

Modern Monetary Theory: a critique from the periphery

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Abstract

This paper intends to present the recent debate on the modern monetary theory (MMT) and to contribute with a critical view on its application on modern economies, giving special attention to monetary specificities of peripheral countries. MMT concerns have been centered on both demystifying postulates of the “new consensus” and offering an alternative theory to reach full employment with price stability. However, it has been criticized for assuming that most constraints domestic policies are self-imposed and do not arise from international markets. From the perspective of a well-defined international currency hierarchy, this paper argues that the majority of countries are not fully sovereign in determining its own macroeconomic policy. Peripheral countries are subject to even further constraints that cannot be ignored.

Keywords: modern monetary theory, fiscal policy, currency hierarchy.

JEL reference: E00, E02, E10, E12, E24, E40, E62, E63.

1. Introduction

The Modern Monetary Theory (MMT) approach has gained increased visibility for predicting the crisis of European Monetary Union (EMU). Already in the 1990s, MMT claimed that the EMU institutional design would lead to growth problems due to the absence of fiscal branch. “It will be as if each EMU member country were to attempt to operate fiscal policy in a foreign country; deficit spending will require borrowing in that foreign currency according to the dictates of private markets” (Wray, 1998, p. 92). Although there is much disagreement regarding the causes of EMU stagnation (even among heterodox economists), MMT-eers took advantage of its acknowledged economic forecasts to claim victory of its theoretical assumptions over mainstream economics (see Wray, 2012).

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On the one hand, MMT has been valuable at questioning and demystifying some elements from the new consensus. For instance, it denies that there is any limit to governments' capacity to issue debt in its domestic currency. In addition, it refutes the necessity of causing recession and unemployment as the only efficient path to restore balanced growth.

On the other hand, it has been criticized for assuming that countries are, in almost every case, free from international markets to unrestrictedly expand government deficit and set domestic macroeconomic policies so as to provide full employment. Any fear of deviating from markets' rules would be based on irrational fear and on misunderstandings on how economy and public budget actually functions. Because of this posture, MMT has attracted critics from both the orthodoxy and heterodoxy.

The purpose of this article is to compile the main heterodox arguments against MMT, considering its theoretical, political economy and empirical weaknesses. Moreover, it argues that the disciplinary power of international markets over domestic macroeconomic policy is greatly asymmetric, being more severe in those countries that issue peripheral currencies.

The article is divided in four sections, in addition to this introduction. Section two introduces MMT's theoretical underpinnings as well as its policy proposals, based on Wray's seminal work *Understanding modern money* (1998) and some of author's more recent articles. The third section presents some general appraisals from heterodox economists. Thomas Palley's works were greatly considered, since it provides a wide compilation of MMT's problems, from both theoretical and practical standpoints. Section four adds a periphery perspective in order to contradict MMT's main claim of "macroeconomic sovereignty" as a generally applicable rule. This section is aligned with the research scope on "international monetary hierarchy" that has been developed by some Brazilian recent works². Finally, some conclusive remarks are considered.

2. Modern Monetary Theory: foundations and policy proposals

The modern monetary theory (MMT) seeks to demystify some common views regarding the functioning of the economy and builds a theoretical framework to support its bold policy proposals. The present section explores the MMT view on i) the nature of government deficits; 2) supply of money; and 3) policy propositions. The main reference was Wray (1998).

² Carneiro (1999), Conti, Biancarelli & Rossi (2013); Conti (2011); Prates (2002); Conti, Prates & Plihon (2014).

According to common view, government spending relies on tax revenues. Any deficit budget should be financed either through the issuing of non-interest bearing debt by the Treasury (currency) or through the selling of interest-earning bonds. The first alternative is commonly believed to cause inflation, since it directly expands the money supply. Government borrowing, on the other hand, adds the demand for loanable funds, thus driving up interest rates and, at least partially, crowding out private borrowing. Over the long run, this could lead to supply bottlenecks and cost-push inflation.

