

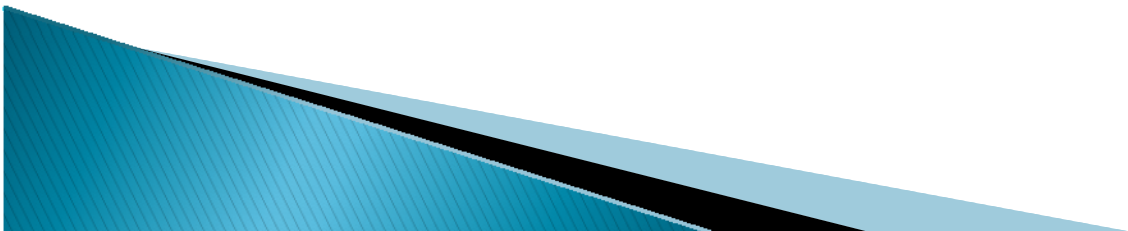
Understanding Modern Money: how a sovereign currency works

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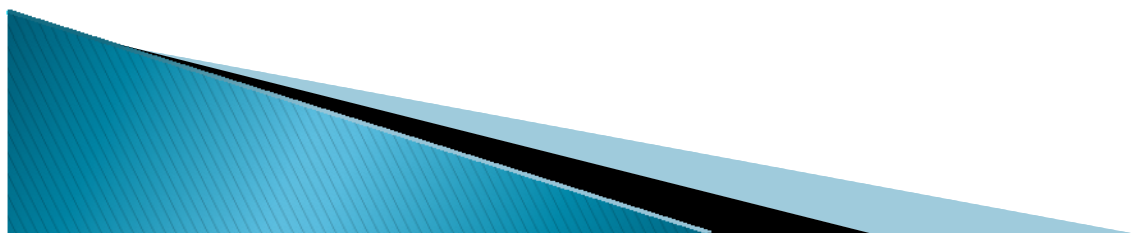
www.levy.org

www.cfeps.org



How does a sovereign currency work?

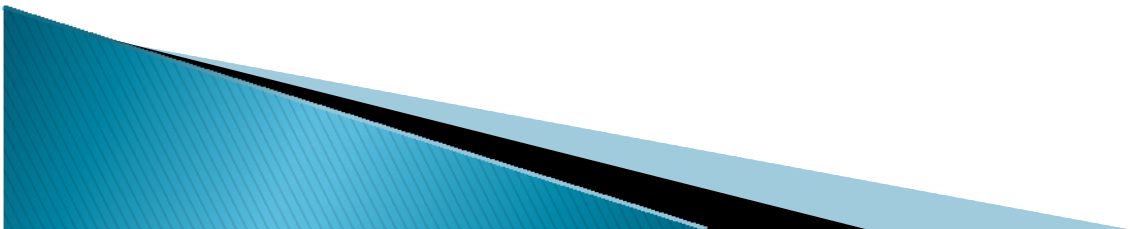
- ▶ First ... we will take a quiz.
- ▶ No cheating! Write down your answer.
- ▶ No trick questions; all have straight-forward answer
- ▶ Descriptive: the way it actually works; no mythologies; no ideologies; no proposals for reform



