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ORIGINAL ARTICLE

Monetary sovereignty and external constraints: Identifying the flaws of modern monetary theory

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Abstract

The concept of monetary sovereignty employed by Modern Monetary Theory has been criticised on many fronts. One of the most important criticisms points out that Modern Monetary Theorists (MMTers) ignore or underestimate problems arising from external constraints. Another important (and complementary) criticism is that MMTers focus only on purely macroeconomic aspects and ignore political and geopolitical issues. In this paper, we discuss these important criticisms and we conclude that, although the MMT concept of monetary sovereignty is useful and can be considered an analytical advance, it is incomplete and biased because it minimises macroeconomic problems arising from external constraints and because it does not take into account international political factors.

Keywords: chartalism; external constraints; monetary sovereignty; modern monetary theory; money

JEL Codes: E40; E42; E62

Introduction

The concept of the nature of money has always generated debate. In recent years, a specific (and ancient) view of money has become more important, thanks to the growing prominence of authors framed within the Modern Monetary Theory: Chartalism. According to this view, money is a creature of the State whose widespread use is achieved through the demand for taxes denominated in that money. Precisely because of this, taxes have to be logically prior to public spending, since the State could not collect any money until such money existed. The only way for it to exist would be through the State, specifically through its public spending since: 'the state cannot possibly collect currency through taxes before it has provided it through spending' (Tcherneva 2016, 9) (once there is money in circulation, at a point in time taxes can be raised without prior public expenditure and the payment of taxes draws on existing State money). However, MMTers note that the latter assertion is not even true in all cases and situations, as it will depend on the specific circumstances surrounding the particular state. This issue leads us to talk about monetary sovereignty, a relatively simple but highly controversial concept, which has been strongly contested by critics of MMT.

For MMT, a State has monetary sovereignty when it issues the currency it uses, when it allows it to float freely in the market, and when the public debt issued is denominated in the currency it issues. If these conditions are fulfilled, the State would have the ability to mobilise its own domestic and real resources (because they are sold in the unit of account issued by the State; the same does not occur with foreign real resources) (Ehnts and Wray

2024), which would give it the capacity to reach full employment without losing price stability. However, critics challenge this idea in many different ways, among them the fact that, in open economies such as present times, the stability of the national currency will depend on productive and trade relations with the external sector, so that simple internal control of the national currency does not confer full sovereignty. For example, if the local currency were to depreciate too much – due to a fiscal stimulus – the local economy would only be able to buy products at a higher price, which would imply a loss of real income. In addition, critics also point out that the position of each country's currency in the world monetary system is important, and is highly dependent on political, as well as economic issues.

In this paper, we will review both the MMT's concept of monetary sovereignty and the criticisms it has received in order to conclude with a clear position on the matter. To achieve this objective, we structure the paper in several parts. First, we review the concept of monetary sovereignty used by MMTers. Secondly, we review the most important criticisms that this concept has received. Thirdly, we discuss the responses to these criticisms. Finally, we draw our conclusions.

MMT concept of monetary sovereignty

The MMT places great emphasis on the distinction between the issuer of money and the users of money. The state that creates the money that is used is the issuer, while the households and firms (as well as other regional governments) that use the money are the users. This is a simplification for ease of exposition, although the matter is more complex. It is the central bank which issues money whereas it is government which spends (central bank) money, but MMTers consolidate the two institutions. Moreover, private individuals do not directly use the money created by central bank which is held by commercial banks as reserves. Private individuals use commercial bank money, but this ultimately depends on state money, according to the MMTers. So, issuer states can spend before collecting (in fact, what MMTers argue is that they have to spend before collecting because otherwise, the money would not exist), but households and firms cannot do so because they cannot create money (banks can create money but that, in any case, from the MMT perspective, such money creation is subordinated to state money). So they have to get money before they can spend it, but issuer states cannot because they create the money that is used by economic agents in their territory.

However, although all households and all firms are users of money, not all states are issuers of money; some are users, and they use money that they do not create. Among these states, there are several types. Some states simply use the currency created by other states, for example, Latin American countries such as Ecuador, Panama, or El Salvador, officially use US dollars. Similarly, European microstates (sovereign countries characterised by having a very small geographical area and, generally, a small population) use euros (or the Swiss franc in the case of Liechtenstein). Obviously, these cases do not operate the chartalist implications; the state cannot spend without first having obtained these currencies somehow, as it cannot create them (Tcherneva 2016, 18).