Most economists believe that government deficits may even be desirable in specific situations. However, its persistent shape should be avoided because it could lead to some deficit-to-GDP ratio at which market loses confidence in governments' capacity to retire its debt. In this sense, government deficit is supposed to rely on domestic public expectations and its will to take up the debt. Eventually, the government would have to impose austerity on its population with the aim of selling bonds internationally.

The MMT approach is based on Lerner's concept of "functional finance". It states that, rather than tax revenues or bond sales, government spending is financed through fiat money³. The reasoning is considered as follows.

First, the government issues fiat money and spends it by hiring services and buying products from the public. The state money is widely accepted because it is the only unit of account that officially meets tax liabilities. From this perspective, taxes serve simply as a reserve clearing drain that is flowed back to the government funds⁴. Because taxes cannot be paid until state money is injected in the economy, persistent government deficits derive from the normal functioning of the economy and surpluses, on the contrary, unleash strong deflationary forces.

As a result, according to MMT, government deficit spending is never subject to market discipline as long as the bonds are issued in the domestic currency.

(...) most of the pressures that governments currently believe arise from international markets are actually self-imposed constraints that arise from a misunderstanding of the nature of government deficits (Wray 1998: 75).

³ Taxes and bonds are required only to serve other policy objectives, as discussed in the following passages of the article.

⁴ This specific type of chartalist approach is called "taxes-drive-money view" by MMT-eers.

This reasoning rests upon the idea that the government is sovereign to issue any amount of state money and is completely capable of maintaining its value. In addition, its acceptability could never be questioned because it is enforced in the payment of tax liabilities.

Another important theoretical underpinning of MMT regards the supply of money. Some economists have not abandoned the traditional monetarist belief that the Fed determines the quantity of money and that this determines the rate of inflation. In this view, the monetary authority provide reserves to the banking system and, through a “stable” money multiplier, it expands the money base. In the textbooks, this has been called the “verticalist” approach (money supply being completely inelastic to interest rates).

However, according to MMT-eers, the central bank has never controlled the quantity of money or the quantity of reserves. “In the real world banks make loans independent of reserve positions, then borrow reserves to meet requirements” (Wray 1998:107).

The decision to lend money depends on the price of reserves and the expected returns. In other words, the bank borrows money if it assumes this operation to be profitable, regardless of the quantity of reserves. It plays an active role in determining the composition of its assets and liabilities. Hence, the causation is reverse of what is commonly believed: first, the demand for finance usually meets the provision of loans; secondly, the bank buys reserves from the central bank in order to meet the legal requirements. In this scheme, the central bank plays a quite passive role, providing or draining the amount of reserves determined by the banking operation.

MMT incorporates the “horizontalist” approach, which means that: i) the central bank determines the short-term interest rate directly (and the short-term retail lending indirectly, as the wholesale rate is marked up); and ii) the supply of money is endogenous to finance demand⁵.

The assumptions on money supply, government finance and value of the currency have important implications on the role of monetary and fiscal policies.

The orthodox view assumes that the monetary policy has discretionary control over the reserves and the quantity of money. The MMT claims that “the orthodox view fundamentally confuses fiscal policy with monetary policy; fiscal policy has more to do with the quantity of money and with the value of money, while monetary policy simply determines overnight interest rates” (Wray, 1998, p. 98).

⁵ It should be noticed that while the banking-money-supply is horizontal, the fiat money is vertically determined (through deficit spending) (Wray 1998: 111).

Monetary policy is defensive and dependent of the Treasury operations. It includes those Treasury and central bank operations that drain reserves or that sets the overnight interest rate target. Bond sales are destined to substitute an interest-earning government liability for non-interest-earning government fiat money (and constitute an interest rate maintenance account).