Question 1

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

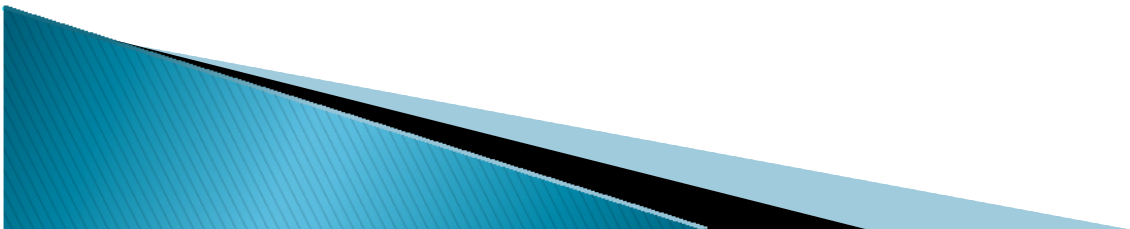
TRUE OR FALSE



Question 2

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

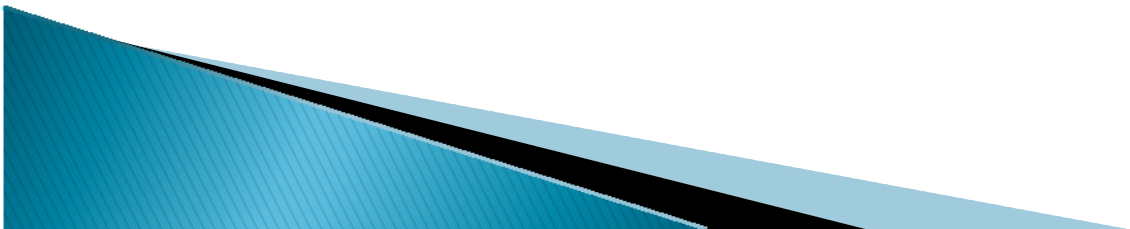
TRUE OR FALSE



Question 3

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

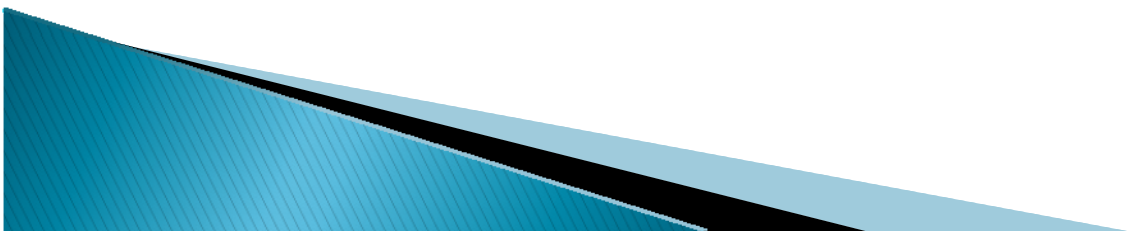
TRUE OR FALSE



Question 4

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

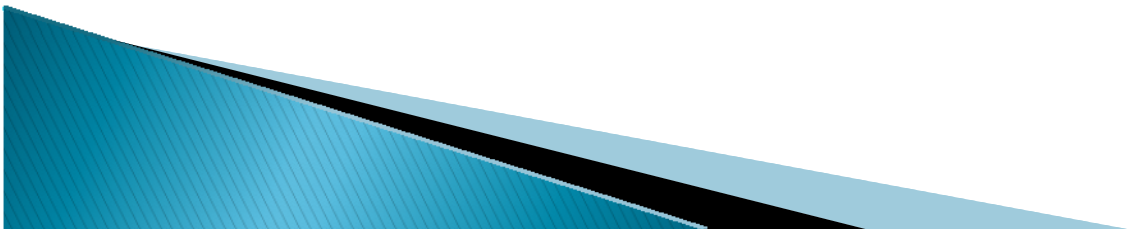
TRUE OR FALSE



Question 5

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

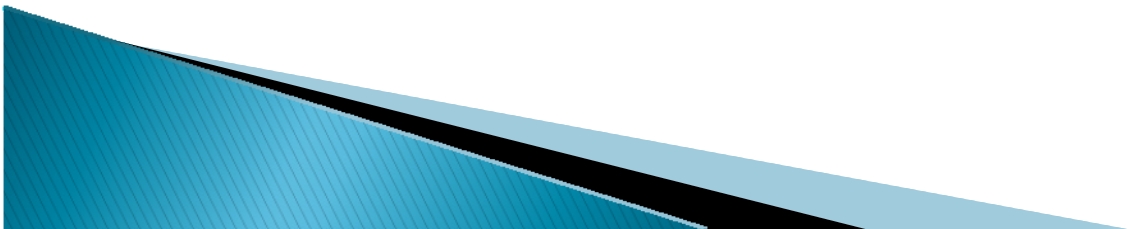
TRUE OR FALSE



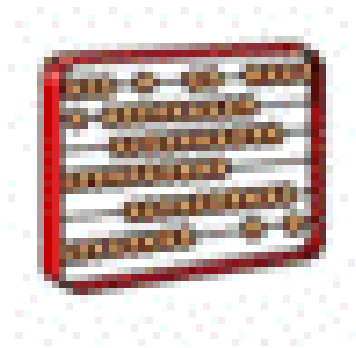
Question 6

- ▶ Running budget surpluses now will help build up the funds necessary to cope with the demands that the ageing population will place on health and personal care services in the coming years.