There are other states that use neither their own currency, nor the currency of another state, but the common currency shared by several countries. Examples are the Eurozone states in Europe or the Common Monetary Area states in Southern Africa. These states are like households and firms: they also need to raise money before they spend it, through taxation, borrowing, or in some other way. They cannot do as money-issuer states do, which is to spend without needing to get money from anywhere. As a result, their fiscal room for manoeuvre is considerably reduced, as Tcherneva explains in the case of the European Monetary Union (EMU) (Tcherneva 2016, 18–19). In reality, belonging to a

monetary union would be tantamount to using a foreign currency, or becoming a regional public administration, as the state in question cannot create money without permission from the issuer public administration (Mitchell 2016a, 11). The EMU, through the Stability and Growth Pact and its successors, seeks to impose limits on budget deficits and debt ratio, and that reduces room for manoeuvre, although in practice, the limits have often not been observed. EMU countries are able to run budget deficits and to expand public expenditure, which implies that the European Central Bank (ECB) does, if indirectly, provide the currency to national governments.

Indeed, regional governments are not issuers of money either, even if they belong to a state that is. So regional administrations also need to raise money before they can spend it, whether by taxation, borrowing or otherwise (grants received, sale of assets . . .). This is what has led some proponents of MMT to suggest a redesign of the countries' fiscal federalism so that it is the money-issuer state administrations that bear the heaviest fiscal burden, thereby relieving the pressure on the non-money-issuer regional administrations (He and Jia 2020; Liu and Wray 2016; Wray 2019).

Consequently, the chartalist thesis that taxes do not finance public spending only applies to currency-issuer states, not to user states or regional governments, which are by definition, users of the money. In any case, according to the MMT, the money used by these user states always comes from an issuing state. They can create money and give it to these user states or regional administrations. Moreover, if they were to do so systematically and free of charge or in exchange for very advantageous conditions (lower interest rates, few guarantees . . .), these recipient public administrations would have greater scope to increase public spending without having to resort solely to taxes or borrowing.

However, the MMT also envisages important differences between money-issuer states. On the one hand, there are states that link the value of their currency to the value of the currency of another state (e.g. Denmark, some countries in the Balkans, the Persian Gulf and Central Africa, which link their currencies to those of the euro and the dollar). This implies limits on creating their own money, because if they create more than they should, then the value of their currency may fall relative to that of the reference currency, and this is something they want to avoid (Tcherneva 2016, 9). As a result, these issuer states do not have full monetary sovereignty, because, as they have committed their currency to be pegged to others, they cannot create as much money as they want; they are dependent on what the states of the currencies they have pegged to do. In this case, they might be forced to resort to financing their new spending through taxation or borrowing rather than by creating new money. But the MMT stresses that this is a self-imposed constraint because they are in fact issuers of their own money and could cancel this commitment and have a free hand to create as much money as they need. This is why, according to Tcherneva, when there are severe economic problems, states often break such a process (Tcherneva 2016, 20).

However, as Tymoigne (2020) points out, some states can peg their currency to a foreign currency and enjoy broad – albeit, not full – fiscal flexibility if they hold a lot of international reserves, thanks to their favourable external balance, something that may derive from their pattern of economic growth. In such cases, abandoning monetary sovereignty would not necessarily be as detrimental to them as to other states with a worse external balance (Tymoigne 2020, 3).

Finally, there are states that, although they issue their own money and do not tie it to any other currency, have borrowed in a foreign currency. In this case, these states are obliged to pay their debts with a currency that they do not issue. This puts them in a more compromising situation than those who borrow in their own currency because the latter will always be able to pay their debts (by creating money). But these states we are talking about cannot create a foreign currency to pay off their debt. For example, Argentina is a country that, although it issues its own money – Argentine pesos – it tends to borrow in a

foreign currency, usually the US dollar. Again, the MMT stresses that this is a political decision, even though it is traditionally an imposition by international institutions; the key point is that they are not obliged to do so.

