MINSKY AND MODERN MONEY

L. Randall Wray, Levy Institute, UMKC and CFEPS

wrayr@umkc.edu

www.levy.org

www.cfeps.org

"I think there is an element of truth in the view that the **superstition that the budget must be balanced at all times** [is necessary]. 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**.

We have taken away a belief in the intrinsic necessity of balancing the budget if not in every year, [then] in every short period of time. If Prime Minister Gladstone came back to life he would say "uh, oh what you have done" and James Buchanan argues in those terms. I have to say that I see merit in that view."

(Paul Samuelson in Blaug, 1995)

Money: Heterodox Approaches

- Marx, Keynes, Veblen, Minsky: M-C-M'; MTP; Theory of business enterprise; money in,money out
- Institutionalists (Veblen, Minsky): M is all bound up with power: to do good and bad; perhaps the most important institution in Capitalist Economy
- (Post) Keynesians (Keynes, Davidson, Minsky): M and uncertainty; M and contracts; holding M→ "quells disquietude"
- Chartalists (Knapp, Innes, Goodhart, Minsky): State M, bound up with sovereignty
- Functional Finance (Lerner, Minsky): State M and Govt spending
- TOGETHER: MODERN MONEY

Modern Money

What is Money?
Why is it accepted?
What is the relation of the State to its Money?
What is fiscal policy?
What is monetary policy?

Are These Money?

Or These?

These?


100
50
50


Richmond
April 16th 1863
Fifty
50
Cents
The Confederate
50
104470
1st SERIES.
The Confederate States of America
Will pay FIFTY CENTS to bearer.
REGISTER
TREASURER
Six Months after the Ratification of a Treaty of Peace between the Confederate States and United States.
Issued by authority of Congress under Act of March 23 1863

What Backs Up Our Money?

- Gold?
- US Dollar: "this note is legal tender for all debts, public and private";
- Canadian Dollar: "this note is legal tender";
- Australian Dollar: "This Australian note is legal tender throughout Australia and its territories."
- UK Pound: "I promise to pay the bearer on demand the sum of five pounds"
- Euro: No legal tender laws
- Fiat??? Nothing???

Alternative: Modern Money

- Use of currency and value of M are based on power of issuing authority, not intrinsic value.
- State played central role in evolution of M.
- Goodhart: One Nation, One Currency Rule
- Separate currencies not a coincidence. Tied up with sovereign power, political independence, fiscal authority.
- Minsky: one reason bank money is accepted is because it is accepted for taxes
- Lerner: TAXES DRIVE MONEY

Alternative: what is money

- Social unit of account
- State money of acct
- Representation of social value
- Money things; hierarchy
  - Denominated in the state money of acct

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)

Importance of Money

- Monetized to move resources to public purpose
- "Unemployment develops, that is to say, because people want the moon;--men cannot be employed when the object of desire (i.e. money) is something which cannot be produced and the demand for which cannot be readily choked off." (GT p. 235)
- "In the absence of money…the rates of interest would only reach equilibrium when there is full employment." (GT p. 235)
- mek1 = mek2 = mek3… only at Nf

Implications

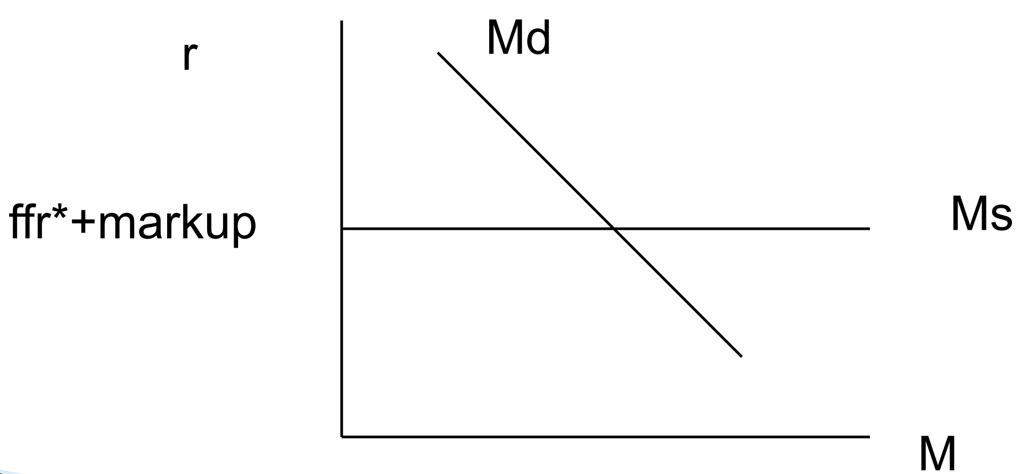
- “Fiat” money is not “worthless”; valuable due to state’s promise to “redeem” it in payments to state. Innes, Goodhart, Lerner, Minsky
- Money and debt inextricably linked:
    - All debts denominated in state money of acct
    - Minsky: anyone can create money, the problem is to get it accepted
    - All “monies” are created as liabilities of issuers
    - All issuers must accept own liabilities

