Book Review

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Modern Money Theory – A Primer on Macroeconomics for Sovereign Monetary Systems (2nd edition)
by: L. Randall Wray
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The second edition of L. Randall Wray's textbook *Modern Money Theory: A Primer on Macroeconomics for Sovereign Monetary Systems* was published in 2015, with slightly more pages and a restructured outline. The book is the standard of modern mone(tar)y theory (MMT) – a Post-Keynesian variety centred on monetary macroeconomics, whereby the economy is explained through the examination of balance sheets, heavily focused on the monetary side.

In the preface to the *General Theory*, Keynes (1936[2010], p.7) wrote, "whilst it is found that money enters into the economic scheme in an essential and peculiar manner, technical monetary detail falls into the background". Wray puts this technical monetary detail into the spotlight, resulting in a very different macroeconomics textbook than the typical mainstream text. Indeed new thinking is needed, since many economists have lost their predictive power in recent years, forecasting hyperinflation and debasement of the currency after quantitative easing (QE); that income growth would accelerate given public sector spending cuts and lower wages, etc. Those seeking advice from Wray's first edition would probably have fared well in recent policy discussions.

Modern Money Theory is structured around institutions and their actions. After starting with the basics of macroeconomic accounting, spending by the issuer of the domestic currency is examined; the book then covers banks and central banks before returning to government spending and taxation. A chapter on exchange rate regimes follows, succeeded by two chapters on policy recommendations for government, a chapter on inflation, and the concluding chapter.

Having earlier used the first four chapters of Wray's first edition (2012) in teaching macroeconomics, I can say that the students' reaction was very positive. Imagining the economy as a web of contracts and transactions provides a very insightful point of view, and moving step-by-step is a sensible approach. Boxes on frequently asked questions provide background and ensure that readers are not alone with their questions. Progress in the beginning is slow, but given that "money enters into the economic scheme in an essential and peculiar manner" that is to be expected. After learning that government spends first and taxes later (taxes drive money), and that banks can create money without

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any need for savings, the student needs some time to think through the consequences. Wray provides plenty of space and issues to ease this thinking..

The changes in the second edition are modest. There are no major revisions of how balance sheets 'work'. The old chapter eight on the nature of money was deleted, which is probably a good idea: Understanding modern money does not require the reader to understand monetary history, and given that since 1971 money has not been fixed against gold or the dollar, it would probably have overburdened the reader to understand how money used to work. The added chapters on inflation and taxation are useful, even though both topics had been discussed in the first edition.

The second edition remedies weaknesses of the first edition, like adding an appendix on the dynamics of the debt to GDP ratio, and addressing critiques of the 1st edition chapters on taxation and inflation. Nevertheless, the latter chapter does not seem to provide a definitive answer. Baumol's disease and the fact that items are more expensive because they are more useful are offered to explain positive rates of inflation. This seems to be quite a simplification, especially since both issues concern the long-run, whereas the book is otherwise focused on the short-run. Surely in a situation of high aggregate demand some demand-pull inflation is possible? Wray addresses inflation arising from market power – unions and oligopolies – in passing, but then concludes, "some inflation is probably a good thing". While I agree, more space should have been given to labour market institutions. Discussing the role of wage-price spirals in the 1970s, for example, would have added significantly to the chapter. The discussion of the Weimar inflation misses the fact that the Rhineland was occupied by French troops and the German government decided to give money to workers who had been on strike.

The chapter on alternative exchange rate regimes now contains a discussion of monetary history, which I found not very helpful. A bit of economic history does not hurt, but does it help to explain sovereign monetary systems of today? The chapter's main idea is to demonstrate that flexible exchange rates are superior, because they give the most policy discretion. Wray admits that China, even though it runs a pegged exchange rate, has kept all its policy space because it has trillions of US dollars in assets. Additional discussion of other issues connected to flexible exchange rates would have strengthened the book, e.g., countries with trade partners, and pegged currencies, if they devaluate, shift demand to the rest of the world while the inflation rate falls, possibly into negative territory. How should a government react? Also, what happens when there is a need for imported inputs to the industrial sector and the exchange rate depreciates, leading to unwanted high rates of inflation? Some words on industrial policy and trade-offs between domestic and external stability would have helped the reader understand the implications of sovereign monetary systems with flexible exchange rates.

The strongest part of the book is the three longer sections covering the eurozone in chapter 5. Sectoral balances are used to explain what happened and also what needs to happen to resuscitate economic growth. In the book's conclusion, Wray returns to the eurozone crisis boasting that 'MMT got it right'. This seems to be correct. However, claiming "the problem [is] not be the Maastricht Criteria", which limited the public deficit and the public debt to GDP ratio, is something that I find very odd. It is true that the Greek Government ran deficits in excess of the allowed 3%, but without the stability and growth pact (not the Maastricht criteria, which determined who would get into the eurozone in the first place) there would have been no political leverage. Governments would have been able to finance themselves, and the European Central Bank would have

had to buy up their sovereign securities on the secondary bond markets in order to ensure that the interest rate in Greece did not diverge from that of other members of the European Monetary Union. The vicious circle of increasing interest rates and higher debts did not have to happen – rather, it was the stability and growth pact that gave the power over national budgets to the European Union's institutions. Also, it seems to be a bit much to claim that the ECB was 'operating under the thumb of the Bundesbank'. The ECB repeatedly rejected the advice of the Bundesbank, and former 'Bundesbanker' Jürgen Stark stepped down as chief economist of the ECB in 2012 after claiming that the ECB overstepped its mandate by moving into fiscal territory.

All in all, the second edition is an improvement and is recommended. Students at all levels, and the general public, can profitably read the book.

In times of weak demand, it is crucial to understand the limitations and flexibilities of a sovereign monetary system in order to fight unemployment, deflation and stagnation. *Modern Money Theory* hence is a theory that is descriptive, and opens up policy space for whatever is deemed feasible. It is also crucial to point out flawed arguments, like the savings paradox, from a balance sheet perspective. It is perhaps the best book for anyone who wants to understand the basic functioning of modern money.

References

Keynes, J.M. (1936[2010]) *The General Theory of Employment, Interest, and Money*, Harcourt, Brace and Co., New York.