Fundamental Frictions of Legal and Political Policy of National Economic in Contrast to the Capital and Result based Economic System in *Modern Monetary Theory*

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Abstract. The Modern Monetary Theory (MMT) has been one of the most argued and discussed since it is being implemented by countries in the world with various degrees of success, which generally is claimed to be effective in strengthening the economy in various sectors and perspectives. The discussion addresses the problems of main factors causing MMT to collide with Indonesia's economic system and the adjustment on the frictions so that it can be implemented effectively. This study involved secondary data and employed a normative and empirical legal approach with qualitative data analysis techniques to investigate policies that were contrasted to the MMT concept. The findings showed that the MMT concept was predicted to bring some fundamental frictions regarding financial policymaking in Indonesia. Therefore, the adjustment is suggested by reorienting the national economic-political goals to the concept of a new economic perspective, i.e. the concept of a Protective Economy that encourages independence.

Keywords: Policy; Fundamental Friction; Modern Monetary Theory

1 Introduction

Apart from the military and technology, the economy is one factor that becomes an indicator of state strength because the advancement of the economy creates strength and prosperity for its community. If a country's economy is weak, it becomes unreliable and even means that the country is not sovereign in its homeland. Therefore, a country needs to have a good system of economic democracy, without economic democracy, a nation has not be categorized as an independent (1). Indonesia is an independent country, yet there are times when its economy is in a dilemma between independence and colonization due to its reliance on the developed countries which has significant impacts on the life of the national economy. It can be seen in the undertaken policies which frequently cause misunderstanding and, in some cases, lead to losses. It is against the purpose of the Indonesian constitution, which is stated in the preamble of the 1945 Constitution in the 4th paragraph: "…to form a government of the State of Indonesia which protects the entire Indonesian nation in order to promote the general welfare, to educate the nation's life and participate in carrying out world order based

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on freedom, eternal peace, and social justice"(2). As a result, the existence of policies that causes losses is incorrect phenomenon when compared to what the Indonesian constitution aspires to achieve.

Another example can be found in the amendments made to the 1945 Constitution, which demanded the implementation of economic democracy, as stated in Article 33 paragraph (4) of the 1945 Constitution(2). In the economic democracy, the principle of efficiency-fairness is introduced which is suspected to be a component of a capitalist economic system that carries the spirit of neoliberalism(3), so there is a part of the law that is apparently not in accordance with the philosophy of the nation. The issue is discussed further in this article. In understanding macro and microeconomics, money becomes the pulse. In the implementation, the system in applying money is called as a financial system. This system is a central concept for the economy where the direction of the economy is strongly influenced by the management policies of the financial system. There are a number of bodies responsible for the growth and development of the national economy in Indonesia, with powers that are distributed and coordinated with one another because the economy is a very complex domain. Therefore, it needs to map the economy based on the authority they have, among the Ministry, Agency, or Institution including the Coordinating Ministry for the Economy, Ministry of Finance, Financial Services Authority (OJK), Bank Indonesia (BI), Investment Coordinating Board (BKPM), Deposit Insurance Corporation (LPS) and others.