The Nature of Money

- If M causes unemp, why are economies organized around its use?
- Orthodoxy: M originated to reduce transactions costs
- Some PK: M invented to deal with uncertainty
- Keynes: M prevents the economy from operating at its efficient, full capacity, level.
- Drafts of GT: Theory of monetary economy: one in which changing views about the future influence quantity of employment

Endogenous Money: Horizontal approach

- Some PKs claim: ‘Money supply’ accommodates ‘money demand’, thus liquidity preference theory is flawed as rising Md will not raise interest rates. Endogenous money; horizontalism (vs structuralism)



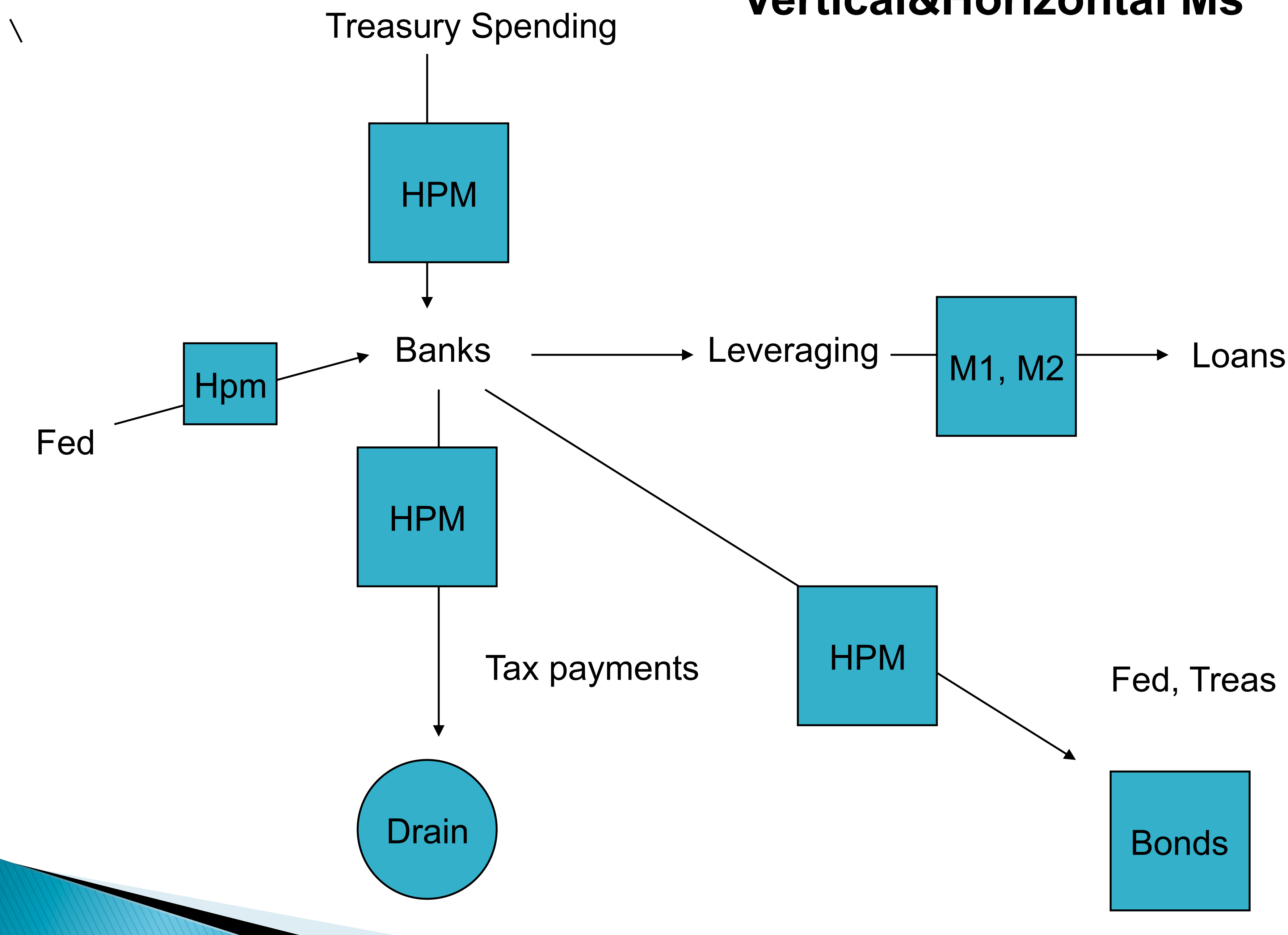
Endog M and LP?

- Keynes must be wrong: as LP rises, Ms rises, so cannot be any effect on r
- Keynes: the individual taking the *ex ante* decision to invest weighs the MEK vs MEM.
- Doesn't depend on any particular Ms function
- All that is necessary is that money have "peculiar characteristics" so it "rules the roost".