Consequently, full monetary sovereignty, which allows a state to spend without any financial constraint, would only be enjoyed by issuing states that do not tie the value of their currency to any other currency or asset, and that do not borrow in foreign currency, such as the United States, Japan, Switzerland, and Australia. These states would enjoy maximum fiscal space because they would not need to collect taxes to finance their spending. Nor would they need to obtain any foreign currency or tie the value of their currency to any asset, so they could spend as much as they wanted and also avoid insolvency or bankruptcy if they wanted to (Mitchell 2016, 10).

However, their spending would have other kinds of limits, such as the availability of real resources or political considerations (Tcherneva 2016, 20). In other words, Eric Tymoigne underlines this point: 'a [sovereign] government faces no financial constraint; it cannot involuntarily run of out of money. Such a government, however, does face political and potential resource constraints that limit its ability to operate in the domestic economy' (Tymoigne 2020, 68).

The issue of political constraints is not a minor one for MMT; its authors point out that it is possible (and frequent) for a state with full monetary sovereignty to self-impose spending constraints. This is the case, for example, with the United States, which has a debt ceiling, or Australia, which is obliged not to exceed certain deficit or debt levels. In this case, if the state does not want to violate the legal provision, the state would not be able to spend as much as it wants. Of course, the MMT insists that it is important to be clear that these would be voluntary, political restrictions, not technical constraints (Wray 2015, 138; Mitchell 2016, 16; Nersisyan and Wray 2016;). Anyway, in most cases, the legal provision is changed, or circumvented in some way. Thus, in cases such as the UK, where the limits may not have force of law, they are simply side-stepped as required. Moreover, the limits apply to deficits and/or debt ratios, rather than the ability to finance government expenditure.

In short, 'MMT does not conceive of monetary sovereignty as a binary state.[1] Ideally, it is imagined as a matter of degree or a spectrum on which we can place different countries according to whether they have more or less of that sovereignty' (Kelton 2020, 315). Specifically, 'at one end of the spectrum are fully sovereign monetary regimes. These are cases where the state issues non-convertible freely floating national currency (. . .) At the other end of the spectrum are countries that have completely abdicated monetary sovereignty, thus giving up the right to issue and manage their own national currency' (Tcherneva 2016, 17–18). Taking this classification into account would be crucial to facilitate policy recommendations (Liu and Wray 2016).

Criticism of the MMT concept of monetary sovereignty

The MMT concept of monetary sovereignty has been widely questioned. From an orthodox point of commodity-money view – the use of money emerges from a barter economy to get away from issues of the 'double coincidence of wants' and to facilitate trade – the critique is simple: since money is a creature of the market and not of the state, the state does not have monetary sovereignty but depends on the private sector to be able to make any expenditure, by raising money first, by borrowing, or by obtaining it in some other way. If the private sector loses confidence in the state for whatever reason – usually financial irresponsibility for spending too much or creating too much money – then the state's currency would be less valued and used. As economist Robert Murphy summarises, 'in short, the reason most governments (including state governments in the US) in the world

aren't "monetary sovereigns" is that members of the financial community are worried that they would abuse a printing press' (Murphy 2020, 239–240). From this point of view, it is the loss of confidence in the state currency by economic agents that leads states to abandon their monetary sovereignty (using a foreign currency, pegging or borrowing in it) (Murphy 2020, 240).

Moreover, the loss of confidence in the state currency by private agents could affect even the most developed economies issuing their own currency. For example, Omran and Zelmer (2021) point out that even the Canadian state could suffer a significant devaluation of its currency (leading to import-led inflation and less fiscal space) if financial investors lose confidence in the stability of its public finances (Omran and Zelmer 2021, 8). The key would be that investors, in a context of international capital freedom, would be able to withdraw their funds quickly and easily from any country about which they had the slightest doubts regarding the stability of public accounts. Therefore, they criticise MMT on the grounds that it 'overstates the degree of monetary sovereignty that governments enjoy in a world where both domestic and foreign investors can deploy their funds wherever they see fit with the click of a mouse' (Omran and Zelmer 2021, 3).

As can be seen, orthodox critics consider that the monetary sovereignty of countries depends on the mood and actions of private agents, especially financial ones. In contrast, the criticisms coming from the heterodox world are much more complex.