Fiscal policy, on the other hand, is intended to determine the quantity of state money available and, through taxation, maintain the value of the currency. As mentioned above, the goal of the fiscal policy is to operate based on the functioning of the economy and not on what the traditional doctrine calls “sound finance”. The principle of functional finance, advocated by Abba Lerner, states that:

(...) the first financial responsibility of the government (...) is to keep the total rate of spending in the country on goods and services neither greater nor less than that rate which at the current prices would buy all the goods that is possible to produce (Lerner 1943: 39, in: Wray 1998: 76).

Spending and taxes, therefore, should be balanced to accommodate full employment. However, the operation of functional finance is not sufficient to guarantee that condition. How could the government generate full employment and, at the same time, maintain price stability?

The MMT recommends the government acts as employer of last resort (ELR), providing jobs at a basic public sector wage (BPSW). Any person who is able and willing to work would be provided with a job in the ELR program. The BPSW would be set by the government at a level that is lower than the minimum wage in the private market. As the economy grows, some workers would be transferred from ELR program to the private market, getting better salaries. On the other hand, in cycle downturn, ELR could accommodate workers dismissed by private firms. This way, the buffer stock program would stabilize aggregate income and aggregate demand, diminishing regressive effects of recession.

At the same time, for constituting an important element in the production cost of every economic activity, the unskilled labor is the best commodity for the buffer stock program. The stabilization of the ELR wage would serve as reference to other wages, costs and prices, thus contributing to overall price stability.

The ELR, therefore, would allow the government deficit to vary countercyclically, filling the demand gap and avoiding deflationary pressures.

To sum up, the MMT claims that the government has autonomy to increase deficit spending by issuing money or selling bonds at any amount needed (so long as the bonds are issued in the domestic currency). Because it could never default the payment of a debt that is denominated in its own currency, the market would not doubt its payment capacity. Since the government is free of any market constraints in its policy-making, it should implement a fine-tuning between monetary and fiscal policies in order to reach and maintain full employment with price stability.

The MMT recognizes that, if the country is forced to international indebtedness, because it is obliged to issue debt in a foreign currency or because it needs goods or services that are not available in exchange for the domestic currency, then it would be subject to constraints of international markets.

Sometimes governments believe that the 'market' forces them to issue foreign-currency-denominated bonds. There is only one case in which this would be true - when the government wishes to purchase goods and services that are not for sale in terms of the domestic fiat money. (...) [in this case,] it will have to obtain additional foreign currency in the future to service the debt. In some situations, markets might fear that a government will not be able to do this – which could lead to default – causing a rational run out of these bonds. As a result, the government may be forced to impose austerity on its population to maintain a trade surplus to obtain the needed foreign currency (Wray 1998: 88).

This condition, though, is considered by MMT-eers to be punctual and not apply to the general case:

In this one case, the austerity can be at least partially blamed on 'market discipline'. However, it must be recognized that this is only because the government desired goods and services that were not for sale in the domestic currency. In all other cases, the government is not subject to 'market discipline', and any austerity and hardship is self-inflicted (Wray 1998: p. 88).

3. General critique

Several critiques have been placed on the modern monetary theory. In this section, some of the most important heterodox appraisals were considered (with especial emphasis on Thomas Palley's work – see references). Additionally, from a Keynesian and Minskyan perspective, some considerations were also added by the present author.

The general critiques are organized in three groups: theoretical, political and empirical.

On theoretical framework

From a theoretical perspective, Palley (2013) questions the lack a rigorous explanation of the functioning of both inflation and interest rate. According to Palley, MMT implicitly assumes “L-shaped” inflation curve⁶ and ignores the developments attained by the Phillips curve (less unemployment tends to lead to inflationary pressures). In addition, it also places no role to expectations in the process of price formation. Palley believes this configures a regression in the understanding of the inflationary phenomenon.

Furthermore, Palley (2013) argues that a zero natural interest rate, as MMT implicitly assumes, would lead to inflation and asset instability (Minskyan perspective). Monetary policy, supposed to operate exclusively in a defensive manner in response to fiscal policy measures, loses its purpose in fighting instability of domestic financial sectors. Tymoigne & Wray (2014, p. 31) replied to that critic by arguing that financial regulation should be enough to counterbalance low interest rate and promote stability.