Resolution

- Ms is endog; Ln → DD (Minsky: DD finance positions in assets)
- Res are horiz; overnight rate is exog
  - CB cannot constrain Q, only change P
  - Necessity of clearing, etc
  - But higher overnight rate→economizing, innovation
- Balance sheets matter
  - Banks lend to credit-worthy borrowers
  - Banks care about own balance sheets
  - Minsky: the skeptical banker (“ephor”)

Vertical&Horizontal Ms



Minsky, Knapp, Lerner

- Knapp and State Money
- Lerner and Functional Finance
- Minsky and Reagan
- Minsky and Bretton Woods

Keynes and the International Monetary System

- Three forms of State Money: 'Commodity Money, Fiat Money and Managed Money' (TOM, p. 7).
- Commodity money is "actual units of a particular freely-obtainable, non-monopolised commodity which happens to have been chosen for the familiar purposes of money", or "warehouse warrants for actually existing units of the commodity" (ibid.).
- Fiat money is representative money "which is created and issued by the State, but is not convertible by law into anything other than itself, and has no fixed value in terms of an objective standard" (ibid.).
- This is distinguished from managed money, which "is similar to Fiat Money, except that the State undertakes to manage the conditions of its issue in such a way that, by convertiblity or otherwise, it shall have a determinant value in terms of an objective standard" (ibid.).

Advantage of floating rate

- Sovereign nation with floating currency can use domestic policy to pursue full emp and economic growth. (“Mngd M”: internal vs external stability)
- Minsky: BW→barrier to full emp, predicted floating rates with $ as reserve currency
- Strictly speaking: Exog interest rate only w/ floating rate
- Sovereign nation can adopt expansionary fiscal policy with less worry about effects of trade deficits on exchange rates or international reserve balances.

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

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

Question Time

How does a sovereign currency work?

- First … we will take a quiz.
- No cheating! Write down your answer.
- There is a correct answer for every question.
- Questions concern statement of fact. No theory or ideology is contained in statements.
- There are no policy proposals involved; the questions concern current operating procedures already in place in all sovereign currency nations.

Question 1

- Just like a household, the government has to finance its spending.

TRUE OR FALSE

Question 2

- The role of taxes is to provide finance for government spending.

TRUE OR FALSE

Question 3

- The National Government borrows money from the private sector to finance the budget deficit.

TRUE OR FALSE

Question 4

- By running budget surpluses the government takes pressure off interest rates because more funds are then available for private sector investment projects.

TRUE OR FALSE

Question 5

- Persistent budget deficits will burden future generations with inflation and higher taxes.

TRUE OR FALSE

Question 6

- Running budget surpluses now will help build up the funds necessary to cope with the ageing population in the future.

TRUE OR FALSE

Time to count up your own score …

- All statements are FALSE
- Responsible faculty will explain why.

Question 1 FALSE

- Just like a household, the government has to finance its spending.

Primer:

- Unlike a household, govt is the issuer of its own currency (HPM).
- It must spend before it can collect revenue.
- Govt spending is constrained only by what is offered for sale in exchange for that currency.
- All other constraints are self imposed.

Question 2 FALSE

- The role of taxes is to provide finance for government spending.

Primer:

- Taxes create sellers of real goods and services purchased by the government.

- From inception, purpose of the monetary system is to transfer resources from private to public domain.

- TAXES DRIVE MONEY

Question 3 FALSE

- The Federal Government borrows money from the private sector to finance the budget deficit which allows them to avoid the inflationary effects of “printing money”.

<u>Primer:</u>

- The Government does not/cannot borrow to run a budget deficit.
- Fiat currency typically does not enter the economy via “printing money”.
- How does money enter the economy?

Question 3 FALSE (continued)

- Commercial banks keep reserve accounts with the central bank to facilitate clearing.
- Govt spends by simultaneously crediting bank deposits and reserves.
- When G>T this shows up as increases in the reserve accounts.
- And when G>T, money in the form of bank accts is net created.

Question 3 FALSE (continued)

- When G>T, net reserves are created; often creates excess reserves

- This puts downward pressure on overnight rate
- Central Bank and Treasury sell bonds to drain excess reserves
- This relieves interest rate pressure
- Whether sold by Treas or CB, effect is same
- Sales of Bg are effectively monetary policy

Question 4 FALSE

- By running budget surpluses the govt takes pressure off interest rates because more funds are available for private investment.

Primer:

- Budget surpluses drain reserves, hence put upward pressure on rates
- Budget deficits actually put downward pressure on interest rates.
- Interest rates are controlled thru monetary policy: selling/buying bonds
- Same result can be accomplished by paying target rate on reserves

Question 5 FALSE

- Persistent budget deficits will ultimately lead to inflation and higher taxes to be paid by the next generation.

Primer:

- It would clearly be inflationary to keep pushing the deficits beyond the level required to achieve full employment.
- Any past deficit does not have to be repaid but the government can service debt on schedule.
- Taxes do not fund spending or govt interest payments

Question 6 FALSE

- Running budget surpluses now will help build up the funds necessary to cope with demands of the ageing population in the coming years.

Primer:

- Ability of govt to provide future services is in no way influenced by current (or past) budget outcome(s).
- When govt runs a surplus it destroys money, income, reserves, and wealth. There is no "war chest" of funds waiting to be spent.
- The Govt can spend whenever it wants to.
- The issue of how much to spend is always a political decision.
- The only real constraints on govt spending are the available goods and services for sale.

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