The main criticism of the MMT concept of monetary sovereignty from a heterodox point of view, is that it is only valid for a very few national economies, most notably the United States. After all, most economies use a foreign currency (or link it to another currency, if they do not borrow in foreign currency), so the concept of full monetary sovereignty would only apply to a few of the more than 200 states in the world. Hence, the usefulness of the concept of monetary sovereignty and MMT itself is questioned from the beginning; they would only apply to those few economies, not the rest (Epstein 2019). This is why MMT is often criticised for suffering from a view that focuses only on developed economies and does not contribute much to developing economies (Cesaratto 2020; Vergnhanini and de Conti 2018; Bonizzi et al 2019; Epstein 2019; Edwards 2019).

In any case, the central issue is not that most states do not currently have monetary sovereignty, which is not in dispute (although some authors such as Marc Lavoie (2022) consider that the definition provided by MMTers is insufficient), but rather, whether they can ever have it. While MMT does not ignore the current situation of most countries, it simply points out that, as long as they do not have full monetary sovereignty, they will have less fiscal space than economies that do. As a corollary, its policy recommendation for these countries is not to use foreign currencies, to establish a flexible exchange rate so as not to tie themselves to any other currency or asset, and not to borrow in foreign currency (Mitchell 2016b; Kelton 2020, 31). The point made by most critics is that these economies, even if they wanted to, cannot do such a thing. Why? Basically because of the implications of the 'external constraint', as developed by several authors, including Thirlwall (1979); that is: the limitations that a country faces in its economic growth and development due to its reliance on foreign currency or foreign resources to support its balance of payments.

According to that approach, most economies need to continually import many products from other countries, for which they need foreign currencies, not their own. This continued trade and current account deficit leads to a constant need for foreign currencies which, if not secured, causes a significant depreciation of their domestic currency (something that makes imports more expensive, which could lead to imported inflation if passed on to other domestic products). Moreover, given the dependence of these economies on financial flows to obtain the foreign currencies they need, any significant withdrawal of financial investment by foreign economic agents could depress the value of the national currency and lead to imported inflation. Finally, in many of these economies

firms and households tend to avoid the local currency and use a foreign currency (usually the US dollar) to protect themselves from the inflation they have historically suffered.

This delicate macroeconomic context would force these economies to abandon their full monetary sovereignty through two different channels. On the one hand, to avoid investment flight by foreign agents, they tend to adopt a fixed exchange rate that sends signals that the currency will remain stable. On the other hand, to obtain the foreign currencies they may need in crisis situations, these economies tend to resort to foreign borrowing (usually US dollars). As a result, these economies would be setting aside full monetary sovereignty – as defined by the MMT – practically out of obligation, in order to avoid financial investment flight and a high depreciation of their currency that would only lead to imported inflation. As Rodrigo Vergnhanini and Bruno De Conti summarise: 'in the context of financial globalization, are not fully sovereign in determining its own macroeconomic policy (. . .) the exchange rate is potentially under the pressure of this capital flows movements. Finally, monetary, fiscal and exchange policies in peripheral countries have constrains that are not considered by MMT' (Vergnhanini and De Conti 2018, 16).

This is why only a few national economies, whose currencies enjoy a certain stability, could afford to meet the criteria for full monetary sovereignty even if they were to run continued current account deficits. One of the most important factors that would make currencies stable is that they are in demand internationally because they are used in trade, financial transactions, or simply as a store of value. Hence, some like Epstein point out that 'only countries that issue their own internationally accepted currency ("hard currency") could have the policy space to pursue MMT policies' (Epstein 2019). Some critics have emphasised that this comes about because of the economic, political, and financial strength of the country in question: 'not all national currencies are on the same plane. There are currencies that by virtue of the economic and political soundness and financial solvency of the issuing country (which for example has no history of financial failure) are commonly accepted in international payments' (Cesaratto 2020). This approach reverses the causality between monetary sovereignty and exchange rate flexibility posited by MMT. Instead of the flexible exchange rate granting monetary sovereignty, it is precisely monetary sovereignty that grants the possibility of establishing a flexible exchange rate (Bonizzi et al 2019).

Some go further and indicate that, in reality, only the United States has complete monetary sovereignty because its currency is the only hegemonic one at the international level, used also massively as an international reserve. It is estimated that 90% of world trade is conducted in dollars (Reinbold and Wen 2019) and that approximately 60% of international reserves are denominated in dollars (FED 2021), which de Gaulle's Finance Minister Giscard D'Estaing called an 'exorbitant privilege' (Ocampo 2021, 49).

