The Nature of Money: A System of Credits and Debits

L. Randall Wray, Levy Institute and UMKC
wrayr@umkc.edu
www.levy.org

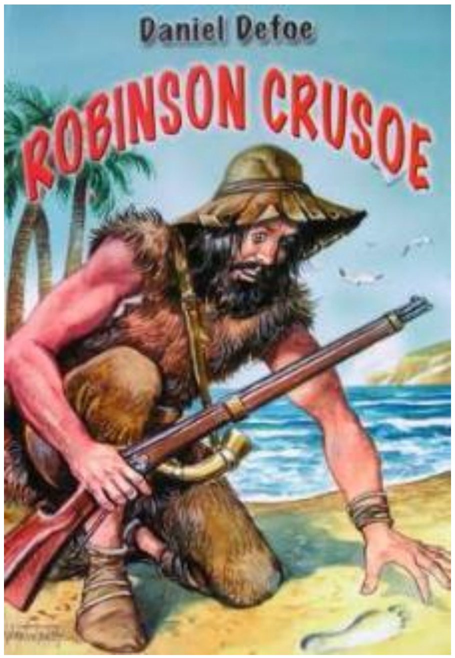
Blogs:

Great Leap Forward http://www.economonitor.com/lrwray/

NEP http://neweconomicperspectives.org/

Orthodox Nature of Money

- The Barter Story



The Goldsmith-Bank Story

Fiscal Constraints

- President Obama: government is running out of money
- Unsustainable debt path
- Look at Euroland!
  - Sovereign debt crisis
  - Default risk
  - Bond vigilantes

Alternative: what is money

- It is a State monopoly
- Social unit of measurement
- State money of acct
- Representation of social value
- Money things; hierarchy of IOUs--Denominated in the state money of acct

Ingham

- Money is social in 3 ways:

  -produced outside mkt; no ind is free to produce own M; must be legitimately sanctioned; counted by those who count

  -monetary exch consists in social relation; unlike barter; involves an IOU

  -today, money-stuff consists in symbol of state’s or bank’s promise to pay

Keynes and State Money

- TOM: "money of account comes into existence along with debts," and he distinguished between "*money* and *money of account* by saying that the money of account is the *description* or *title* and the money is the *thing* which answers to the description" (TOMa p. 3)

- Further, the state "claims the right to determine *what thing* corresponds to the name, and to vary its declaration from time to time—when, that is to say, it claims the right to re-edit the dictionary. This right is claimed by all modern States and has been so claimed for some four thousand years at least." (TOMa p. 4)

Innes and State and Credit Money

- The state “enforces the dictionary” by imposing a tax liability, ensuring the money it issues—denominated in that unit—is generally accepted by agreeing to accept it in tax payments.
- The “very nature of credit throughout the world”, which is “the right of the holder of the credit (the creditor) to hand back to the issuer of the debt (the debtor) the latter’s acknowledgment or obligation”. (Innes 1914, p. 161)
- Government money is “redeemable by the mechanism of taxation” (Innes 1914, p. 15)
- “[I]t is the tax which imparts to the obligation its ‘value’…. A dollar of money is a dollar, not because of the material of which it is made, but because of the dollar of tax which is imposed to redeem it”. (Innes 1914, p. 152)

Minsky and Modern Money

- “Anyone can create money, the problem lies in getting it accepted.”

- “The need to pay taxes means that people work and produce in order to get that in which taxes can be paid”.

Alternative: Modern Money

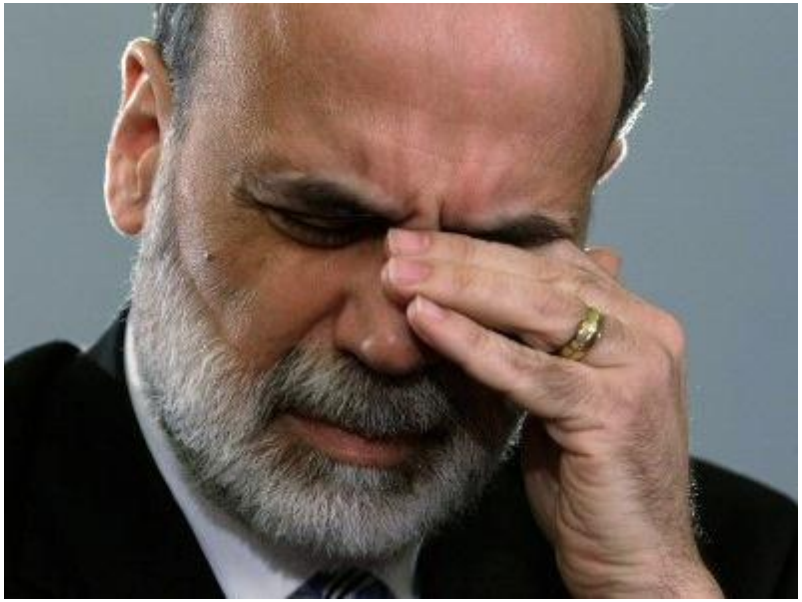
- Use of currency and value of M are based on the power of the issuing authority, not on intrinsic value.
- State played central role in evolution of M.
  - From beginning monetary system mobilized resources
- One Nation, One Currency Rule
  - Separate currencies not a coincidence. Tied up with sovereign power, political independence, fiscal authority.
- TAXES DRIVE MONEY:
  - State chooses money of account, imposes obligation denominated in that unit, issues currency denominated in that unit, and accepts its own currency in payment of the obligations

Reaction to MMT

- Federal government spends through keystrokes that credit bank accounts so it can afford anything for sale in dollars.
- The reaction typically goes through four stages:
  - 1. Incredulity: That’s Crazy!
  - 2. Fear: Zimbabwe! Weimar!
  - 3. Moral Indignation: You’d destroy our economy!
  - 4. Anger: You’re a Dirty Pinko Commie Fascist!