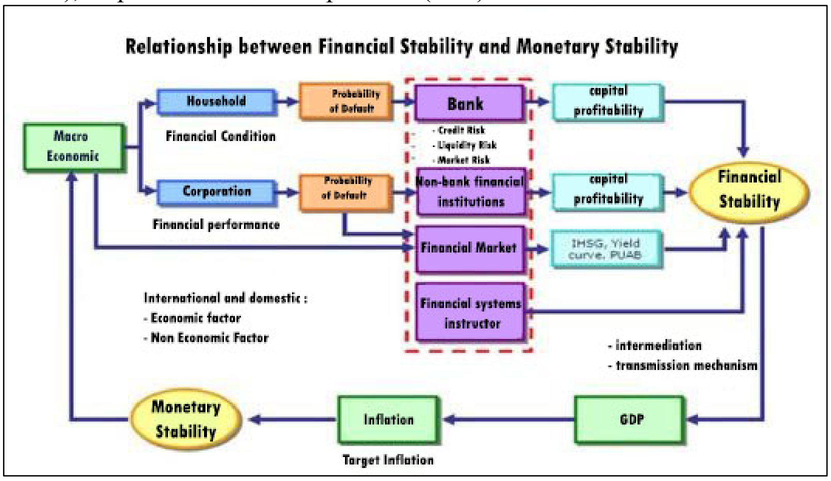

Fig. 1. Relationship betwen Financial Stability and Monetary Stability

The main discussion of this article is about the comparison between Modern Monetary Theory, which focuses on the financial system and monetary system, and national economic policies. The scope of the discussion of this article is limited to the financial system, as well as referring to the monetary system, where currently the relationship between financial stability and monetary stability is concerned. In Indonesian, macroeconomics is described as a broad picture of the overall economy which in its application affects households and corporations. The households and corporations are connected to financial institutions according to their needs which are also related to their respective development. In the run, it indicates the level of financial system stability, which builds the Gross Domestic Product (GDP). Based on the GDP, inflation rate monitoring is carried out as well as a policy-making compass that creates monetary stability. Eventually, the monetary stability will affect macroeconomic policies.

The implementation of this function suggests that the Ministry of Finance plays a significant role in the development carried out by the current government. One of the most important issues is related to the funding of national strategic projects development that costs the state a lot of money. It raises the question of whether the state has sufficient funds for its implementation. The obvious answer is no, as the government frequently runs a deficit, then several other financing policy schemes are chosen for the implementation of the development. The income strategies that are usually utilized as options to carry out the national development are tax and non-tax revenue schemes, debt schemes, investment financing schemes, State-Owned Enterprises (BUMN) revenues, and other schemes. The schemes aim to restore the state treasury to carry out the government and development.

During the Covid-19 pandemic, the economy experienced pressure or depression, resulting in an exceptional recession that affects numerous sectors and impeded significantly the economic growth. In other words, the source of government revenue that was previously reliable is deteriorating and results in a systemic effect that weakens the stability of financial and monetary which will eventually threaten the economic stability. This issue has prompted many people to consider adopting a new habit, commonly known as the new normal and reviewing some existing economic theories to avoid the worsening crisis. One of the most discussed topics is implementing the Modern Monetary Theory System which might be implemented by several developed countries such as America, Canada, China, and Japan to run their economies. Could this theory be adopted and have a favorable effect on re-growing the Indonesian economy? To answer the question, this article was developed. Furthermore, it examined the main factors that lead MMT to collide with the Indonesian economic system as well as proposed to alleviate the frictions so that it can be implemented in the Indonesian economic system.

2 Methodology

A combination of juridical normative and empirical approaches was employed to carry out the research. The approach refers to legal norms contained in laws and regulations and responds to the implementation of economic policies in carrying out these rules. The norms were compared with the theory that is the focus of the discussion. Thus, this research is analytical descriptive which uses secondary data to be processed to get answers to the problems (4).

3 Results and Discussion

The discussion in this article involved international issues which was an important topic because as a legal state, the determination of economic direction and strategy must be based on the law and follow the developments of the world geo-strategies and geo-economics. So, this article is intended to answer existing questions and is expected to be a source of thought regarding the initial steps for the introduction of unconventional economic thought such as MMT which is discussed in this paper. Before going further on the discussion, it is important to clearly understand that the basic concept of supply and demand theory is the basis of this discussion and that the theory of supply and demand absolutely influences price formation in the market where prices are formed due to the balance of supply and demand. When converted into financial implementation, the connection is that when more money is circulating, but the quantity of product remains similar, then the price of the product will rise, resulting in a decline of the money value so that inflation occurs. In other words, the excess circulation of money will lead to inflation. This explanation is used to describe the main concerns of the theory in the following discussion.