It has also been pointed out that it is not necessary for the currency to be used internationally to enjoy monetary sovereignty, it can also routinely run current account surpluses, which is just what gives them enough foreign currencies and international reserves to control the stability of their own currency (Vergnhanini and de Conti 2018, 23). As mentioned above, this is something that the MMT also contemplates: countries that maintain a sustained current account surplus 'have a steady inflow of foreign currency reserves, they are able to maintain an exchange rate peg even while pursuing domestic policy independence and (if they desire) free capital flows' (Wray 2012, 139). This recognition does not run counter to the MMT postulates of monetary sovereignty. Even if having a flexible exchange rate always provides more fiscal space, it does not mean that it is not possible to have ample fiscal space with a fixed exchange rate, even if this requires running current account surpluses. If this were no longer the case, the state would lose that greater degree of fiscal space. By contrast, this would never happen if the flexible exchange rate is maintained; so for the MMT, the latter is a preferable option for fiscal

space, especially given that, by accounting identity, it is not possible for every economy in the world to run current account surpluses.

From a Marxist point of view, it is emphasised that it is not only the economic or commercial power of these developed economies that explains why their currencies are used in the global monetary system, but also their political and military power. One scholar has noted that 'those superpowers like the United States can afford a significant surplus of imports over exports because the strength of their monetary domination is based on their political and military power, which keeps the demand for their currency. (. . .) However, the economic capacity of individual states is reduced by neo-chartalists to strictly accounting issues, while the political dimension seems neutral' (Winczewski 2021, 12). This idea is shared by analysts of development economics and international political economy (notably Helleiner 1994, Strange 1988 and Kaltenbrunner and Paanceira, 2018). This would have been the case throughout history, as Kirshner (1995) explains. Central or hegemonic states manipulate international money markets, controlling exchange rates or disrupting the functioning of financial markets, in order to subjugate weaker countries in the periphery. As Lapavitsas and Aguila aver, 'international monetary payments to have an obligatory rather than a voluntary character, that is, nations are obliged to deliver the prevailing form of world money. (. . .) Lack of monetary sovereignty is the result of international structural constraints, rather than policy choices' (Lapavitsas and Aguila 2020, 14).

From a Keynesian point of view, Prates (2020) combines this factor of the political position of currency at the international level with the concept of monetary sovereignty (understood here as the ability to issue the currency being used) to explain the degree of policy space available to different countries. Therefore, from this point of view, simply having monetary sovereignty does not confer the greatest degree of fiscal manoeuvre, but it is also important to consider the position of the currency in the international hierarchy of currencies. This hierarchy would be explained by the liquidity of currencies, which in turn, following Davidson (1972), would depend on the number of contracts signed and which would be related to their capacity to perform the three functions of money at the global level. Thus, at the top of the pyramid would be the most liquid and used currency of all, the US dollar, which would act as the centrepiece around which the other, less liquid and used currencies would be organised; it would be followed by the euro as an important international reserve currency; then the currencies of the other central economies; and finally the currencies of the peripheral economies (Prates 2020, 503).

According to this classification, the state with the highest degree of fiscal space would be the United States, followed by the rest of the central economies with their own currency (Japan, Canada, United Kingdom, Australia . . .). These would be placed before the Eurozone states as they do not have monetary sovereignty (to the Eurozone countries, could be added countries such as Denmark with fixed rate to the euro and generally constrained by limits on budget deficits and debt). Next to Eurozone would be the developing economy states that have monetary sovereignty, then those that have partial monetary sovereignty because they do not manage to have their currency fully used in their own territory, and finally those that do not issue their own currency. As can be seen, this is a more complex and detailed classification than the one made by the MMT. Not surprisingly, it reaches different conclusions, since, for example, it places the Eurozone with a higher degree of fiscal space than other states with monetary sovereignty: 'if we consider the actual monetary, financial, and macroeconomic asymmetries of the current IMFS, we come to very different conclusions from Wray's (2015) one regarding the relationship between policy space and exchange-rate regimes in emerging-market economies' (Prates 2020, 505).