Chairman Bernanke: Keystrokes

- As Chairman Bernanke
- explained on 60 Minutes in
- 2009:
- (PELLEY): Is that tax money
- that the Fed is spending?
- (BERNANKE): It’s not tax
- money. [W]e simply use the
- computer to mark up the
- size of the account.



St. Louis Fed

"As the sole manufacturer of dollars, whose debt is denominated in dollars, the U.S. government can never become insolvent, i.e., unable to pay its bills. In this sense, the government is not dependent on credit markets to remain operational. Moreover, there will always be a market for U.S. government debt at home because the U.S. government has the only means of creating risk-free dollar-denominated assets. "

Government can NEVER run out of Dollars; It can NEVER be forced to default; It can NEVER be forced to miss a payment; It is NEVER subject to whims of "bond vigilantes".

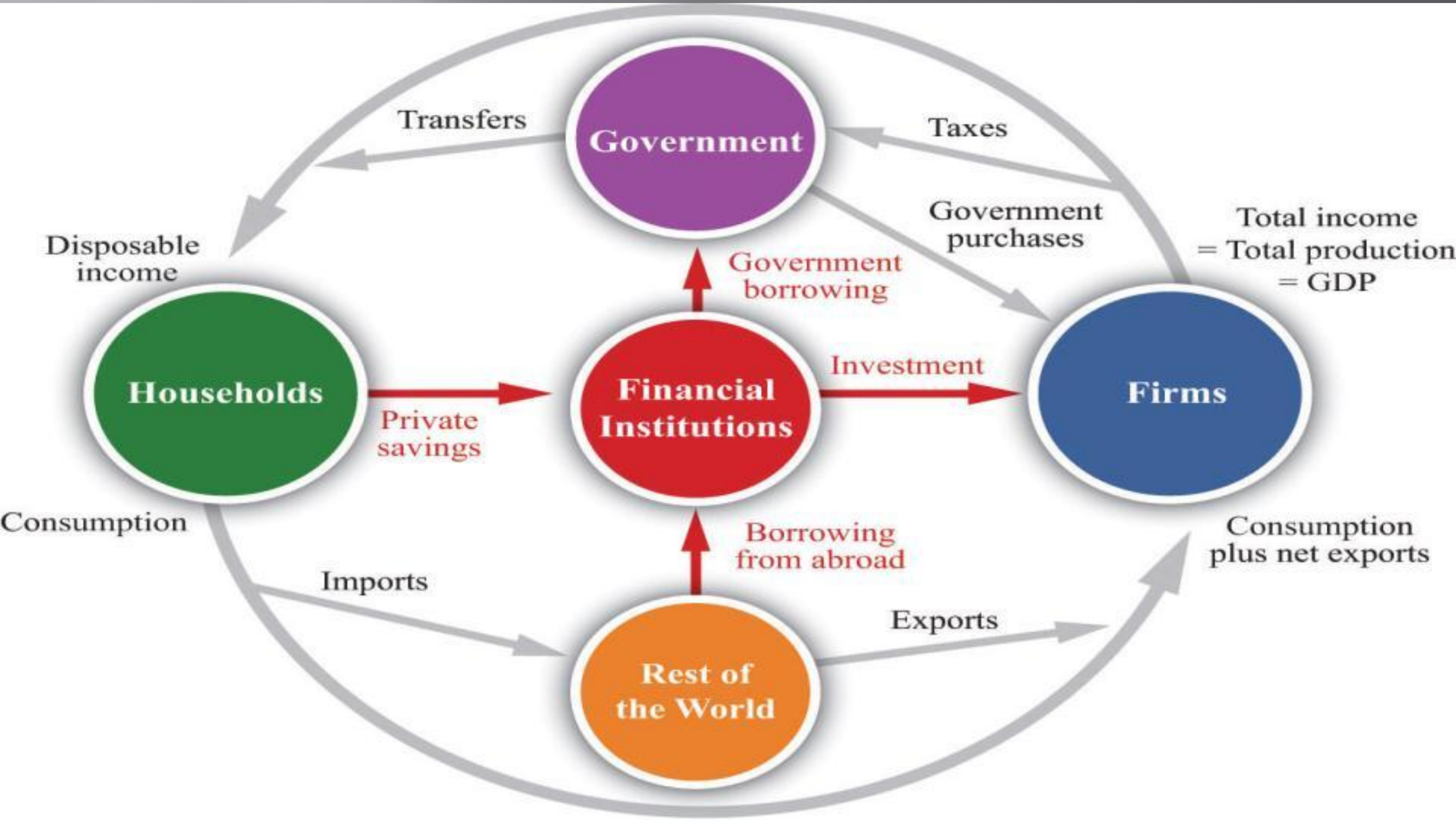
How to Reconcile

> "*I think there is an element of truth in the* ***superstition that the budget must be balanced at all times****. Once it is debunked [that] takes away one of the bulwarks that every society must have against expenditure out of control. There must be discipline in the allocation of resources or you will have anarchistic chaos and inefficiency. And one of the functions of* ***old fashioned religion was to scare people by sometimes what might be regarded as myths into behaving in a way that the long-run civilized life requires.****"* (Samuelson)

