

# Monetary sovereignty is a spectrum: modern monetary theory and developing countries<sup>1</sup>

Bruno Bonizzi, Annina Kaltenbrunner and Jo Michell [University of Hertfordshire, UK; University of Leeds, UK; University of the West of England, UK]

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## Abstract

Critics of modern monetary theory (MMT) have alleged that its conclusions rely on the “exorbitant privilege” enjoyed by the US in issuing the global reserve currency, and thus do not apply to developing and emerging countries (DECs). MMT proponents deny this but have recently moderated earlier claims with the introduction of the idea of a “spectrum of monetary sovereignty” (Tankus, 2018; Tcherneva, 2016). In this paper, we assess claims made by MMT proponents regarding the application of MMT to the problems faced by DECs. We argue that MMT proposals fall short of providing a basis for effective development policy and that a broader conceptualisation of development strategy is required, one that acknowledges that external constraints are likely to bind over any plausible policy horizon and takes into account the constraints a hierarchical international monetary and financial system creates for DECs. We conclude that while neo-chartalism provides useful insights in considering monetary and legal arrangements, MMT adds little to the well-established heterodox and structuralist development economics literature.

**JEL Codes** E40, F41, F62, O11

**Key words** modern monetary theory, development, currency hierarchy, balance of payments

## 1. Introduction

The prominence achieved by modern monetary theory (MMT) is remarkable for a set of ideas originating with heterodox economics scholars. This success is arguably due to a particular confluence: the growing realisation that monetary policy in isolation cannot stabilise the economic system has provided an audience for ideas which have been promoted effectively through the use of blogs and social media.

While discussion has largely focused on the application of these ideas in major developed economies, particularly the US, proponents claim that MMT is a general theoretical framework that applies widely, and is therefore relevant for all contemporary economic systems. In contrast, critics have alleged that both MMT analysis and policy recommendations rely on the “exorbitant privilege” enjoyed by the US in issuing the global reserve currency, and thus do not apply to other nations – developing and emerging countries (DECs) in particular (e.g. Epstein, 2019). MMT proponents deny the allegation of limited applicability, but have recently moderated earlier claims with the introduction of the idea of a “spectrum of monetary sovereignty” (Tankus, 2018; Tcherneva, 2016), thus acknowledging that the position of states within the international trading, financial and monetary system influences the degree of policy autonomy available to governments.

DECs face widely acknowledged policy constraints relating to exchange rates, foreign exchange availability, and external and foreign-denominated debt obligations. MMT has a

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distinctive take on these issues, focusing in particular on the policy autonomy available to countries that issue their own currency and operate flexible exchange rates and are therefore, in the terminology of MMT, monetarily sovereign. MMT also claims to provide recommendations for countries facing externally imposed constraints on policy, which is framed as achieving or increasing monetary sovereignty. These include fostering domestic food and energy sufficiency through Employer of Last Resort (ELR) policies, ensuring low domestic interest rates, and fostering development banks.

In this paper, we consider the MMT approach to open economy macroeconomics, and the focus on monetary sovereignty in particular. We assess claims made by MMT proponents regarding the application of MMT to the problems faced by DECAs, and discuss whether the MMT emphasis on achieving monetary sovereignty provides a sound basis for policy in those countries. We argue that, as defined by MMT, monetary sovereignty does not overcome the policy constraints faced by DECAs, and that proposals for achieving monetary sovereignty fall short of providing a basis for effective development policy. A broader conceptualisation of development strategy is required, that acknowledges that external constraints are likely to bind over any plausible policy horizon and takes into account the constraints a hierarchical international monetary and financial system creates for DECAs. We conclude that while neo-chartalism provides useful insights in considering monetary and legal arrangements, MMT adds little to the well-established heterodox and structuralist development economics literature.

## **2. MMT and the balance of payments**

It is not straightforward to summarise “what MMT says” on any given topic. MMT itself is hard to characterise; it could reasonably be described as a school of economic thought, a group of scholars, or a political campaign. Much of what comprises MMT is also to be found in other heterodox traditions, Post-Keynesian economics in particular. The distinctive element of MMT is neo-chartalism: MMT places particular emphasis on the role of the government in issuing and enforcing the money of account, and the power this bestows. In the following summary of MMT views on open economy issues, we rely on writings and statements from core MMT authors and spokespersons, and draw on the recently published MMT textbook (Mitchell et al., 2019).