3.1 Modern Monetary Theory

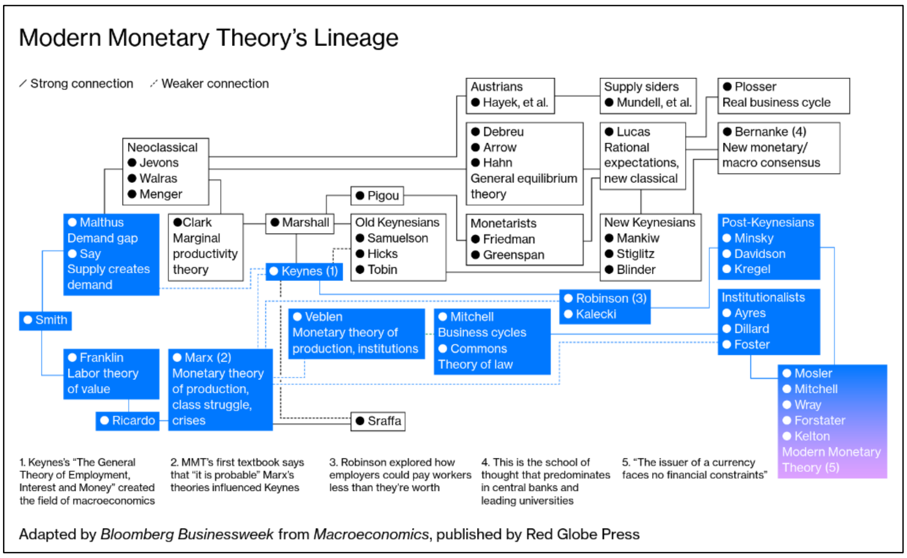

Fig. 2. Medern Monetary Theory's Lineage

Modern Monetary Theory (MMT) is a post-Keynesian system that the initial development occurred in the era of the 90s. It is called Modern Economic theory developed by Professor Bill Mitchell and some academics from the United States such as Professors Randall Wray and Stephanie Kelton(5) as well as a banker namely Warren Mosler. This theory, Warren Mosler' thinking, is derived from the thought of John Maynard Keynes, an economist from England(6) in which this theory put forward the core of Keynes' macro policy; how the government can influence aggregate demand (as a result, it will affect the macro situation), to close its Full Employment position(7). This referred aggregate is the entire amount of money spent by all levels of society to buy goods and services in one year. It can be formulated as follows:

$$Z = C+I+G \quad (1)$$

a) Household consumption expenditure (C)
b) Investment expenditure by the company (I)
c) Government expenditure (G); the government can influence aggregate demand directly through government's expenditure and indirectly on consumption's expenditure and investment's expenditure.

