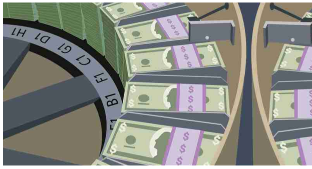

Advice from Emerging Markets on How Best to Implement Modern Monetary Theory

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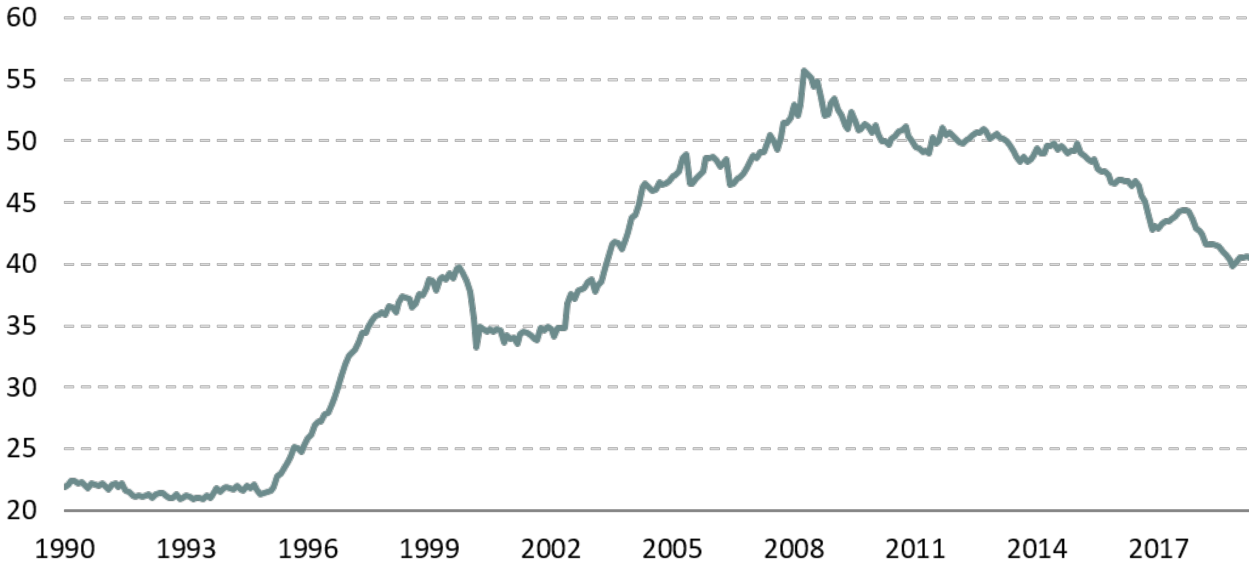
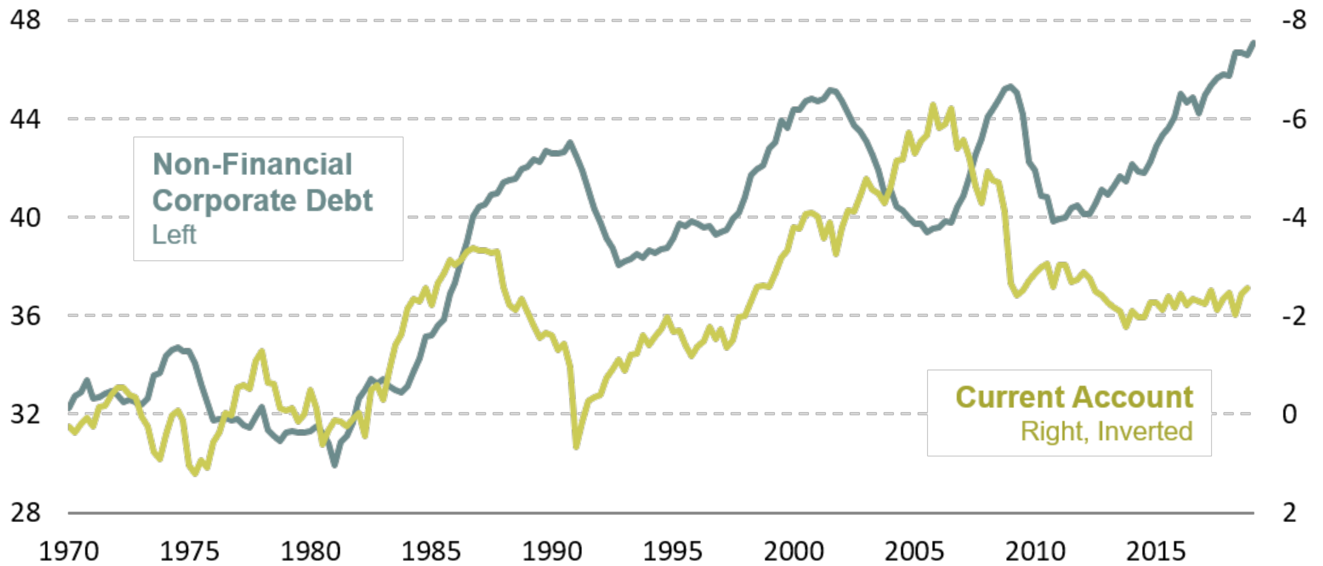
In recent years, a theory by the name of Modern Monetary Theory (MMT) has gained prominence in the economic policy arena in the U.S. In brief, MMT argues that countries that issue their own currencies can never run out of money the way a business or a person can and that government taxing and spending decisions should prioritize achieving full employment. Therefore, a country need not worry about the ensuing budget deficits as these will be financed by money printing.

The theory has "modern" as its first word, but there's nothing modern about it. Emerging markets (EM) have engaged in MMT for decades and here's the key takeaway: it works until it doesn't. Heterodox macroeconomic policies lead to economic imbalances which eventually get resolved—sometimes in quite dramatic fashion. Implementing MMT in the U.S. will ultimately be a political decision. What follows is some advice gleaned from EMs on how to delay the eventual reckoning.

1. **Term out your debt.** Short-term debt maturities mean frequent opportunities for creditors to evaluate your situation and potentially refuse to roll over debt coming due. On the positive side, U.S. debt coming due within one year is at multi decade lows—at under 30%—although the gross size is a staggering $4.1 trillion.
2. **Beware of foreign debt holdings.** Domestic-currency debt is indeed easier to pay back, but when foreigners hold your local-currency debt, things can quickly turn. If foreigners flee your domestic debt, this can place downward pressure on your currency which can exacerbate inflationary and financial market imbalances at just the wrong time. Foreigners currently hold 40% of U.S. Treasury marketable debt.



3. **Limit current account deficits.** A current account deficit is by definition a sign of insufficient savings to fund investment. The shortfall is made up by borrowing although it can show up in different places and has partly manifested itself in the U.S. corporate sector where debt loads have risen substantially. While affordability and interest coverage are currently (?) comfortable that may not always be the case.



4. **Recognize the tradeoff between money printing to pay debt and inflation.** The theory is factually correct in stating that a sovereign can always print money to pay down its domestic-currency debt. However, there is no such thing as a "free lunch." Money printing often has inflationary consequences, unless offset by otherwise tighter monetary policy.
5. **Be mindful of the domestic political cycle.** Imbalances can persist for a long time, but what unsettles investors is unexpected policy changes. These usually occur after changes in political leadership which is why election years in EM countries tend to be dicey.

The MMT crowd will argue that none of the aforementioned matters, because of the dollar's status as the world's reserve currency. However, reserve currency status does not last forever. Just ask the British pound, the French franc, the Dutch guilder, the Spanish peseta, or the Portuguese escudo.

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