Palley (2013) also questions MMTs taxes-drive-money view. According to this chartalist approach, money is originated when the government enforces the payment of taxes in a certain unit of account. In order to retire such liability, and avoid arrestment by public authorities, the public has to obtain such units of money by exchanging in the market. Although Keynesians (and Keynes himself) recognize the power of the state to define the unit of account, and change it whenever it desires, they define money by its three essential properties: unit of account, mean of exchange and reserve of value. The latter, for example, leads to important implications concerning the monetary quality of modern economies. According to Keynes, liquidity preference is a defensive action against fundamental uncertainty and, because of that, economic agents tend to allocate their wealth in either the monetary form or more liquid applications. In conclusion, the property of reserve of value makes it possible that some part of the aggregate wealth is allocated in irreproducible assets, generating employment scarcity. By the same mechanism, the liquidity preference leads to higher levels of interest rate. This monetary dimension of modern economies is completely absent in the MMT theoretical framework.

⁶ Tymoigne & Wray (2014) dismiss this model representation, but do not offer any other formal alternative instead.

On political economy

From the political economy viewpoint, MMT greatly neglects institutional arrangements, political obstacles and the effects of inflation control over the distributive conflict. Firstly, the ELR program and even the operation of “functional finance” demand *fine tuning* between the Treasury and the central bank. However, the functioning of these institutions is currently very detached. The new consensus in macroeconomic policy requires the central bank to be independent of any political influence and committed to inflation targeting. According to Palley (2013), MMT-ers are dismissive of this fact and simply assume there is and should be full consolidation of the fiscal authority and central bank.

Regarding the ELR program, Palley reminds us that its application could be politically difficult, if not unfeasible. Some of the obstacles were treated by Kalecki in his classical work “Political aspects of full employment” (1943). Firstly, the increase in the size of the government and the expansion of public jobs could be object of intense struggle for ideological motivations. Secondly, capitalists resist full employment policies because of the political and social transformations that arise from it (worker class-consciousness and weakened bargain power in the definition of wages).

In addition, Palley argues that if there is some limit to budget expansion, which is contrary to MMT advocacy - but in accordance with Palley’s view of feasible macroeconomics - the costs with ELR is positive:

(...) there are macroeconomic consequences to issuing money. As regards financial cost, a prudent government is limited in the amount of money it issues, and that means ELR expenditures implicitly displace some other expenditures. That displacement may still be worth it but the opportunity cost is non-zero (Palley 2013: 30-31).

As previously stated, MMT believes that government spending should be committed to countercyclical balance, filling in the demand gap. This operation, however, would require the abandonment of any other fixed obligation to welfare or any other social programs.

By that, it is not meant that those policies should not be pursued, but simply that they do not constitute simple, obvious path as they have been treated by MMT-eers. They would need to face

political obstacles and be discussed as one political option - a choice of a certain priority at the expense of others, at some positive cost.

Still regarding dismissive political economy judgments, MMT does not clearly assert the possible effects on work unions and real wages. ELR wage could create pressure to lower the minimum wage in the private sector (Palley, 2013). Moreover, the full provision of jobs at a basic wage would substitute the former welfare state. The government would not guarantee a whole set of social rights, including federal unemployment compensations, health care etc. Wray (1998) argues that workers would have to negotiate private supplied benefits. He recognizes, though, that ELR could affect negatively wage and benefits:

On one hand, ELR removes the fear or threat of unemployment (...). On the other hand, the ELR pool will also dampen wage (and benefit) demands of non-ELR workers as employers will have the alternative of hiring from the ELR pool. Thus, it is not clear that ELR is biased in favour of workers or employers (Wray 1998:145).