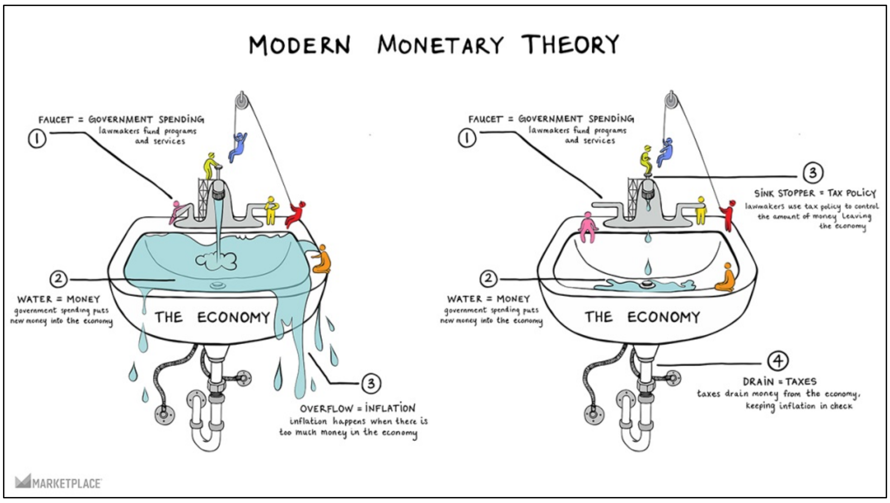

Fig. 3. Model of Modern Monetary Theory

This theoretical model is not recognized visibly by big countries as an adopted method or adhered schools' of thought but apparently, it has been applied by some countries with great world economies such as America, Canada, China, and some countries in the European Union. It is illustrated by the countries' political and economic policies in printing money based on projects carried out with various names. These project examples are the quantitative easing policy by the Fed in March 2020, the policy of quantitative easing and the purchase of bonds in Europe by the European Central Bank in March 2020, Bond Purchases by the Reserve Bank of Australia in March 2020, Bank of England provides direct loans to the government in case of insufficient bonds on April 9, 2020, the Bank of Canada announces purchases of bonds and repos on March 12, 2020, and Purchases of ETFs and corporate bonds by the Bank of Australia Japan in March 2020.

Recently, Modern Monetary Theory (MMT) is discussed intensively in public discussion as the option to solve world economic problems, especially in Indonesia. It is caused by the current implementation of the monetary system by using the *Fiat Money System* (Fiat Financial System) so that it supports this theory's implementation which no longer uses Commodity-Based Money(8) and actually, it has changed the financial milestones in Indonesia and even the world in which the value of the currency is influenced by the instrument that is called GDP (Gross Domestic Product). This is the meant gap that the issuance of money can be done if it meets certain indicators. At a glance, the presented Modern Monetary Theory (MMT) theory can describe the stated scenario above. The government can provide funds by money issuance both directly or in the form of debt/bond which is issued and purchased directly by the Central Bank as the basic form of money issuance. Then, the earned funds from the loan are channeled into productive sectors that the government wants to run with the aims to finance the economic course so that it will have an impact on the high economic growth towards its climax and open up vast employment opportunities to solve unemployment problems significantly. From the amount of money that is put into the market to anticipate inflation, the government controls it through taxes. Taxes are used as a tool to control inflation and some other controls can be done by expanding and investing abroad so that inflation can be overcome. In other words, unlike the current concept applied by many countries that taxes are a source of income but taxes are used as inflation control.

From an MMT perspective, the concept of tax and bond offerings are not funding resources for Treasury but as a reserve draining device to maintain the stability of price and interest rate(9). This becomes one of the essential differences from the current existing macro-economic concept namely the implementation of state finances is not the same as the implementation of household finances. The implementation of MMT is not easy because the main condition for its implementation is the sovereignty of a country's currency which is not intervened easily by other countries. It is caused MMT's implementation to reduce the weight of foreign loans amount that is very burdensome for the economy. This is necessary to be well comprehended to unify perceptions and interests. There always find questions in discussing this theory such as whether the control carried out is indeed proven to be effective in overcoming the problems faced by the current macroeconomy and problems that may arise from this theory's implementation in the economy of a country so that in some articles at the *Levy Economics Institute of Bard College* which discuss this quite a lot. From these articles, it can be seen some perspectives in which the actual criticism of MMT can be grouped into five categories: views on the origin of money and the role of taxes in currency receipt government, views on fiscal policy, views on monetary policy, the relevance of MMT conclusions for developing countries, and validity of MMT policy recommendations(10).