Related to this last assessment is the criticism by Marc Lavoie (2022), who considers that the current MMT concept of monetary sovereignty, besides being insufficiently

defined, does not fit well with the institutional set up of the European Monetary Union. From his point of view, the Eurozone crisis arose from the combination of Maastricht-like rules and the convention that the ECB would not act as a purchaser of last resort, something necessary for monetary sovereignty.

On the other hand, there are critics who consider that even countries whose currency is used internationally do not have full monetary sovereignty, basically because such a phenomenon might cease to occur and thus the privilege might end (Epstein 2019). Moreover, some critics believe that, today, even the United States is not safe from losing its full sovereign status, something that recent history would have already demonstrated. As Palley (2020) argues, 'the reality that the United States is, in principle, potentially subject to the same kind of constraints as other governments is evidenced by the economic history of the 1970s. That era was a period of dollar weakness, and shows that the US can also be subject to strong financial constraints'.

Discussion

Many supporters of MMT recognise that the United States is in an extraordinary position because of its 'exorbitant privilege', or as one analyst notes, 'the United States is special in the sense that the US dollar (USD) plays a central role in the international monetary system' (Tymoigne 2020, 13). They also recognise that something similar is true of the major developed economies: 'countries such as Japan, the United Kingdom and Australia also have a high degree of monetary sovereignty. Even China, which administers and decrees the value of the yuan, enjoys considerable monetary sovereignty' (Kelton 2020, 315). Although there are other MMT authors, such as Fazi and Mitchell, who have rejected the idea that there is a hierarchy of currencies dominated by the dollar: '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, as outlined above' (Fazi and Mitchell 2019).

The main point, in any case, is that MMT authors consider that any country can have full monetary sovereignty, and even less developed economies can claim such (Wray 2014, 2015, 186). The idea is not that an economy, simply by achieving monetary sovereignty, will reach a certain level of development or that it will be free of problems. Rather, the idea is that it will thus be able to freely mobilise all idle real resources that are sold in the currency issued by the sovereign state, or more specifically, 'of course, issuing one's own currency doesn't make a nation "rich." 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). In this sense, proponents of MMT reject 'external constraint' altogether and replace it with 'real resource constraint', which would be very different (Mitchell 2016c), and which may greatly limit the potential of poorer economiesIt t would, in any case, present fewer limits than if the state were to abandon its monetary sovereignty, thus 'while there are some general statements that can be made with respect to MMT that apply to any nation where the government issues its own currency, floats its exchange rate, and does not incur foreign currency-denominated debt, we also have to acknowledge special cases that need special policy attention. In the latter case, the specific problems facing a nation cannot be easily overcome *just* by increasing fiscal deficits' (Mitchell 2016c).

There are several arguments used by MMT proponents to deny the external constraint. The first is that running continuing current account deficits does not necessarily imply currency devaluation, thus 'while the usual assumption is that current account deficits

lead more-or-less directly to currency depreciation, the evidence for this effect is nor clear-cut' (Wray 2012, 139). They have often presented some real examples to empirically support such an assertion, such as in the case of Australia. As one author asked, 'why hasn't the growing current account deficit over the last 40 years or more precipitated a balance of payments crisis?' (Mitchell 2016b). This has been answered by Cesaratto pointing out that the case of the Australian currency is special and not extrapolable to the rest of national economies, not only for reasons of international positioning of the currency but also for reasons of real wealth and stabilisation in external debt over GDP. Indeed as has been asserted, 'Commonwealth WASP countries seem to enjoy this privilege (...) The economic, social and institutional stability of these countries has probably favoured this privilege, as has their immense natural wealth. Moreover, being constantly indebted to other countries counts for little if the economy develops and the debt-to-GDP ratio is stable' (Cesaratto 2020).

The second argument of MMT to deny the importance of the external constraint is that any misalignment that the current account deficit may produce will sooner or later be corrected by the exchange rate since depreciation cannot happen forever; either the depreciation itself makes exports so cheap that its momentum stabilises the exchange rate, or external agents stop saving in local currency, so that the current account deficit would disappear, and therefore so would the depreciation (Mitchell 2016c). Moreover, the risk that such currency depreciation could lead to import-led inflation, appears to be minimised given that, 'these exchange rate movements will tend to be once off adjustments anyway to the higher growth path and need not be a source of on-going inflationary pressure' (Mitchell 2016b).