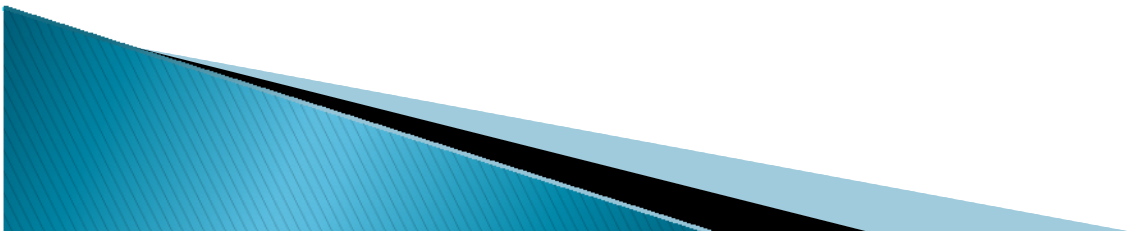
TRUE OR FALSE



Time to count up your own score ...



- ▶ All statements are **FALSE**
- ▶ Count up your score ... no cheating ... one point for each correct question.

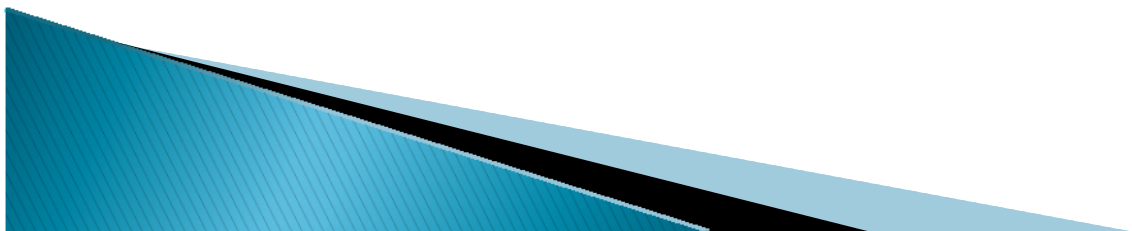


How did you do?

Score	Scientific Assessment from our Experts
0	You have the talent to serve as Obama's Treasurer
0-1	Seek election for any major political party
2	Become an advisor for a major political party
1-3	Work in the financial markets
4	There is hope – pay attention!
5	Start advocating for deficits to restore full employment
6	Give this presentation!

Money: Heterodox Approaches

- ▶ Marx, Keynes, Veblen: $M-C-M'$; MTP; Theory of business enterprise
- ▶ Institutionalists: M is all bound up with power: to do good and bad; perhaps the most important institution in Capitalist Economy
- ▶ Post Keynesians: M and uncertainty; M and contracts; holding $M \rightarrow$ “quells disquietude”
- ▶ Chartalists: State M, bound up with sovereignty
- ▶ Functional Finance: State M and Govt spending
- ▶ TOGETHER: MODERN MONEY



Modern Money

What is Money?

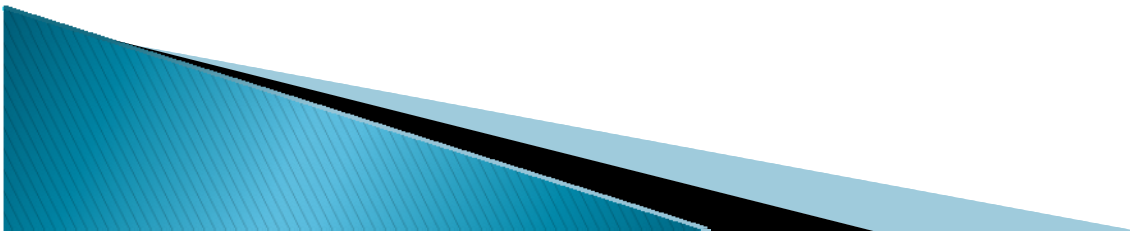
Why is it accepted?

What is the relation of the State to its Money?

What is fiscal policy?

What is monetary policy?

How does a sovereign currency create policy space?