The view of origins of money can be answered that MMT allows a country to print money without making GDP as the only basic parameter but also based on the needs of state spending to carry out development and the economy. Meanwhile, the role of taxes in receipts of government currency is no longer as a source of treasury for the government but as a controller of money circulating in the economy, which causes the state to control inflation not only through instruments in the form of determining interest rates but also through taxes. MMT changes the view of fiscal policy in which obtaining fiscal of the country does not depend on tax revenues and debts, but the state can print its own money sovereignly but still refers to certain parameters both regarding TKDN, Resources, and other parameters. The view of monetary policy adopted by the MMT in the state has great independence and authority to have fresh funding by printing them for the needs of the government, this means economic independence. In short, if you look at the relevance of the MMT conclusion for developing countries, MMT can be a solution for developing countries to be able to grow and utilize their resources as well as their sovereign currency and can overcome financial deficits, reducing the unemployment rate consequently a country is at its economic climax. The last thing that needs to be comprehended that is how the validity of this MMT policy recommendation to be implemented does not result in the worst risk, namely inflation by controlling interest rates from the central bank and controlling taxes from the government through restrictive fiscal policies(11).

3.2 National Economic Management

According to the elaborated theory above, it illustrates the implementation of different strategies, conducted by Indonesia macroeconomic management following the current mainstream strategy in the world in which in implementing macroeconomic policies, the Indonesian Minister of Finance states that debt management is always carried out prudently and professionally. Indonesia always maintains the stability of the financial system in which the meaning of the own financial system are the financial services institutions, financial markets, and financial infrastructure, including the payment system. They interact to facilitate the collection of public funds and their allocation to support national economic activities(12).

In implementing the national economy, some factors become the main attention as the parameter of government concern such as Financial System Stability, Monetary Stability, Tax Policy, Investment Policy and Management of State Debt. In the financial system, there are situations of the government to encounter positive and negative situations. It means that the situation is not always stable. Therefore, it is needed the Financial System Stability (SSK) namely an adjustment of the Financial System effectively and efficiently and be able to withstand shocks originating from within domestic and foreign(13). This term can be interpreted as the condition in which economic mechanisms in pricing, allocation of funds, and risk management function properly and support strong economic growth, are resistant to economic disturbances, and be able to absorb economic shocks. Maintaining the SKK is certainly not easy because the state revenues to carry out their functions are often not on the target. It is caused sometimes by the retarding in tax revenues as well as from some fixed income other countries so that the deficit is experienced which is caused by many factors. For this reason, the Ministry of finance needs to take strategic steps to solve these problems including using loans and debt options. In contrast to MMT, MMT recommends to printed money refer to the government's needs so that the deficit is not experienced. However, certainly, if the concept of printing money is only implemented, it will interfere with the SKK because the improvement of money will cause inflation. It means this concept can't be investigated partially.

One of the parts of financial system is a monetary system. In Indonesia, the monetary system is a step in determining policies and actions that have a chain effect on the interaction of monetary factors in a monetary environment, in this case is the state, including foreign exchange supervision, wherein Indonesia the authority lies in the Bank of Indonesia and the Ministry of Finance as an extension of the government. Meanwhile, the term "monetary policy" itself is defined by the law as a policy determined and implemented by Bank Indonesia to achieve and maintain the stability of the rupiah value, which is carried out, among others, through controlling the money supply and/or interest rates (14). Bank Indonesia has a goal of achieving and maintaining the stability of the value of Rupiah. This goal is mandated by Law No. 6 of 2009 in Article 7. The stability of the rupiah has two dimensions. The first dimension is the stability of the prices of goods and services, which is reflected in the development of the inflation rate. Meanwhile, the second dimension is related to the stability of the Rupiah exchange rate against other currencies. Indonesia adheres to a free floating exchange rate system, namely the supply and demand in the foreign exchange market (Forex) determine the price of a country's currency. The role of exchange rate stability is very important in achieving price stability and stability in the financial system in both positive and negative terms.