MMT analysis of open economy issues, particularly those faced by DECAs, is relatively scant. In the recently published MMT textbook, a single chapter is devoted to the open economy, alongside short case studies on balance of payments constraints, currency crises and exchange rate regimes. The discussion of exchange rate determination is conventional: the “real price of a hamburger” purchasing power parity theory is contrasted with interest parity (the authors note that neither provides a sufficient account of how exchange rates are determined). A simple Keynesian open economy income-expenditure model is presented, in which net exports are a function of the real exchange rate. In the case studies, the authors argue that there is no evidence linking budget deficits to serious currency crises.

None of the above distinguishes MMT from conventional analysis. There is divergence, however, in MMT’s characterisation of the balance of trade: “Imports ... represent a real benefit to residents. Exports represent a real cost ... It is obvious that the only motivation for a

nation to export, is to gain foreign currencies” (Mitchell et al. 2019, pp. 374–375).<sup>2</sup> The implicit assumption is that, in the case of a trade deficit, it is sufficient to consider only the immediate benefits of increased current consumption or accumulation of physical capital, while ignoring the implications of the accumulation of cross-border financial positions; Mitchell goes so far as to argue that cross-border liabilities do not need to be “paid back”: “A current account deficit reflects the fact that a country is building up liabilities to the rest of the world. ... While it is commonly believed that these must eventually be paid back, this is obviously false.” (Mitchell 2018a) This is a corollary of the assumption that current account deficits are always financed in the currency of the deficit country or that foreign currency can always be purchased, without adverse consequences, for the domestic currency:

“A [current account deficit] can only occur if the foreign sector desires to accumulate financial (or other) assets denominated in the currency of issue of the country with the [current account deficit]. This desire leads the foreign country (whichever it is) to deprive their own citizens of the use of their own resources (goods and services) and net ship them to the country that has the [current account deficit], which, in turn, enjoys a net benefit (imports greater than exports). A [current account deficit] means that real benefits (imports) exceed real costs (exports) for the nation in question” (Mitchell, 2018a).

For MMT, current account deficits are therefore not the result of domestic consumption and investment exceeding productive capacity or capability, but a reflection of foreign demand for financial assets: “If the other guy has a desire to net save in your currency, he has to earn that currency by giving you goods and services” (Mosler, 2018). But the assumption that exports are priced in foreign currency, while the liabilities associated with current account deficits – resulting from payments for imports for example – are denominated in the currency of the deficit nation does not match the reality of the majority of the international trading and financial system. Even if countries can pay for their imports in domestic currency, this does not necessarily imply explicit demand for the currency, but simply the acceptance of that currency as means of settlement for a “real” transaction.

The MMT approach to the trade balance also downplays the aggregate demand, employment and distributional consequences of export demand. Demand for exports may generate jobs and income; the reason that MMT treats this as unimportant is that MMT claims that the employment rate is a pure policy variable: “the government *chooses* the unemployment rate. An elevated unemployment rate is *always* a political decision” (Mitchell, 2018a, emphasis in original). Export demand is thus regarded as unnecessary to maintain aggregate demand.

The MMT corollary is that action to reduce current account deficits is misplaced: “the mainstream view is that policy should be focused on eliminating [current account deficits]. This would be an unwise strategy” (Mitchell, 2010). Aside from the arguments above, the point seems to rest on the fact that action to reduce current account deficits is assumed to mean austerity: a loanable funds version of the twin deficits hypothesis regards a government deficit as causing insufficient national saving, as recently suggested by former president of Federal Reserve Bank of New York, Bill Dudley:

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<sup>2</sup> “MMT emphasizes that in ‘real’ terms, imports are a benefit and exports are a cost. Floating the currency and relaxing capital controls allows a nation to enjoy more ‘benefits’ (imports) and fewer ‘costs’ (exports)” (Wray, 2014).

“The U.S. trade balance depends primarily on how much the country as a whole spends, earns, saves and invests. Americans collectively spend more than their income, which means that the country’s savings do not cover its investment needs. To make up the difference, the country must borrow from abroad ... Together with higher caps on federal discretionary spending, the [Trump tax cuts] sharply increased the government budget deficit. This widened the gap between domestic saving and investment, requiring even greater foreign capital inflows – and a bigger trade deficit – to maintain balance” (Dudley, 2019).

While we concur on the incoherence of this loanable funds analysis, and that fiscal contraction is likely to be undesirable in many cases, this does not mean that current account deficits are never a problem and action should never be taken to address them, or that this action necessarily entails fiscal contraction. Further, current account positions do not tell us much about patterns of financing, and are not indicative of financing problems per se (Borio and Disyatat, 2011), but they may indicate problems with the structure of domestic aggregate demand, and, in many countries, potential exposures to foreign currency shortages.