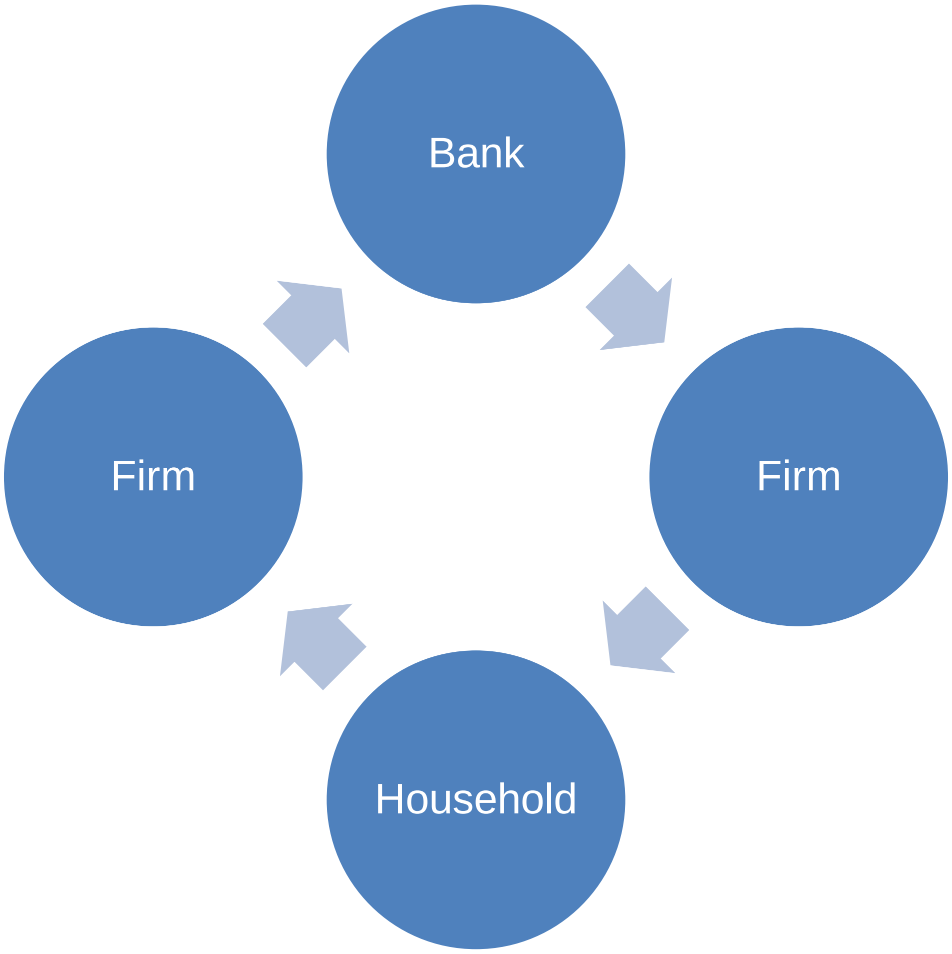
Necessity of balancing the budget is a myth, a superstition, the equivalent of that old-time religion.

So what is the truth? If economics is to rise above superstition, we need to know.

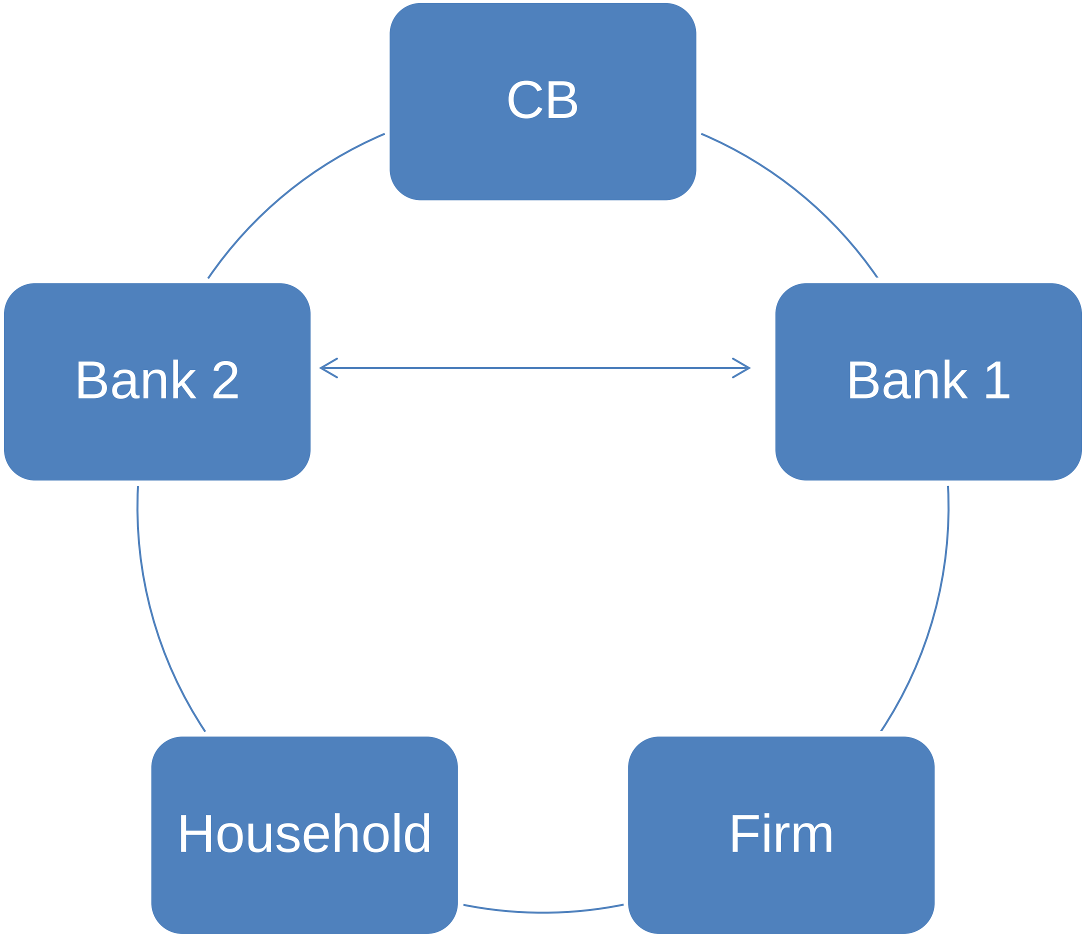
The Circular Flow With Bank, Govt and Foreign Sector Story