Since July 1, 2005, the Indonesian Central Bank has adopted a framework called the Inflation Targeting Framework (ITF)(15), which previously switched from a monetary policy framework with base money to a flexible ITF. This is an adjustment after reflecting on the 2008/2009 global financial crisis. The Flexible ITF framework is built on five main elements, namely: (1) The inflation targeting strategy as the basic strategy of monetary policy; (2). Integration of monetary and macroprudential policies to improve policy transmission while pursuing macroeconomic stability. (3) The role of exchange rate policy and capital flows in supporting macroeconomic stability. (4) Strengthening policy coordination between Bank Indonesia and the government to control inflation as well as to maintain monetary and financial system stability. (5) Strengthening policy communication strategies as part of policy instruments. The implementation of Bank Indonesia's duties as the central bank looks independent in the explanation above because it acts in accordance with the response that the economy needs generally without any demands to carry out institutional requests that affect its policies, especially when it comes to fiscal and quasi-fiscal operations. This is in contrast to the MMT, which makes the central bank or BI explicitly independent because it has to adapt to the needs of the government.

In the current fiscal and quasi-fiscal operations or money printing, the implementation is carried out very strictly with reference to GDP so that the government is not free to print money but is very careful in monitoring the volume of JUB (Amount of money in circulation) because Bank Indonesia and the Indonesian government believe that the more money in circulation, the greater the risk of hyperinflation can definitely occur, so each expenditure budget is carried out by budgeting, which is adjusted from income collected through taxes and other income in the government treasury. For unconventional conditions such as this pandemic period, Bank Indonesia issued a Quantitative Easing (QE) policy, but this was not enough to overcome the deficit. This budget deficit ultimately hampers the government's ability to carry out development and investment, making it very difficult to achieve full employment and economic climax. Thus, the policy taken by the government to cover the deficit is carried out through the option of opening the investment and debt. From this option, the government issued a pro-investment policy in which development financed by investment has a positive as well as a negative side because, basically, investment is an activity to invest funds or capital that is intended to gain profits in the future(16). It means that this is not something free but an activity that is full of bargaining negotiations. Hence, it is not a simple thing because in bargaining, each party has an interest that will be defended. In theory, a win-win solution is an ideal thing to strive for. However, practically, one thing must be sacrificed. In this case, a frequently sacrificed item is public goods such as the environment and labor numbers. Certainly, all of this will take a long time.

To get a shorter time, the debt option is the most optimal. Apparently, we will see data on Indonesia's debt level. Currently, the debt position based on publications in September 2021 State Budget as of the end of August 2021 is IDR 6,625.43 trillion. There was an increase in the amount of IDR 55.27 trillion from the position in July 2021. The data of August 2021 shows that the Gross Domestic Product (GDP) until the end of the month was 40.85%(17). While this amount is still relatively safe when compared to the maximum debt limit of 60% and a deficit of 3% of GDP(18), especially in the rules for handling Covid-19, the deficit may be more than 3%(19). However, this increase will cause long-term pressure on state revenues as the source of income owned by the state. The income power of the state will be depleted to pay the debt and other obligations incurred, , income resources owned by the state will be depleted to pay off debts and other obligations incurred, especially debts denominated in foreign currencies, the exchange rate of which can change at any time from foreign debt. Therefore, maintaining the stability of the exchange rate is something that must be carried out. It means that our currency is not yet independent and sovereign over its debts, while in MMT theory, this is the main requirement for the application of the theory.

4 Conclusion:

The main factors of the friction between MMT and the economic system in Indonesia are:

a) Indonesia’s currency is not yet sovereign when compared to Indonesia's debt burden, because there is still a lot of influence from foreign currencies, especially in debt denominated in foreign currencies.

b) The economic system that still refers to GDP does not allow the Indonesian government to print money freely even though BI has implemented Quantitative Easing (QE), but this is still limited.
c) The concept of taxation is as a source of income, not as a tool to regulate inflation.

The adjustments to friction from the current Indonesian economic system so that MMT can be implemented on it, namely:

a) Indonesia needs to make adjustments to the basic rules regarding finance and monetary GDP.
b) The concept of financial management must be changed as a form of household financial management because, basically, the state is able to print money with its power.
c) Economic parameters related to Quantitative Easing (QE) no longer depend on GDP but are based on the productive value of the economy (aggregate value) to the limit of fully utilized economic capacity (fully employment).

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