### **3. Monetary sovereignty and the open economy**

The views outlined above on the balance of payments are derived from the main distinctive contribution of MMT: the neo-Chartalist theory of money (Tcherneva, 2006). In this view there are, at worst, only limited monetary and financial constraints on current accounts and trade, because of the power of government over the domestic monetary system. Indeed, “monetary sovereignty” is the central framing concept of MMT: Tymoigne (2019) defines MMT as “a theoretical framework that aims at understanding how a monetarily sovereign government operates”.

While there is some variance among definitions of monetary sovereignty provided by MMT authors, there are three main elements: 1) the government issues the national currency and imposes tax liabilities in that currency 2) the currency is fully floating and non-convertible,<sup>3</sup> and 3) the nation has no debt denominated in foreign currency.<sup>4</sup>

On the first, MMT contends that in stipulating the instrument in which taxes, fines and other obligations are to be discharged, a government can ensure the adoption of its chosen money of account. This neo-chartalist view, summarised as “money is a creature of the state” or “taxes drive money” is controversial, but space doesn’t permit extensive discussion here (see e.g. Parguez and Seccareccia, 2000; Mehrling, 2000; Fields and Vernengo, 2013). The recently published MMT textbook claims that currency issuance and taxation are sufficient to ensure widespread domestic use and acceptance of that currency:

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<sup>3</sup> Non-convertible in this context means that the government does not stand ready to convert their currency to any other, as is the case in fixed exchange rate regimes. The term is, confusingly, perhaps more commonly used to refer to the opposite case: currencies that are not freely traded and are thus confined to domestic transactions. See Mitchell (2009b) for discussion.

<sup>4</sup> “MMT describes and analyses the way in which ‘fiat monetary systems’ operate and the capacities that a government has within that system. It explains how monetarily sovereign states—that is, states that issue their own currency, float it on international markets and only issue liabilities in that currency—can never run out of money or become insolvent.” (Fazi and Mitchell, 2019).

“We can conclude that taxes drive money. The government first creates a money of account (such as the dollar), and then imposes tax obligations in that national money of account. *In all modern nations* this is sufficient to ensure that most debts, assets and prices, will be denominated in the national money of account” (Mitchell et. al, 2019, p. 137, emphasis added).

Specific examples are provided: “Currency-issuing nations... such as Turkey, and Argentina after it abandoned the currency board, ... created a currency for domestic use” (ibid. p. 325).

Elsewhere, however, Wray (2011) acknowledges that this will only hold for what he calls “the normal case – let us say, in the US or the UK or Japan”:

“These sovereign governments never find that they cannot buy something by issuing their own currency... the situation can be different in developing nations in which foreign currencies might be preferred for “private” transactions... To be sure, the population will want sufficient domestic currency to meet its tax liability, but the tax liability can be limited by tax avoidance and evasion. This will limit the government’s ability to purchase output by making payments in its own currency” (Wray, 2011).

Wray gives the example of a country that collects one twelfth of output in tax revenue, and explains that this will enable the government, at a minimum, to “move one-twelfth of national output to the public sector through its spending of the domestic currency” (i.e. to run a balanced budget), but in practice the government is likely to be able to spend more (i.e. run a deficit). Little elaboration is provided on what determines how far beyond its tax base a government can spend, and where increases in the tax base reach a tipping point at which currency demand becomes effectively unlimited and thus full monetary sovereignty is achieved.

The second precondition for monetary sovereignty in MMT is a fully floating exchange rate regime. Tcherneva (2016) presents a six-level ranking of “modern monetary regimes”<sup>5</sup>, in which “nonconvertible freely floating sovereign currency regimes (US, Japan, UK, Canada, most nations in the world)” (p. 19) are ranked at the top, with pegged floats, fixed exchange rates, currency boards, dollarisation and monetary unions offering consecutively lower degrees of monetary sovereignty.<sup>6</sup> Tcherneva argues that,

“In fully sovereign monetary regimes... the economic possibilities before a nation with a freely floating nonconvertible national currency are constrained largely by political considerations and the availability of *real* resources to achieve those priorities, not by the availability of money” (Tcherneva, 2016, p. 20).

While the Mitchell et al. definition appears to claim that by imposing tax obligations in national currency, governments are able to determine the denomination of debts directly, it is more common to include, as a precondition for monetary sovereignty, an explicit stipulation against

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<sup>5</sup> The “modern” in “modern monetary theory” modifies “monetary”, not “theory”: MMT is a theory of “modern monetary regimes”, not a modern theory of money.