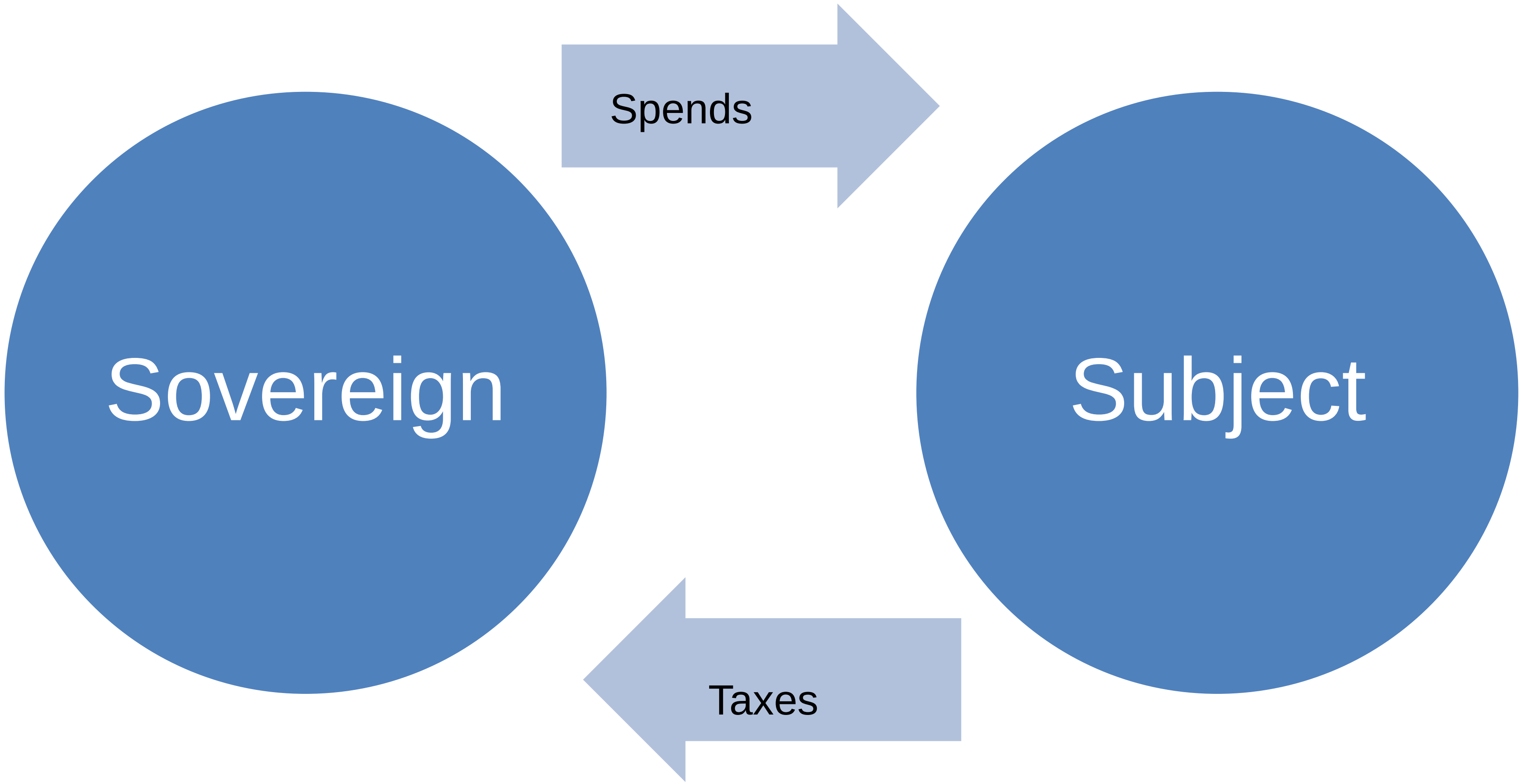
A Simple Model of Money: Single Bank



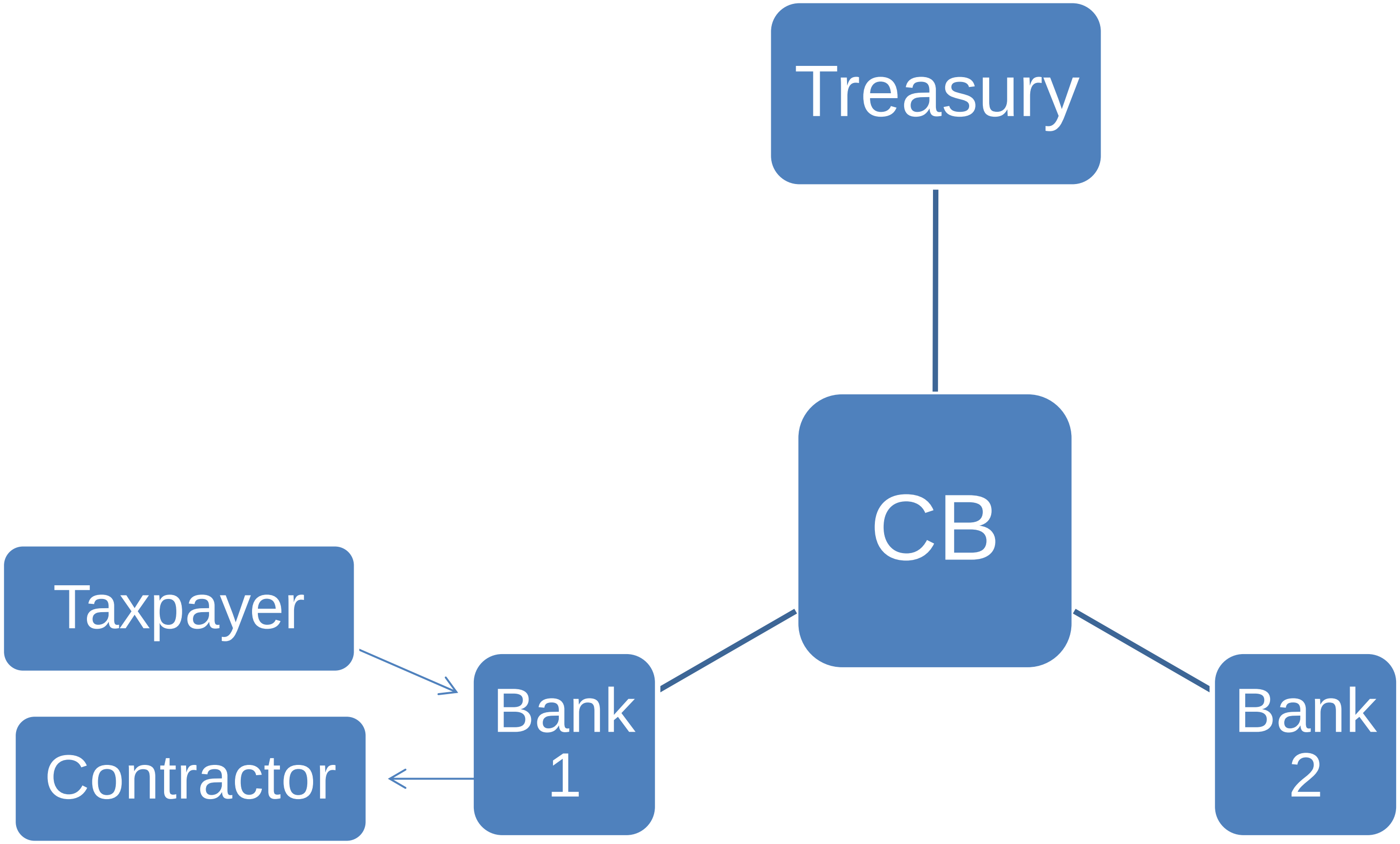
Simple Model: Multiple Banks



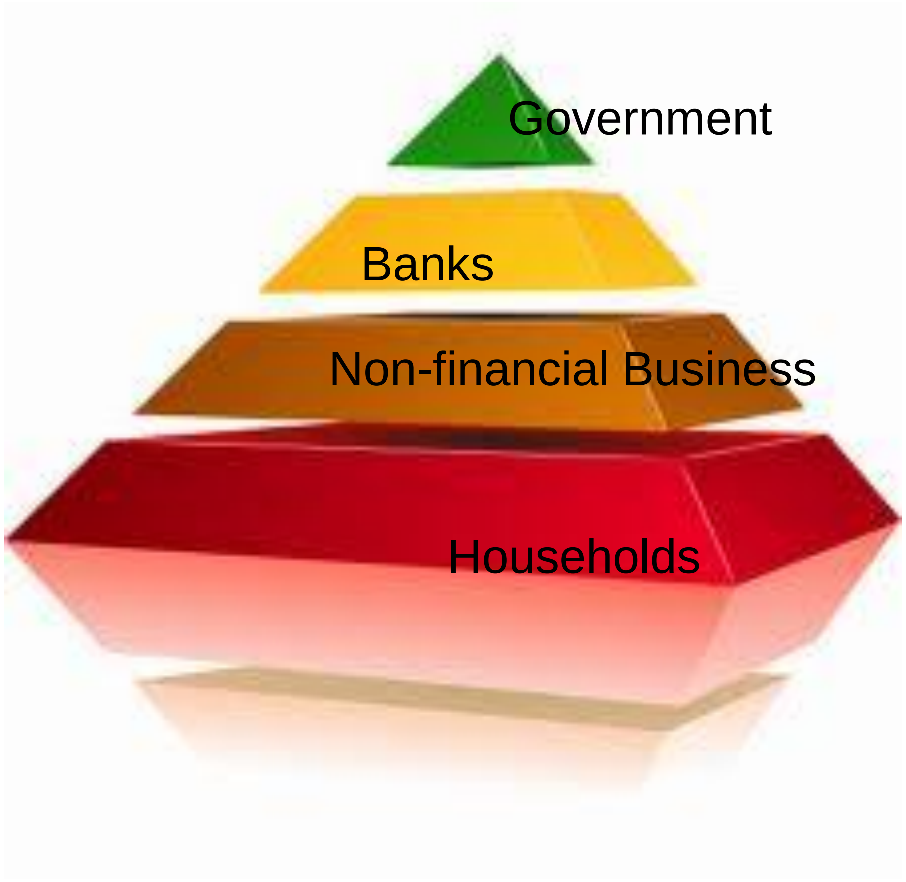
Simple Model: Sovereign Currency Issuer



Sovereign Currency w/CB and Banks



Pyramid of Liabilities



Most acceptable

Least acceptable

How Government Spends its Own Currency: Keystrokes

- Spending → credits
  - Government credits bank's reserves; bank credits account of recipient