Moreover, regarding the criticism that having a fixed exchange rate is a necessity for many economies to show monetary stability, the inference here is that speculation against the domestic currency would be counter-productive. However, MMTers note that history shows that even a monetarily sovereign economy such as the United Kingdom is vulnerable to speculation when it imposes a fixed exchange rate – see the analysis of the collapse of the European Exchange Rate Mechanism in 1992 (Mitchell et al 2019, 509). Developing economies with (i) their currencies being subject to limited trading on currency markets; (ii) being reliant on imported capital goods; and (iii) having minimal export capacity would be vulnerable to speculation.

Consequently, while MMT recognises the complicated situation of many developing economies, they still maintain that all of them can achieve full monetary sovereignty to mobilise whatever real resources they have. This approach would not be invalidated; they recognise that if the economy has few real resources, then it will have more trouble increasing economic development and social welfare (Wray 2014). In any case, MMTers believe that enjoying full monetary sovereignty gives these countries more fiscal space to achieve their objectives, so they should ideally use the monetary sovereignty they have achieved to develop and diversify their productive structure and their energy and food self-sufficiency. In these ways, they are not so dependent on imports and not so sensitive to currency depreciations (Kaboub 2013; 2019a; 2019b; Mitchell 2016b, 2016c). However, they also point out that they may need to implement some additional measures to protect themselves from the risks of sharp devaluation, such as, for example, capital or import controls:

> *The MMT principles apply to all sovereign countries. Yes, they can have full employment at home. Yes, that could lead to trade deficits. Yes that could (possibly) lead to currency depreciation. Yes that could lead to inflation pass-through. But they have lots of policy options available if they do not like those results. Import controls and capital controls are examples of policy options. Directed employment, directed investment, and targeted development are also policy options* (Wray 2014).

Capital controls are thus understood as a last resort that certain economies should use to, above all, protect themselves from speculative movements in finance. As one noted author has asserted, 'nations should consider imposing capital controls where they can be beneficial bulwarks against the destructive forces of speculative financial capitalism' (Mitchell 2016c). Such forces, that, according to Mitchell, it would be desirable to prohibit and abolish 'a further progressive policy intervention, which, ideally, should be agreed to at the international level should be to declare illegal speculative financial flows that have no necessary relationship with improving the operation of the real economy' (Mitchell 2016c). Another possibility mentioned to prevent government spending being transformed into imports and putting pressure on currency devaluation is to make in-kind payments, thus, 'payments in kind may also be necessary (to make sure to create a demand for the domestic production and to avoid imports of foreign products that are similar)' (Tymoigne and Wray 2013).

They also incorporate a class view to point out that it is, after all, a choice between different scenarios in which there are different winners and losers. Outcomes can be either full employment and some depreciation and inflation, which they believe would benefit the poorer population and hurt the better-off; or unemployment and low inflation and a stable currency value, which would benefit those at the top to the detriment of those at the bottom. It would therefore be a purely ideological and political question. On the one hand, maintaining a fixed exchange rate would particularly benefit the wealthy (Wray 2014). On the other hand, currency depreciation – the result of letting the currency float freely – could especially benefit the unemployed, who are most in need, and hurt the better-off (Mitchell 2016c).

In any case, several proponents of MMT have pointed out that the serious problems faced by less developed economies should not be solved by themselves in isolation but should be addressed internationally in a way that developed economies really do their part. One possibility mentioned by Mitchell is to create an international institution that would provide sufficient real (non-monetary) resources to the neediest economies (Mitchell 2016c). Alternatively, Kelton suggests that the United States could use its 'exorbitant privilege' of creating dollars with stable value to mobilise the idle resources of all the world's economies to achieve full employment with price stability:

> *The US government can supply all the dollars our domestic private sector needs to achieve full employment, just as it can supply all the dollars the rest of the world needs to accumulate its own reserves and protect its trade flows. Instead of using its monetary hegemony to mobilise global resources in its own limited self-interest, the United States could thus lead a campaign to mobilise resources for an international Green New Deal that would keep interest rates low and stable to promote global economic calm* (Kelton 2020, 181).