<sup>6</sup> Tcherneva’s claim that “most nations in the world” operate a floating exchange rate echoes Wray’s description of this as “the normal case”; in reality a minority of countries operate systems classified by the IMF as “floating” or “free floating” (IMF, 2018).

foreign-denominated debt: “a monetary sovereign government does not need foreigners for its finances... no sovereign government should be allowed (by its citizenry) to issue IOUs denominated in a foreign currency” (Tymoigne and Wray, 2013, pp. 39-40).<sup>7</sup>

MMT proponents argue that, for monetarily sovereign regimes, the government can, by issuing currency, directly purchase anything that is for sale in that currency, including all idle labour.<sup>8</sup> This is the reason that, as previously noted, the level of employment is treated as a policy variable:

“...a nation that adopts its own floating currency can always afford to put unemployed domestic resources to work. Its government will issue liabilities denominated in its own currency and will service its debt in its own currency. Whether its debt is held internally or externally, it faces no insolvency risk” (Mitchell et al., 2019, p. 517)

When discussing the implementation of MMT policy proposals, MMT proponents often proceed on the assumption of full sovereignty, even for DEC: it is assumed that domestic currency will be accepted without limit by both the domestic population and by the foreign sector, either in direct exchange for goods and services or in foreign exchange transactions. In a similar vein, foreign currency borrowing is presented as a domestic policy choice, rather than an international structural constraint. As a result, both budget deficits and trade deficits are argued to be essentially riskless for “most nations in the world”:

“For a sovereign nation with a floating currency, a budget deficit is indefinitely sustainable. Such a government, logically, does not and cannot spend tax revenue. Even Turkey, with a budget deficit equal to 20 per cent or more of GDP, logically does not and cannot ‘borrow’ from the private sector or foreign sector. And, for such a country (even Turkey), both a budget deficit and a current account deficit are indefinitely sustainable” (Wray, 2006, pp. 117–118).

Much of the MMT literature therefore proceeds as if external constraints on policy and development are self-imposed (Vergnhanini and De Conti, 2017): currency pegs should simply be abandoned while foreign currency debt should be disallowed. Where the existence of binding constraints is acknowledged, it is presented in semantic terms: dependence on food imports is not a balance of payments constraint, it is the result of arbitrary lines drawn across space:

“It is true that a currency depreciation can be damaging for a nation that is wholly dependent on imported food. Note that this is not a balance of payments constraint as it is normally considered. It is a real resource constraint: insufficient domestic production of food. This can arise from domestic policy choices that are biased against the production of food crops, or from the unequal distribution of resources across geographic space and

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<sup>7</sup> Kaboub (2019a), gives a four-point definition of monetary sovereignty: (1) a country issues its own sovereign currency (2) taxes, fines and fees are imposed in that currency (3) the country only issues debt denominated in their own currency (4) the country operates flexible exchange rates.

<sup>8</sup> Strictly speaking, governments don’t issue currency directly, treasury spending is financed by selling bonds to the central bank. MMT tends to ignore this by – controversially – consolidating the two institutions into a single entity when discussing government finance (see e.g. Lavoie, 2013).

the somewhat arbitrary lines that have been drawn across space to delineate sovereign states” (Mitchell et al., 2019, p. 508).

The refusal, by some MMT authors, to acknowledge the existence of balance of payments constraints effectively dismisses the entire heterodox “balance of payments constrained growth” literature. This literature originates with Thirlwall’s (1979) model, which demonstrates that the relative income elasticities of demand for imports and exports can impose limits to the rate of growth for a country,<sup>9</sup> because beyond a certain growth rate import demand will rise faster than export demand:<sup>10</sup>

“There is nothing to distinguish so-called progressives who make this argument from the neo-liberals at the IMF who also make it. Perhaps a nuance is that progressives tend to focus on import-substitution policies to reduce the balance of payments constraint while the likes of the IMF focus on expanding export potential” (Mitchell, 2016).<sup>11</sup>

Although it is certainly the case that the breakdown of the Bretton Woods system and the shift to flexible exchange rates and open capital accounts for many countries alters, and in some cases loosens, balance of payments constraints, in a world dominated by dollar-denominated invoicing and funding, for many these remain very real.

Some MMT proponents have recently taken a more nuanced position on monetary sovereignty. While MMT has traditionally referred to a “hierarchy of money” (Bell, 2001; Tchverneva 2016), this refers to the relationship between state money, private bank money and “near moneys”; the significance of an international currency hierarchy has received less attention. It is therefore significant that Tankus (2018) introduces the terminology of a “spectrum of monetary sovereignty” in which “monetary sovereigns” coexist with “monetary subjects”. He argues that monetary sovereignty is mainly determined by the size of a country’s foreign currency debt. A similar position is found in Tymoigne and Wray (2013), who effectively describe an international currency hierarchy:

“In the worst case, some countries have limited real and external financial resources... and their government currency might not be accepted externally... In the most favourable case, a country provides the international currency and the rest of the world desires to save the international reserve currency” (pp. 42-43).