- Taxes → debits
  - Government debits bank's reserves; bank debits account of taxpayer

- Deficits → net credits
  - Government net credits bank's reserves; bank net credits account of recipient

Money as Scorekeeping

Self-imposed constraints

- Budgeting, debt limits
- Operational constraints:
  - Treasury writes checks on accounts at CB
  - CB prohibited from buying Treasury Debt new issues
  - Use of Special Depositories
  - Use of Tax and Loan accts

Sovereign Currency: Summary

- Deficit spending creates private financial wealth
  - Note that CB operations do not; it buys government bonds or lends against collateral (helicopter drop is fiscal policy)
  - CB Lends; Treasury Spends

- Doesn’t matter whether bonds must be sold first—so long as CB accommodates reserve demand

- Doesn’t matter whether CB prohibited from buying new issues—roundabout through banks

- Doesn’t matter whether Treasury must have “money” in its acct at CB to spend—CB and banks cooperate

GDP Accounting

- GDP = NI: C+I+G+NX = W+P+T = C + S + T

  -After Manipulation Can Obtain:

  a) Keynes: S = I + DEF + NX

  Leakages = Injections

  b) Kalecki: P = I + DEF + NX + Cp – Sw

- NB: Causation runs from spending to income (from RHS to LHS; from injections to leakages)

Sectoral Balances Approach (Minsky/Godley)

- Fundamental Principles:
  - A. For every surplus there must be an equal deficit
  - B. Flows accumulate to stocks

- Two sectors:

  Govt Balance + Private Balance = 0

  - -i. Govt Deficit = Private Surplus
  - -ii. Govt Surplus = Private Deficit

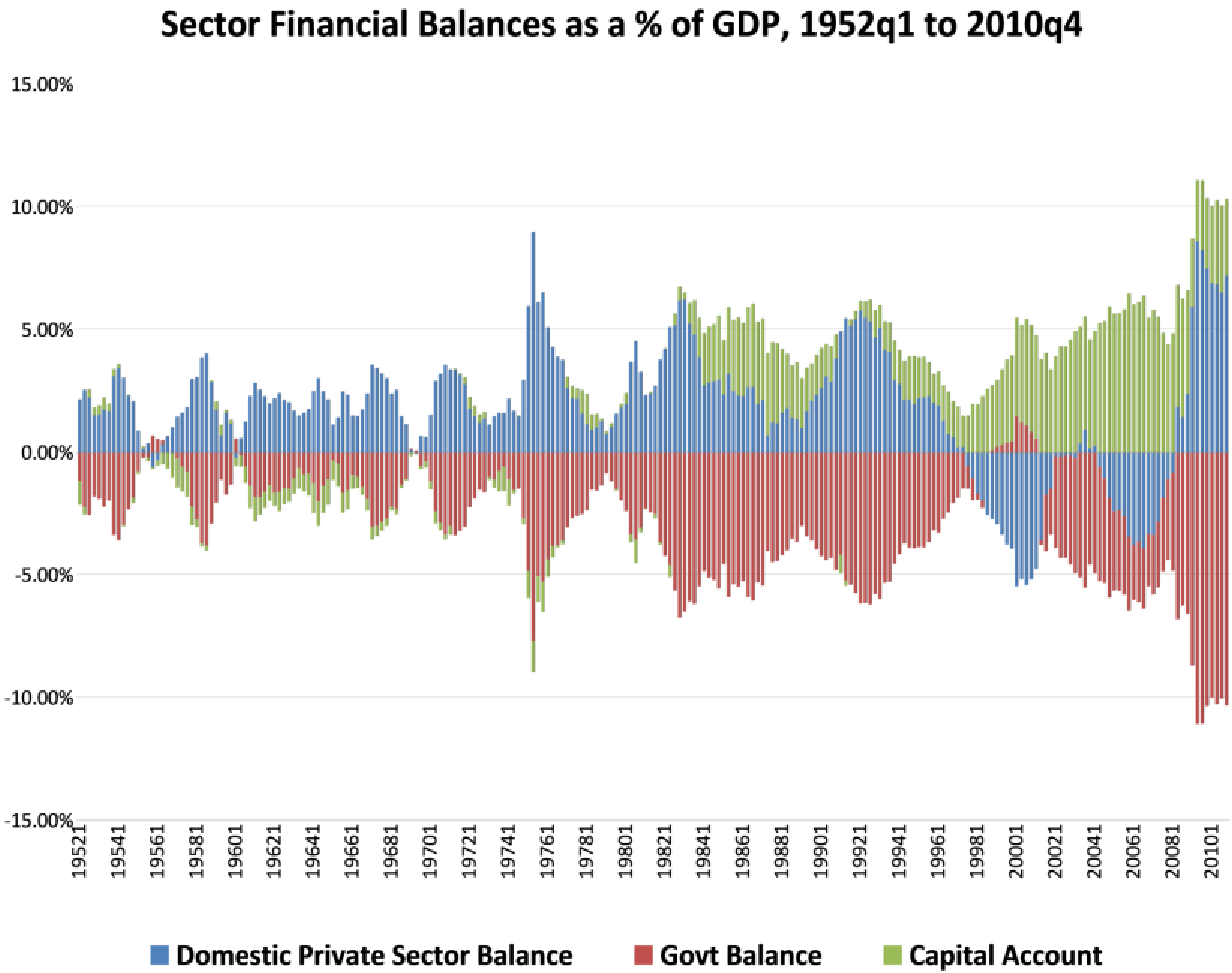
Sectoral Balances (Con't)