In this sense, it must be emphasized that, by acting over the inflation by means of controlling the wages, the government is, in fact, interfering in the distributive conflict and affecting the bargaining power between workers and capitalists. Unlike the MMT discourse, the implementation of ELR depends on a political judgment about distributional effects. Assuming its political complexity should stimulate a more honest debate.

On empirical evidence

Finally, there are some empirical evidences on how economies in fact operate that MMT is apparently dismissive.

There are important open economy considerations that are neglected by MMT. To start with, the great majority of real-world-economies need to obtain goods and services that are not for sale in the domestic currency. This means that the necessity of obtaining foreign currency and maintaining the power parity of its national currency in terms of foreign one is more of a general rule than an exception. Governments may be forced to impose austerity on its population in order to maintain a trade surplus and, thus, obtain the needed foreign currency. Therefore, austerity is not so commonly self-imposed, as argued by MMT, but most of economies are, in fact, subject to “market discipline”.

Secondly, differently from what MMT advocates, exchange rates should not be let to free floating. MMT has recently emphasized the role of flexible exchange rate as a stabilizing device in countries that need to obtain foreign currency. Palley argues that this type of approach bizarrely puts MMT in the company of Milton Friedman. Moreover, he reminds that a major reason flexible exchange rates do not insulate economies comes from structuralist macroeconomics literature, principally associated with Latin America (the specificities of peripheral countries will be explored in the next section). In this perspective, exchange rate depreciation triggered by money financed deficits can cause significant disruptive imported-inflation effects in both developing and open-developed economies. Therefore, exchange rate depreciation can also be contractionary (Palley, 2014).

Thirdly, Palley argues that the covered interest parity (CIP), which is an empirical regularity in international economics, is incompatible with MMT. Its recommendation of setting domestic interest rate at zero would imply steady appreciation of domestic exchange rate, which, in term, would obviously lead to financial instability and real economic disruption (Palley 2014, p. 16).

In response to these critiques concerning the functioning of open economies, some collaborators of MMT have advocated exchange rate pegging. This acknowledgment, however, undermines MMT's main claim about sovereign money freeing governments from standard market disciplines and financial constraints (Palley, 2014c). Pegging limits the freedom of monetary policy, requires foreign exchange reserves, and is also subject to speculative attack which further constrains policy.

In conclusion, MMT oversimplifies its theoretical statements, ignoring important sources of inflationary pressures and financial instability, the property of reserve of value and its role in a context of liquidity preference. Moreover, since most economies are not independent of international trade and financial flows, there are further restrictions, imposed from outside markets, on domestic macroeconomic policies. Not only the external obstacles operate in most of developed countries, but they are also greatly amplified in peripheral countries (as discussed in the following section). In addition, MMT-eers underestimate institutional and political difficulties in the implementation of its policy proposals. They should explicitly assume that ELR program would operate as a clear government intervention in the distributive conflict, at the expense, it appears, of labor earnings and benefits. Therefore, the ELR agenda should place itself within the political debate. It is not a logical result from the correct understanding of public finance, as MMT supports, but rather from a certain political economy standpoint. Would employment security be preferable to dampened wages and suppressed social rights? It should be up to the society to decide.

4. Critique from the periphery

This final section intends to show how some monetary specificities of peripheral countries tend to determine even further restrictions on macroeconomic autonomy. For this purpose, the term “peripheral countries” will be used as simply referring to those countries that issue “peripheral currencies” (which definition will be presented below).

From a more general perspective, there may be other specificities in the periphery, apart from the international monetary aspect, that cause diminished macroeconomic sovereignty. Domestic supply bottlenecks may become difficult for the country to autonomously increase its aggregate demand without causing deficits in external trade. The political obstacles may also be greater than in central countries. However, the present section intends to focus exclusively on the external constraints placed by the monetary nature of peripheral currencies in the international monetary system.