Kaboub (2018; 2019a; 2019b) also concedes that DECs face limited monetary sovereignty, as a result of domestic resource constraints. He argues for domestic policy measures to reduce DECs dependency on food and energy imports, and transform their economies into

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<sup>9</sup> This dismissal is not universal: Kaboub (2018) effectively gives an exposition of the balance of payments constrained growth model, but treats it as evidence that exports should be reduced.

<sup>10</sup> Given that Thirlwall (2012) credits Prebisch (1950; 1959) as the “true forerunner” (p. 319) of his balance of payments constrained model, this also amounts to a dismissal of the structuralist literature developed by Prebisch and his associates.

<sup>11</sup> Mitchell not only takes offence at the theory, but also at the habits of one of its key developers: “Nicholas Kaldor was one of those bourgeois socialist economists that Cambridge University seemed to nurture in the Post War period. He became a member of the House of Lords (Baron Kaldor of Newnham) in 1974, a curious position for a ‘socialist’ to accept. The joke that was around when I was a graduate student at Manchester University in the early 1980s was that he was so unfit and large that he had had a chair on the landing between floors of the Economics building between the tea room and his office so he could rest on the way back to his office after a nice English cup of tea” (Mitchell, 2016).

producers of high-value added industrial exports (these are discussed in more detail in the next section).

In contrast, Fazi and Mitchell appear to deny the Tankus / Kaboub “spectrum” view:

“...the core MMT developers do not... consider a ‘hierarchy of currencies’ with the US dollar at the top, nor do they assume that non-dollar currencies have only limited currency sovereignty. All currency-issuing governments enjoy monetary sovereignty... A nation with limited access to real resources will remain materially poor. Sovereignty, though, means that it can use its currency capacity to ensure that all available resources are always fully employed” (Fazi and Mitchell, 2019).

MMT policy advice to developing countries likewise often downplays the binding external constraints faced by so-called monetarily sovereign countries. Kaboub’s (2007) proposal for a job guarantee programme for Tunisia provides an example.<sup>12</sup> In discussing the open economy constraints, he argues that,

“The mainstream argument claims that there is no international demand for ‘soft currencies’ like the TND or TND-denominated assets such as TND-denominated bonds issued by the Tunisian Government... According to Wray’s analysis (2006), the real meaning of a trade deficit is that the rest of the world (ROW) wishes to net save TND-denominated assets, and that ‘the real national cost of enjoying imports consists of the exports that must be delivered’ (Wray 2006) ... If the Tunisian government adopts a flexible exchange rate regime and allows free convertibility of the TND in international exchange markets, then Tunisia can practically import anything it wants by simply offering to exchange TNDs for whatever other currency is required for that purchase. There will always be a demand for TNDs, albeit at a devalued exchange rate” (Kaboub, 2007, pp. 21-22, 24).

The underlying assumption here is that the government should be able and prepared to exchange domestic currency in FX markets at any exchange rate. However, as we discuss in the next section, FX markets in DECs are often thin and one-sided, resulting in large exchange rate movements. These can have severe consequences for inflation and external debt servicing, both of which are recognised by MMT proponents as policy constraints. The government could therefore find itself in the position of choosing whether to continue issuing domestic currency to buy necessary imports, or preventing the exchange rate from collapsing. Indeed, Wray and Tymoigne (2013) again provide more nuanced policy advice:

“open economies are more sensitive to fluctuations in exchange rates and may desire to curb exchange-rate fluctuations by pegging a currency... MMT does recognize that some small open economies may benefit from dollarization given that almost none of their economic activity is driven by the domestic private sector and government spending” (p. 43).

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<sup>12</sup> A job guarantee (or more specifically an “employer of last resort”) proposal is the flagship policy of MMT. See Mosler (1997–98); Wray (1998); and Tcherneva (2012)

There is therefore some variation amongst MMT authors on questions such as whether resource-constrained countries should be considered to be monetarily sovereign, and even on the existence of an international currency hierarchy. Even those who acknowledge DEC's lower position in the monetary hierarchy, fail to acknowledge the severe structural constraints these countries' subordinate position in the international productive and financial system imposes on domestic policy making – in particular those aimed at productive structural transformation.

#### **4. MMT, foreign exchange and finance for development**

While some MMT authors deny the possibility of limited policy autonomy in the presence of a floating fiat currency (Caldentey and Vernengo, 2019), and therefore regard problems of development as resulting entirely from resource constraints, more nuanced contributions do acknowledge these limits. These are framed, in MMT terminology, as resulting from a lack of monetary sovereignty. In this section, we consider whether proposals to “increase monetary sovereignty” are sufficient to provide policy autonomy to DEC governments and overcome externally imposed constraints.