- Three sectors: Govt Balance+Domestic Private Balance+Foreign Balance=0

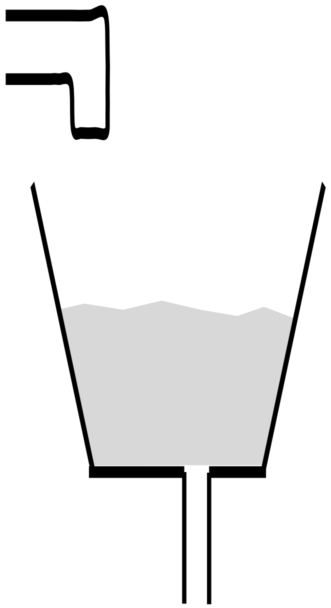
  -i. Govt Deficit = Private Surplus + Current Acct Def

  -ii. Govt Surplus = Private Def + Current Acct Surplus

  -etc

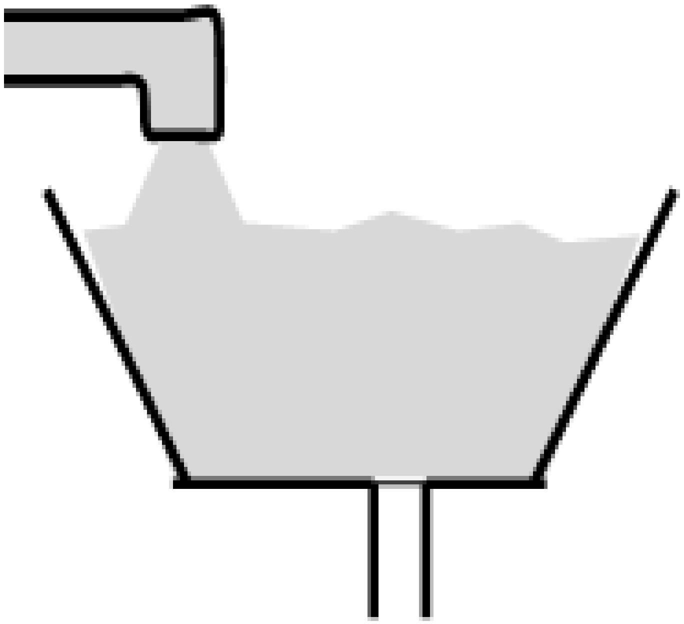

Sector Financial Balances as a % of GDP, 1952q1 to 2010q4
15.00%
10.00%
5.00%
0.00%
-5.00%
-10.00%
-15.00%
19521
19541
19561
19581
19601
19621
19641
19661
19681
19701
19721
19741
19761
19781
19801
19821
19841
19861
19881
19901
19921
19941
19961
19981
20001
20021
20041
20061
20081
20101
Domestic Private Sector Balance
Govt Balance
Capital Account

Stocks and Flows



- The water in the tub is called the stock of water. Currently, there is no water flowing in the tub from the faucet, and there is a stopper on the drain so no water is flowing out of the tub. Thus the stock of water stays the same. This initial level of water will be used as point of reference below.

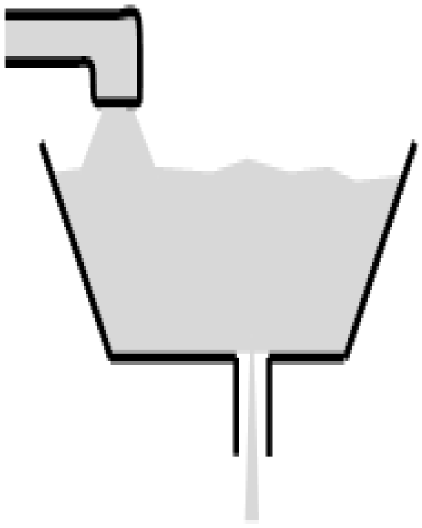
Flows Add to Stocks



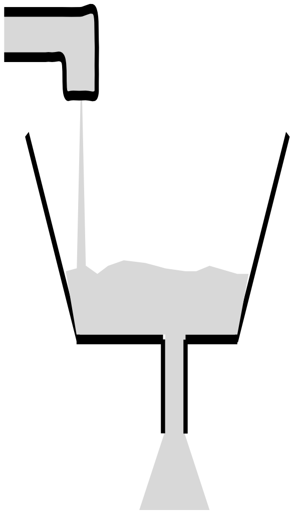
- What would happen if suddenly we turn on the faucet? Water would flow in the tub and the stock of water would rise.