According to Keynes, monetary economies are characterized by fundamental uncertainty and, in this context, the liquidity preference figures as a good thermometer of agents’ expectations and confidence. According to Keynes’ portfolio choice model (Keynes, 1936, chapter 17; Keynes, 1930), an asset yields, altogether with quasi-rent (Q), maintenance cost (C) and capital gains (A), a liquidity premium (L). This justifies why agents allocate part of their wealth in liquid applications - eventually money -, even if they provide lower – or none - monetary returns. The attribute of liquidity depends on the asset capability to be converted into money with little monetary and temporal costs. Domestically, state money is the liquid asset per excellence⁷. Other application opportunities must offer higher return so as to compensate their relative illiquidity against it⁸.

The implicit return attributed to liquidity depends on agents’ liquidity preference. Therefore, this dimension is not objective, but is based on expectations, and could be susceptible to a great volatility. The greater the transactions volume and the more diversified the agents’ motivation in a certain market, the more probable is to find a counterpart for the orders of buying and selling (Conti et al. 2013). In other words, the healthy functioning of a market depends on the financial community confidence and opinion divergence.

⁷ Although there be may be specific historical situations where state money is widely questioned in its capacity to fulfill the classical monetary functions, being hyperinflation a major example of such process.

⁸ Hicks (1967) argues that there is a trade-off between liquidity and expected return, and that money occupies the extreme position in the liquidity spectrum.

In the financial globalization, national currencies are also financial assets associated to the trade-off returns/risks, like commodities, bonds, securities etc.

Some national currencies are able to satisfy the three basic functions of money also in the international scenario. This capacity is determined by international political economy conditions, such as the issuer's country integration with the world's economy, its geopolitical power and its will to internationalize its currency (Conti et al. 2013, pp. 4-5).

Based on Carneiro (1999) and Prates (2002), the authors define international monetary system as being configured by domestic currencies with different abilities to fulfill its functions at the international level and impose its international use. The dollar represents the system's central currency. At a second level, the authors cite the euro, Japanese yen, Sterling pound and Swiss franc. They may be named "central currencies". On the other hand, there are the national currencies that cannot fulfill the classical functions of money in the international scenario: the "peripheral currencies". These currencies are only demanded internationally as financial assets. According to the theory of portfolio choice, "since peripheral currencies are not as liquid as central ones (the same reasoning being valid for the assets denominated in each of these currencies), international agents will demand them only in the quest of high yields" (Conti et al. 2013: 6).

The composition of the international monetary system, therefore, is asymmetric. If we assume the definition of liquidity on the international sphere as the capacity of an asset to be exchanged - with no capital loss, transaction costs or delay - for a globally accepted means of payment⁹, we can rank national currencies according to their international liquidity attribute and obtain a well-defined "international currency hierarchy".

For that reason, the uncovered interest rate parity (UIP) theory is no longer sufficient to explain the determination of the level of interest rate. It states that domestic interest rate should equal international interest rate plus the country risk plus expected exchange rate variation. However, according to monetary asymmetry, peripheral countries must offer an additional premium in order to offset the currency international illiquidity.

Because of the basic interest rates of some currencies are extremely different, international agents may find profitable "carry trade" operations. They may raise funds at higher-ranked currencies, creating liabilities at relatively lower costs, and buy lower-ranked currencies, which offer higher returns. The operation of carry-trade puts pressure over the depreciation of the funding currency and appreciation of the target one. As long as the expectations are sustained, there is over-appreciation of the target currencies. From a Minskyan perspective, the reversal of the cycle

⁹ In accordance with Conti (2011).

determines a sudden “flight from risk” and causes target currencies to depreciate intensively (usually the peripheral currencies). It is not difficult, though, to notice the transmission mechanism from the speculative and unstable character of liquidity cycles to the exchange rate movements in peripheral countries.