Kaboub (2018; 2019a; 2019b) argues that limited monetary sovereignty in DEC's originates in their lower economic development, because external borrowing in foreign currency and fixed exchange rates are imposed by the need to pay for food, energy, and industrial goods imports. In this view, reclaiming full monetary sovereignty therefore depends on developing energy and food self-sufficiency, as well as focusing the economy away from intermediate good assembly manufacturing and commodity exports, which will in turn remove foreign currency borrowing and need for managed exchange rates. Kaboub argues that MMT policies can be used to achieve self-sufficiency in food and energy: a job-guarantee programme can be used to direct labour resources towards agriculture and energy production.

With the possible exception of the job guarantee, these proposals largely parallel the tradition of old development economics, and industrial policy, which Structuralist and Post-Keynesian economists have been advocating since the 1960s (e.g. Prebisch, 1949; Rodríguez 1981, Sunkel and Paz, 1970), yet largely stop short of discussing a central issue in that literature: how is industrialisation to be financed? In this literature, the limited policy autonomy of DEC's (at least partly, as we argue below) stems not only from their lower productive capacity but also from their subordination in the global monetary and financial system. As Kaboub also notes, industrial transformations take time. During the transformation process, there is an ongoing need for foreign currency, to pay for those imports of technology and capital goods that are necessary to develop food, energy and manufacturing production. The crux of the matter is: how to solve the inescapable need for foreign currency to achieve this structural change, if one is to avoid foreign currency borrowing? Some countries may be able to achieve foreign currency financing at favourable terms, for example because of their geopolitical importance (see e.g. Yeung, 2017; Fischer, 2018). However, for the majority of countries this is unlikely to be an option. Developing countries have therefore broadly three other possibilities open to them.

The first is to pursue a neo-mercantilist export-led strategy, and generate the necessary foreign exchange through exports. However, this solution is potentially highly problematic. By definition, many developing countries are poorly developed, shallow economies which are largely import dependent, very often for basic foodstuffs, let alone more complex inputs for

domestic production. At the same time, and for the same reason, their export capacity is low and often dependent on volatile commodities and low-value added intermediate goods. Thus, aiming to reduce their imports in line with their export capacity will seriously undermine any development effort and domestic living standards. Moreover, the real exchange rate devaluation required to generate such a boost to domestic exports might be technically infeasible (due to a low price elasticity of exports), or politically impossible if it requires subdued wage growth and generates inflationary cost-push pressures. Finally, there is the global argument: not all countries can run current account surpluses. If, however, we have a situation - which characterises the current international configuration to a substantial extent - where countries with developed economic structures and strong currencies (see our argument later on) can run current account deficits and “live beyond their means”, whereas DEC countries with weak currencies cannot and are thus bound to “live within their means”, this raises obvious questions about equity.

A second set of solutions is to obtain foreign currency through the financial account, i.e. through “capital flows”, which do not create foreign currency debt liabilities. This could be done either through long-term equity-like flows in the form of FDI or foreign investments in liquid domestic currency-denominated assets such as stocks and bonds. As argued by Kaltenbrunner and Paineira (2015), such investments continue to bear considerable risks and are therefore not a way of increasing monetary sovereignty. The resulting currency mismatch of these operations makes foreign investors very sensitive to expected exchange rate changes which can result in large and volatile asset price and exchange rate movements. This means that even in the case of domestic currency liabilities held by foreign investors, governments cannot neglect the exchange rate which limits their policy autonomy. Attracting FDI, as opposed to loans or portfolio flows, might have stabilising short-term implications, but, as Kaboub also notes, might encourage a race to the bottom as countries compete for foreign investments, as well as locking their productive structure firmly into a subordinate position. Moreover, FDI potentially creates future pressures on the balance of payments in the form of dividends and remittances.

Finally, DEC countries could rely on domestic financing to promote the structural change necessary to reduce the foreign exchange constraint and reliance on foreign (currency) borrowing. Tankus (2018) recommends the promotion of domestic credit through low interest rates and national development banks (he mentions the Brazilian National Development Bank, BNDES, as an example; a similar proposal is put forward by Rezende, 2015, for Brazil, although not explicitly in the context of achieving monetary sovereignty). This domestic financing would then be exchanged into foreign currency on the foreign exchange market to buy the necessary imports. To cover temporary import needs (e.g. for trade credit and short-term dollar financing), Tankus recommends the development of regional payment systems. While we are sympathetic to these suggestions, serious constraints remain which are largely related to DEC countries' subordinate position in an asymmetrically structured international monetary and financial system (e.g. Andrade and Prates, 2013; Kaltenbrunner, 2015; Bonizzi, 2017; Allami, 2018). Indeed, it is this hierarchic and asymmetric structure of the international monetary and financial system, we argue, which (in addition to the productive subordination highlighted by e.g. Kaboub, 2018 and Wray and Tymoigne, 2013) constrains attempts to achieve monetary sovereignty in DEC countries.