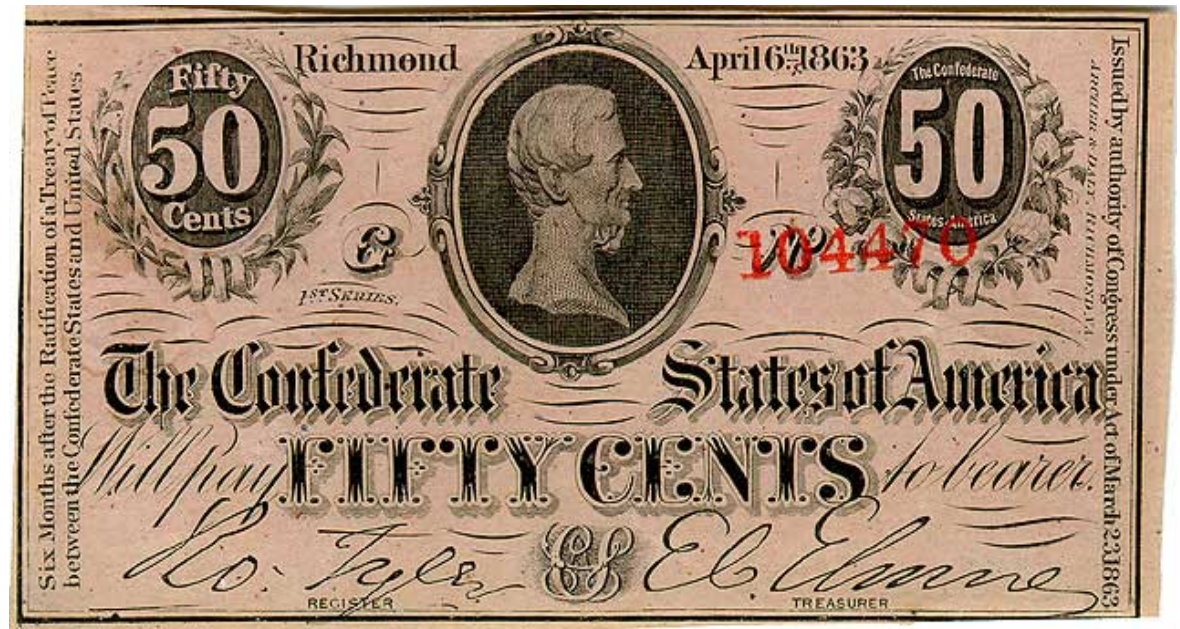
Are These Money?



Or These?



These?



Alternative: what is money

- ▶ None of those are money!
 - ▶ Social unit of account
 - ▶ State money of account
 - ▶ Money things; hierarchy
 - Denominated in the state money of account
 - Minsky: anyone can create money (thing)
- 

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 the power of the issuing authority, not on intrinsic value.
- ▶ State played central role in evolution of M.
- ▶ One Nation, One Currency Rule
- ▶ Separate currencies not a coincidence. Tied up with sovereign power, political independence, fiscal authority.
- ▶ TAXES DRIVE MONEY: state imposes obligation, payable in state's own money thing

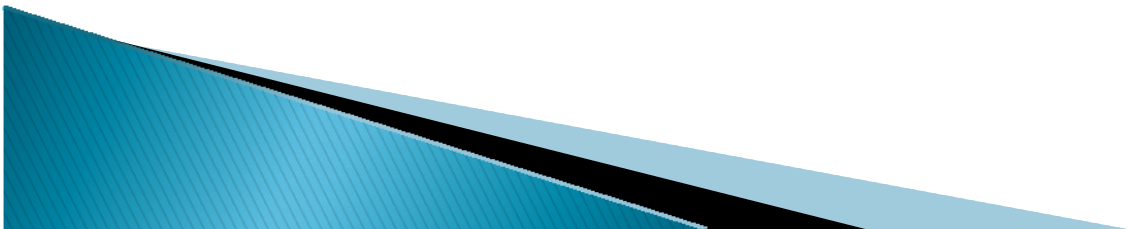


Question 1 FALSE

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

Primer:

- ▶ Unlike a household, the government is the issuer of its own currency (HPM).
- ▶ As such it has to spend before it can collect revenue.
- ▶ Government spending is constrained only by what is offered for sale in exchange for currency
- ▶ All other constraints are self imposed.