Injections/Leakages

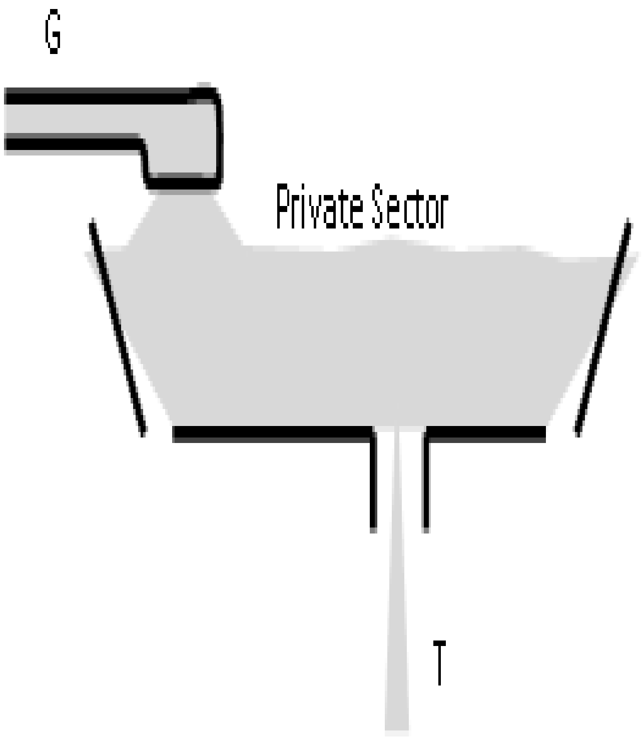
- More water flowing in than out



- More water flowing out than in



Government: G and T



- When the government spends on goods and services (G), this leads to an inflow of funds into the private sector. On the other side, taxes are a drain on the private sector outstanding dollars. In the graph, G is greater than T so the bathtub of the private sector rises.

Stock-Flow Consistency

Flows accumulate to stocks: Deficits→Debt
Surpluses→ Net Financial Wealth

A. Two Sectors: Govt Debt = Private Net Financial Wealth

- Govt Def → Govt Debt = Private Net Financial Wealth

B. Three Sectors: Govt Debt = Domestic Private NFW + Foreign NFW

i. Govt Def →Govt Debt = Domestic NFW + Foreign NFW ($)

(NB: domestic private and foreign sectors can accumulate other nongovt assets, depending on balance position; ie foreign can accumulate private domestic debt if current acct is negative)

Conclusions

- Government deficits equal nongovt surpluses
- Government debt is nongovt net financial wealth
- Current acct deficits equal ROW net financial savings (in $, for example)
- Balances balance!

Modern Money: Fiscal Policy

- Modern govt spends by crediting bank accounts, and reserves of those banks
- Fed and special banks help facilitate process
- Sovereign govt can “afford” to buy anything for sale in its currency
- Taxes by debiting bank accts
- Net credits→deficits→net financial assets
- Govt does not, cannot “borrow” its own currency

Modern Money: monetary policy

- Central bank sets overnight rate
- Accommodates demand for reserves
- Coordinates with Treas to supply/drain reserves

Policy Implications

- Govt cannot go bankrupt in its own currency
- Govt can always “afford” to buy anything for sale in its own currency
- If there is unemp labor, govt can always hire it to put it to work—existence of unemp is ALWAYS a failure of policy
- The only economic constraints govt faces are: full emp of resources, and inflation
- Other constraints are political

Modern Money: What I did and did NOT say

- I did say: Sovereign govt faces no financial constraints; cannot become insolvent in its own currency
  - But it can only buy what is for sale
- I did NOT say that govt ought to buy everything for sale
  - Size of govt is a political decision with economic effects
- I did NOT say that deficits cannot be inflationary:
  - Deficits that are too big can cause inflation
- I did NOT say that deficits cannot affect exchange rates:
  - Sovereign govts let currency float; float means currency can go up and down

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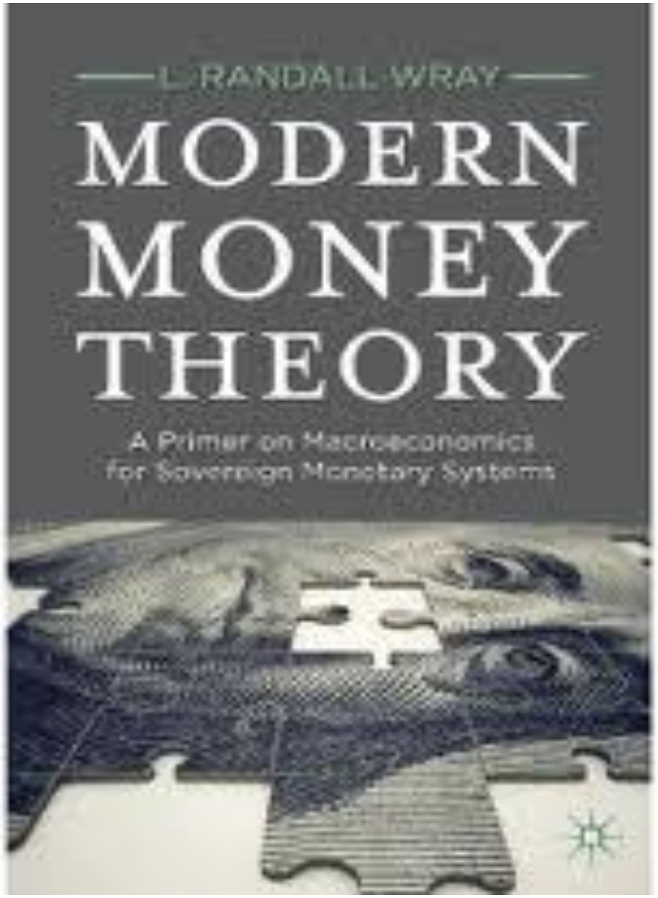

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