First, in addition to their foreign exchange constraint, many DEC countries face considerable domestic financing constraints: the private financial system is not prepared to provide low-cost, domestic currency financing. In a global economy, where private actors can decide between

holding different currencies, an inherent hierarchy emerges among them. Financial institutions will prefer currencies which best perform international money functions, currently led by the dollar. Other currencies, or assets denominated in those currencies (such as domestic bank loans), will have to compensate their inability to perform international monetary functions with higher returns (e.g. interest rates). Additionally, the domestic financial system simply might not be sufficiently institutionally capable of providing long-term “patient” financing for developmental, structural change in DEC. Conversely, as discussed in more detail below, private actors might be unwilling to borrow or hold domestic currency assets such as deposits, whose value is perceived to be excessively volatile. For all these reasons, long-term credit for development is simply not available in many DECs. MMT authors partly acknowledge this restriction and suggest the use of development banks and direct monetary financing by the central bank. We are sympathetic to these proposals, which could in some cases reduce the domestic financial infrastructural gap, increase the circulation of domestic currency and promote the development of credit markets in domestic currency. However, at least in the medium term, the need to pay for capital goods and technology in foreign currencies remains. Therefore the success of such solutions remains contingent on the ability of the local currency to be exchanged internationally to buy foreign currency.

This brings us to a second constraint to domestic financing of development in DECs, briefly mentioned in the previous section. In large developed economies deep and liquid foreign exchange markets and powerful banks allow agents to exchange domestic currency into foreign currency routinely. This is not as simple in DECs characterised by thinner foreign exchange markets and currencies lower down the international hierarchy. Foreign agents are less willing to exchange foreign into DEC currencies to finance foreign exchange shortfalls. Flexible exchange rate regimes are no cure for this problem. The “virtue” of flexible exchange rates seems to be predicated on the notion that the foreign exchange market will quickly find a new lower clearing price as demand for a currency falls, but in many DECs quantity constraints might prove tremendous: if foreigners and domestic agents want to exchange domestic currency for US dollars, it will take a mighty fall in the price of domestic currency to stimulate any actor to buy it. As Coppola (2018) notes,

“the world is littered with examples of countries that have had to run down public sector FX reserves to provide dollar liquidity to local banks and corporations after they are effectively shut out of global markets by local currency depreciation... in an FX crisis, private sector debts become public sector external debt.”

This is particularly the case if foreign currency is needed to finance risky, structural transformations in a global order predefined by developed countries as early movers. However, it might even be problematic in the case of temporary current account deficits due to changing international food and energy prices. Indeed, no country in this world is entirely energy and food sufficient, which means except the US (which can buy for most of its imports in its domestic currency) every country in the world is at least temporarily foreign exchange constrained. This is not a problem for developed countries with deep and liquid foreign exchange markets, whose currencies sit on the top of the international currency hierarchy. It is, however, a problem for DECs characterised by monetary and financial subordination.

Finally, in the extreme case, DECs’ monetary subordination might not only mean that foreign nationals refuse to accept the domestic currency, but even domestic actors might substitute the domestic currency for a foreign currency, at least for some functions. Historically this has

been observed particularly in the case where domestic agents hold their wealth in a foreign currency (Argentina is a good example). This, in turn, seriously undermines the ability of the domestic banking system to provide domestic currency financing because domestic currency loans are frequently transformed into foreign currency deposits, which creates destabilising currency mismatches in the banks' balance sheets. Thus, any domestic currency financing - at least in the presence of low levels of monetary sovereignty - would have to be complemented by domestic foreign exchange regulations which forbid the use of a foreign currency in the domestic economy (which have indeed existed in Brazil for a long time) and capital controls to avoid flight into a foreign currency.

## 5. Conclusion

In the terminology of MMT, a monetarily sovereign government is one for which there is no risk of technical default on its debt; "monetary sovereignty" is thus a synonym for "macroeconomic policy autonomy". Historically, MMT has largely focused on how to implement policy in a situation of full policy autonomy. The limits to that assumption for many DEC's are acknowledged by recent contributions noting that "monetary sovereignty is a spectrum". But this is just another way of saying that the policy space available to governments varies, and that DEC's face binding external constraints on policy; this is hardly a novel observation.