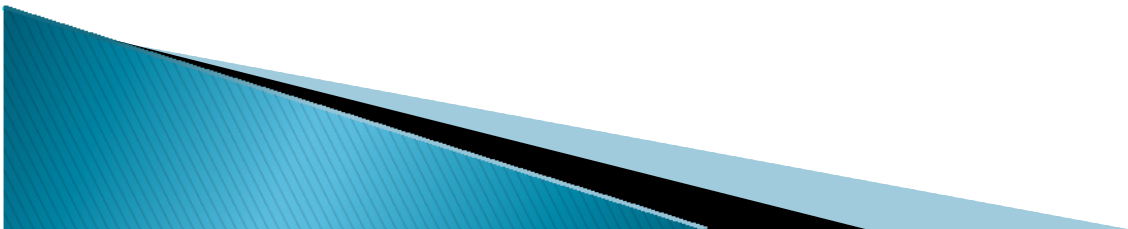


Question 2 FALSE

- ▶ 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 perspective of govt, purpose of the monetary system is to transfer real goods and services from private to public domain.
- ▶ TAXES DRIVE MONEY

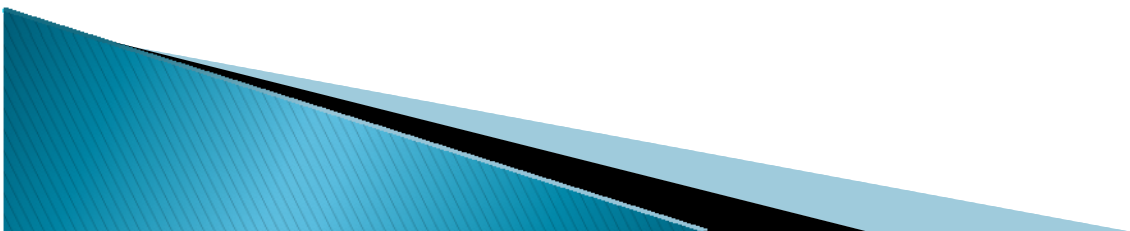


Question 3 FALSE

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

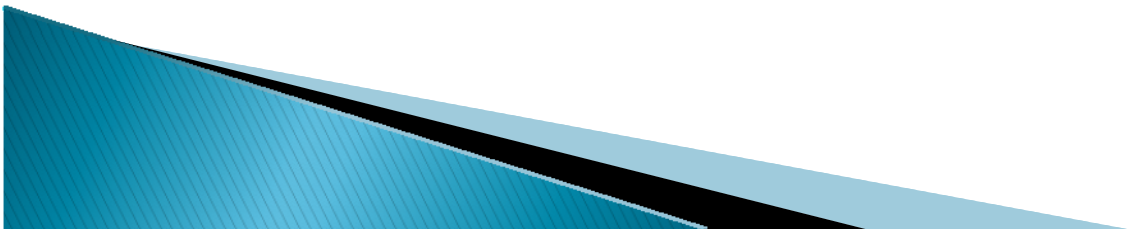
Primer:

- ▶ 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?



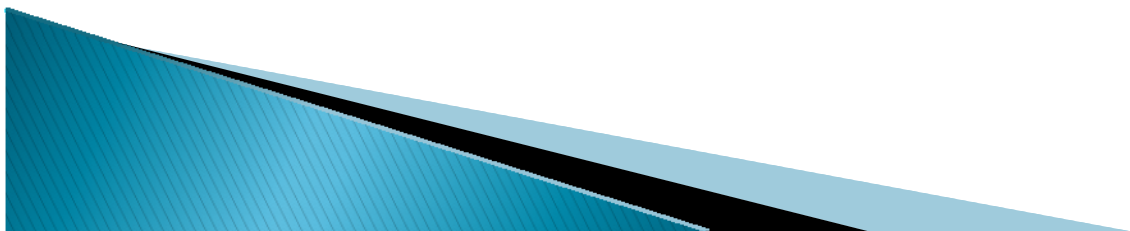
Question 3 FALSE (continued)

- ▶ Commercial banks keep **reserve accounts** with the central bank to facilitate clearing.
- ▶ Govt spends by simultaneously crediting bank deposits and reserves.
- ▶ When $G > T$ 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 the same
- ▶ Sales of Bg are effectively monetary policy
- ▶ THIS IS ACCOUNTING, NOT A PROPOSAL!!!