From the international investor perspective, the portfolio composition is defined considering the variety of assets with their specific risk-return attributes. During the rise of “appetite for the risk”, there is demand for increasingly less liquid assets in the search for exceptional yields. However, in the moment of reversion of the optimistic expectations, there is a sudden movement towards the most liquid assets. In the international markets, this portfolio reconfiguration determines international liquidity cycles. They are characterized both by instability and asymmetry, which affect adversely the peripheral world.

Conti et al. (2013) also highlight that international liquidity preference are determined by reasons that are external to the country where the assets are issued.

From the abovementioned functioning of the international financial system, there are three asymmetries that affect peripheral countries¹⁰. Firstly, the financial asymmetry implies that assets allocated in developing countries are the first sell alternative in moments of risk aversion and/or huge losses in other markets. Secondly, the monetary asymmetry causes that private capital flows are only directed to peripheral countries as long as there is a reduction in international liquidity preference. Third and finally, macroeconomic asymmetry, which is a result of the last two, consists in the necessity to set much higher interest rates as to compensate the lower liquidity of their domestic currencies.

Consequently, the free floating of exchange rate leads to cyclical crisis because private capitals follow a speculative, volatile logic. Peripheral countries, thus, usually adopt pegging exchange rates with the purposes to avoid both sudden default (caused by currencies mismatches of domestic agents) and inflationary pressures. Pegging exchange rates and capital controls may diminish exchange rate volatility, but do not alter its peripheral and subordinate nature of the currency. That means that macroeconomic policy should also be concerned with exchange rate stability objectives.

¹⁰ The term “asymmetry” was first used by Prebisch to characterize the center-periphery system. For a detailed description, see Ocampo (2001). The classification employed in the present paper was freely adapted from the version of Prates (2002). According to the author, financial asymmetries are associated to i) exogenous determination of financial inflows, and ii) small relative dimension of peripheral countries in global financial flows. Macroeconomic asymmetries consist on i) incapacity of peripheral countries of issuing debt on their own currency (thus limiting the role of exchange rate policies), and ii) the fact that center countries are policy-makers, while peripheral ones are policy takers (thus, the latter would have limited freedom to adopt anticyclical economic policies) (Prates, 2002, pp. 154,155, in my own translation).

Besides, international private capitals may impose strict market discipline over government budget, requiring full commitment with decreasing government deficits. If the government decides to abandon primary surpluses targets and increases its public deficits, the market will perceive it as a lower commitment to debt retirement and expect some depreciation tendency of the exchange rate. Not much is needed to cause the “flight to liquidity” movement, considering that financial investments in peripheral countries follow a speculative logic. Any actions that go against “market discipline” and the so called “sound finance” will lead to self-fulfilling prophecy of currency depreciation.

By that, it is argued that the macroeconomic freedom is even more restricted in peripheral countries than in countries that issue center currencies.

5. Final remarks

MMT lacks a theoretical model to support its bold policy proposals. Critics have argued these policies could lead countries to face strong inflationary pressures and financial instability. Moreover, there are also political economy obstacles that would have to be offset. It is not clear if the ELR would be desirable in exchange of established social rights and programs, as well as its effects on functional distribution of income.

When open economies are considered, there are further difficulties placed by international markets. Strong depreciation should be avoided if the economy needs to obtain goods and services that are not available at domestic currency, or if it has debt denominated in the foreign currency, or if it wants to avoid inflationary pressures from outside. Therefore, the country needs to attract foreign capitals by offering a minimum level of interest-rate (which, by the way, is exogenously set by the international interest rate).

Furthermore, if there are several theoretical, political and empirical restrictions in applying the MMT in central, developed countries, the obstacles placed to peripheral countries are even greater. Due to international monetary asymmetry, these countries are obliged to set their interest rate at a higher level as to compensate the relative illiquidity of their domestic currencies. “Sudden stops” could result from exogenous changes in liquidity cycles. Exchange rates, as a result, are very volatile and could be subject to government pegging.

In conclusion, the MMT claim that, in general, countries are sovereign to operate with their domestic currency, being capable to reach full employment with price stability, is fallacious.

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