzzle to resolve.” This in spite of the fact that MMT has a convincing answer to the paradox all along.

How is all this important for a country like India? Many economists dismiss the relevance of MMT outside of the US for the reason Carlson (perhaps inadvertently) mentions: the US dollar is international reserve currency. Although countries are not equally privileged as the US, most do issue their own fiat currencies, possessing monetary sovereignty in varying degrees. It is all the more imperative for them to realize this fact and follow strategic longer-term policies that would enable them to leverage their monetary sovereignty for the common good of their people.

At the same time, it is also important to realize that the US has had a hegemonic influence over the macroeconomic narrative. After all, most standard textbooks are American or rehashes of them and “complete-market two-agent economy” the dominant macroeconomic paradigm across the world. Although many heterodox economists like James Galbraith remain sceptical about a paradigm shift in the US there can be little doubt that if and when it happens, it will certainly reverberate across the world.

Sashi Sivramkrishna is an economist, economic and environmental historian, and documentary filmmaker. Twitter: @Sashi31363. Views are personal.