What matters, instead, for DEC's is how to implement policy under conditions of limited autonomy, and the measures that can be taken to increase the degree of policy autonomy available. On these, the MMT literature does not make a substantial contribution. Moreover, the contributions that do exist do not, in our view, sufficiently acknowledge the structural constraints imposed by a hierarchical international monetary and financial system on successful structural transformation.

Firstly, the threefold criteria identified by MMT - the currency issuer imposes means of settlement of tax obligations, operates flexible exchange rates, and has no foreign currency debt - are insufficient to achieve policy autonomy (see also Caldentey and Vernengo (2019) for a similar argument). Even if these criteria are met, nations may still face foreign exchange shortages. In particular, we showed that the MMT assumptions about the willingness of the foreign sector to hold domestic currency, or of currency devaluation to act as an equilibrating mechanism are highly problematic in the case of DEC's. DEC's face a hierarchical world economy; they remain structurally subordinated in global production chains, reliant on volatile commodity exports, and import dependent for food and energy. Foreign exchange markets are not sufficiently developed to ensure liquidity and are also embedded in a hierarchical international system where the dollar continues to dominate invoicing and funding. In this context, currency devaluations can be prohibitively costly. An argument could be made that the causality between monetary sovereignty and exchange rate flexibility is the reverse: developed countries, with deep financial markets and well developed monetary and financial markets and institutions, whose currency is widely used and traded, can safely implement floating exchange rate regimes; others have no choice but to operate some form of managed exchange rate.<sup>13</sup>

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<sup>13</sup> This has also been acknowledged in a large literature known as "fear of floating" (e.g. Calvo & Reinhart, 2000; McKinnon and Schnabl, 2004).

Secondly, while many of the proposals made by MMT proponents aimed at increasing the policy autonomy of DEC governments, such as increasing self-sufficiency in food and energy and increasing capacity for domestic credit expansion, are sensible, they are already well-established, and more thoroughly explored, in the structuralist heterodox development economics literature. Where MMT diverges from this literature is in advocating monetisation of deficits and implementation of job guarantee schemes.

The efficacy of direct monetary financing is ultimately dependent on the willingness of both the domestic private sector and the foreign sector to hold domestic currency; as already noted, the sanguine assumptions made by MMT proponents about such demand are questionable in the case of DECs. Direct monetary financing is unlikely to be appropriate for funding long-term capital investment, while domestic financial institutions might not have the capacity to implement such a policy. Advocating deficit monetisation under conditions of sustained current account deficits, exchange rate volatility and potential capital flight is at best misguided and at worst irresponsible. The recent experience of Argentina – despite being identified by Mitchell et al. as a “currency issuing nation” – is a case in point (see Bortz and Zeolla, 2018).

Successful development requires a combination of strategies. Greater reliance on domestic financing as part of industrial policy is likely to play a role, although this will require careful consideration of the appropriate institutional forms. Recent MMT contributions advocate the promotion of domestic credit through low interest rates and national development banks (Tankus, 2018; Liang, forthcoming). Such strategies will however need to be combined with some degree of controlled foreign borrowing, alongside strategic trade openness – and a more sophisticated understanding of the role of trade in development than “exports are a cost, imports are a benefit”.<sup>14</sup> Domestic regulations on the use of foreign currencies and a managed financial account are likely to be necessary in order to avoid excessive foreign currency debt and instability arising from volatile capital flows and domestic currency substitution, which could derail any development strategy.

This remains, however, nothing more than a starting point for a successful development strategy, where foreign exchange remains a constraint. This is so, because DECs face a world economy connected by an asymmetric and hierarchical international monetary and financial system. As long as one, or indeed a few, core currencies continue to dominate the international monetary system for invoicing and funding, for many DECs the problem of achieving full policy autonomy will remain extremely challenging. While it is possible for some DECs to improve their relative position and reduce the extent of their current subordination, it is likely that monetary hierarchies will remain for the foreseeable future. To overcome this global power structure and achieve true policy autonomy for all nations will require major reform of international systems of governance and cooperation as well as global and regional financial and monetary systems. It is not yet clear whether MMT acknowledges this.

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<sup>14</sup> “If we are to advance the economic interests of the bulk of the citizenry in a decent and humane fashion, we must promote a full employment policy domestically, and couple this with a flexible exchange rate regime internationally. With these institutions in place (on a global scale), exports become a cost and imports a benefit, and the conditions under which free trade is beneficial will have been established” (Bell and Henry, 2003, p. 24).

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**Author contact:** [Jo.Michell@uwe.ac.uk](mailto:Jo.Michell@uwe.ac.uk), [A.Kaltenbrunner@leeds.ac.uk](mailto:A.Kaltenbrunner@leeds.ac.uk), [b.bonizzi@herts.ac.uk](mailto:b.bonizzi@herts.ac.uk)

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