Question 4 FALSE

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

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
- ▶ Same result can be accomplished by paying target rate on reserves

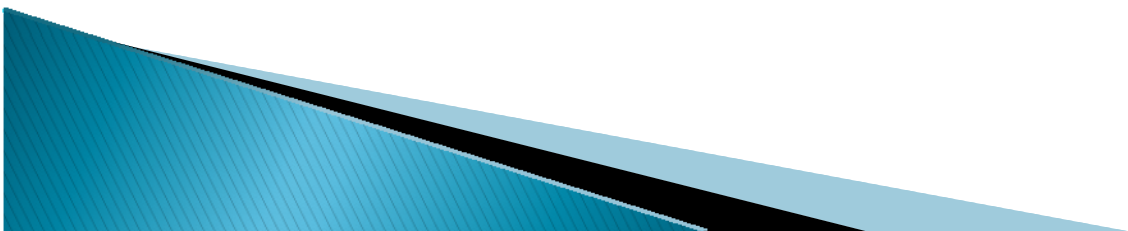


Question 5 FALSE

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

Primer:

- ▶ It would clearly be inflationary to keep pushing 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 the demands that the ageing population will place on health and personal care services in the coming years.

Primer:

- ▶ The ability of the government to provide services in the future is in no way affected by the current (or past) budget outcome.
 - ▶ When the government runs a surplus it destroys money, income, reserves, and wealth. There is no “war chest” full of funds waiting to be spent.
 - ▶ The Government can spend whenever it wants to.
 - ▶ The issue of how much to spend is always a political decision.
 - ▶ The only real constraint on government spending is the available real goods and services that can be exchanged for currency.
- 

Central Bank and Private Banks

- ▶ Private banks create deposits when they make loans.
Their interest rates are set relative to overnight rate set by central bank: mark-up and mark-down. Spread partly determined by competition.
- ▶ Banks clear accounts using reserves; if short, Central Bank lends reserves (overdraft); always accommodates at the “price” (overnight rate) it chooses.
- ▶ Note: private banks are the source of most of our “finance” (“money”), but cannot create net financial wealth .



Conclusions: Monetary Policy

- ▶ Central bank cannot control the money supply; it does not “print money”; it does not provide the raw material from which private banks create money.
- ▶ Central bank sets overnight interest rate target; It hits target within discretionary band by adding/draining reserves.

-It always accommodates bank demand for reserves.

-It always cooperates with Treasury's operations to ensure:

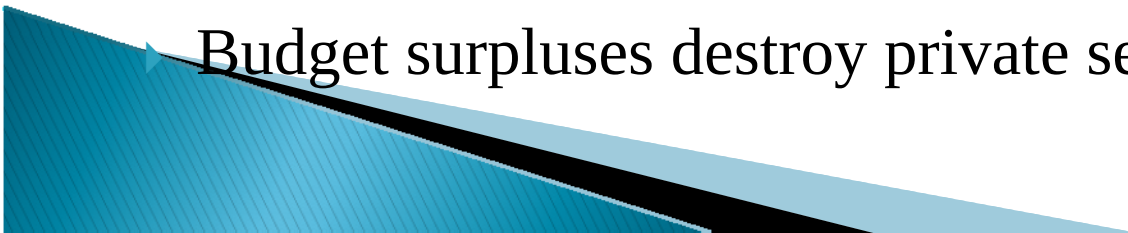
Treasury's checks never bounce;

Taxpayers' checks don't bounce



Conclusions: Fiscal Policy

- ▶ Taxation does not raise money – it destroys it!
- ▶ Issuing government debt does not raise money – It destroys it!
- ▶ Budget deficits drive interest rates down!
- ▶ Budget deficits create private sector financial wealth!
- ▶ Budget surpluses destroy private sector financial wealth!



Conclusions: Fiscal Policy (con't)

1. Only Government can create net financial wealth.
2. Only Government can spend without first obtaining finance.
3. Only Government has monopoly over money issue.
4. Only Government can offer an infinite supply of jobs.

THUS: Only Government can ensure continuous full employment.



→ Conclusion: Government MUST be held responsible for maintaining full employment.

Sovereign Currency Provides Policy Space

- ▶ Currency union, pegged currency, gold standard
→ first priority is to maintain fixed exchange rate
→ reduces policy space
- ▶ Sovereign currency, flexible exchange rate
→ greater fiscal and monetary policy space
- ▶ Policy space → power, to operate in public interest
- ▶ Proposal: pursue full employment with price stability through Job Guarantee
- ▶ Proposal: pursue Gender Equality
- ▶ Proposal: pursue development and growth



Question Time