In the case of the European Monetary Union, Ehnts and Wray (2024) argue that while there was a problem with the original set up of the system, as Lavoie (2022) pointed out, this has been mitigated in the aftermath of the global financial crisis and the more recent COVID-19 pandemic. The Euro area's institutions allow some flexibility, allowing national governments to act as unconstrained currency issuers in times of crisis. The ECB's role as dealer of last resort for government bonds has made this possible, together with the general escape clause in the Stability and Growth Pact, and allows shut down of the excessive deficit procedure, which is the major constraint on the fiscal framework.

Conclusions

The concept of monetary sovereignty used by the MMT is useful analytically despite its simplicity, and it is surprising that it has hardly been considered in academia when

analysing the different macroeconomic situations of countries. However, despite its usefulness, the criticisms it has received have shown it to be an incomplete concept. Some of these criticisms are correct in pointing out that full monetary sovereignty approaches are not equally applicable to all economies around the world, and that many developing economies face significant constraints in achieving and enjoying full monetary sovereignty. While it is true that the proponents of MMT are right to point out that any developing economy could enjoy full monetary sovereignty (own currency, flexible exchange rate, and own currency debt) and thus mobilise all the real resources at its disposal (whether many or few), it is also true that they underplay the economic problems that many developing economies would face if they tried to do so.

In particular, it is hard to find any mention by supporters of MMT of the problem of imported inflation. Even if we agree with them that currency depreciation cannot last forever and that it might even benefit the poorest and hurt the richest, the real problem is that during this time, the rise in import prices can raise the prices of domestic products significantly, dealing a heavy blow to economic activity, and so, the population as a whole. However, this problem is hardly considered by supporters of the MMT, and when they do address it, they minimise its importance. It is not merely a question of a lack of real resources, it is a specifically monetary issue that could make things very difficult for the economy concerned beyond its material wealth. Even with full employment, if inflation is out of control, the situation may be worse for the whole population, not just for the wealthiest. But, in any case, it is true that this is a political and ideological question: it depends on whether one wants to give more weight to full employment or to price stability. Still, the best possible solution to this complex problem must come from the developed economies as some advocates of MMT have proposed, not from the developing economies individually.

Part of this incomplete analysis of monetary sovereignty is due to a strictly economic definition of the concept, when in fact, as many critics point out, monetary sovereignty is not only an economic concept but also a political one. Proponents of MMT speak of monetary sovereignty as a gradient of situations in which only the institutional details (currency issuance, exchange rate and debt issuance) matter, but they forget that the position of each of these states on the geopolitical chessboard is fundamental. This omission prevents them from providing convincing explanations for some situations. For example, the MMT concept of monetary sovereignty alone cannot explain why the United States has a currency that is much more widely used than others. Nor can the chartalist view offer enough. The world's hegemonic currency is not so because its state collects more taxes than anyone else; it is so for quite another reason. A further example is that the MMT concept of monetary sovereignty cannot explain why Eurozone states, even if they cannot issue the currency they use, are better off than many developing economy states that can issue the currency they use. The last example of the limits of the concept of monetary sovereignty is that it cannot explain why there are states that, even though they have full monetary sovereignty, do not manage to have their currency used in their own territory and why part of their transactions are carried out in foreign currencies (usually the US dollar). On the other hand, all these cases can be better explained if the political issue is included. The US dollar is hegemonic because its State is the world's number one economic, military, cultural, and technological power, the euro is more stable than the currencies of developing economies because of the Eurozone's significant political weight on the planet, and finally there are countries in which economic agents use currencies other than those issued by their State because their political power is weakened or in question.

This does not imply a challenge to the concept of monetary sovereignty used by MMT. Rather, it could be seen as the incorporation of the political question as enriching the analysis without overthrowing the concept. After all, the institutional details of the

monetary sphere raised by MMT are important for analysing countries' fiscal room for manoeuvre, and this is a very valuable contribution. The only thing is that, although it makes an important contribution, the concept of monetary sovereignty falls short of accurately explaining the reality.

Note

1 There is only one proponent of MMT, its founder, Warren Mosler, who opposes the multifaceted concept of monetary sovereignty because he considers that it increases confusion and makes it susceptible to a multitude of criticisms. For him, the important thing is to know whether the state is the sole issuer of the currency or not; 'but it is not necessary to be sovereign to be the sole issuer' (Medina 2021).

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