



Money, Sovereignty, and Monetary Regimes

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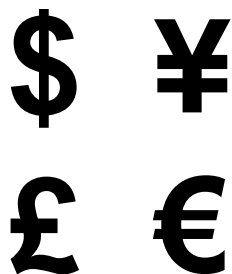
 @ptcherneva

March 8, 2017

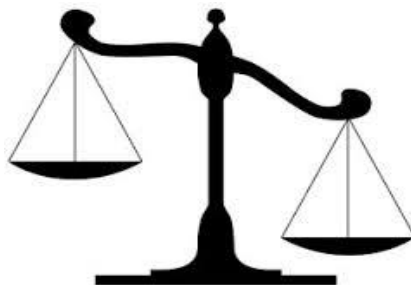


Modern Money Approach

1. Money and Monetary Systems



2. Unique Deficit Perspective



3. New Economic Possibilities

*(full employment
& price stability)*





What Is Money & Where Does It Come From?

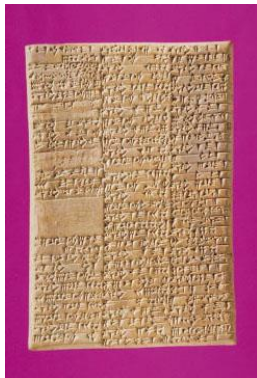
\$ ¥

£ €



The Lost Origins of Money

- The textbook story
- The historical record
 - “No example of a barter economy, pure and simple, has ever been described, let alone the emergence from it of money, all available ethnography suggests that there never has been such a thing.” (Humphrey 2011)





Money: A Creature of the State

- Money is **not an object** of some intrinsic value. Money is **a record**.
- The **unit of account** is **determined** by some authority.
- The most widely accepted **medium of exchange** is **that which** the authority will **accept** in payment of **nonreciprocal obligations**—taxes, dues, tribute.
- Medium of exchange is **usually emitted** by the authority (clay tablets, most modern nation states) **or stamped** by the authority (gold coins).
- **Taxes** create demand for **money**.
- They provision the government in terms of **real** resources.
- Modern examples
 - Colonial Africa
 - US Revolutionary war
 - Argentina's 2001 experience
 - Political and monetary sovereignty
- Rare cases: Ecuador, Eurozone nations



What Is the Currency?

The currency is the **liability** of the government and its **two** key institutions.

It is a **simple public monopoly**

Cash, notes, electronic reserves come *only* from the government

Money is a **public good**





Money As a Public Good

- Firms, households, banks, governments **all issue** liabilities
 - All private sector agents settle their debts/liabilities by delivering **someone else's** liability
 - Only the government settles its debts by delivering **more of its own** liabilities
- Firms, households make payments or settle their debts by delivering a bank liability (a deposit)
- Banks make payments or settle their debts by delivering a government liability (cash or reserves)
- The government makes payments or settles its debts by delivering its own liability (reserves)
- The government is the source of the **final means of settlement** for the entire economy



“There is nothing more deceptive than an obvious fact”

- Sir Arthur Conan Doyle, *Sherlock Holmes*



Consider the problem of counterfeiting



Monetary Regimes

SOVEREIGN

The rule
1 currency = 1 nation
ISSUERS

\$, ¥
£, peso

Institutionalized **coordination**
between the **monetary** and
fiscal authorities

NON-SOVEREIGN

The exception
1 currency = 19 nations
USERS

€
Ecuador

Institutionalized **divorce**
between the **monetary** and
fiscal authorities



Core Implications from Monopoly Money

- The issuer spends **first**, *collects taxes later*
- The issuer spends **first**, *borrowes later*
- The issuer can always choose **how** to provide the currency

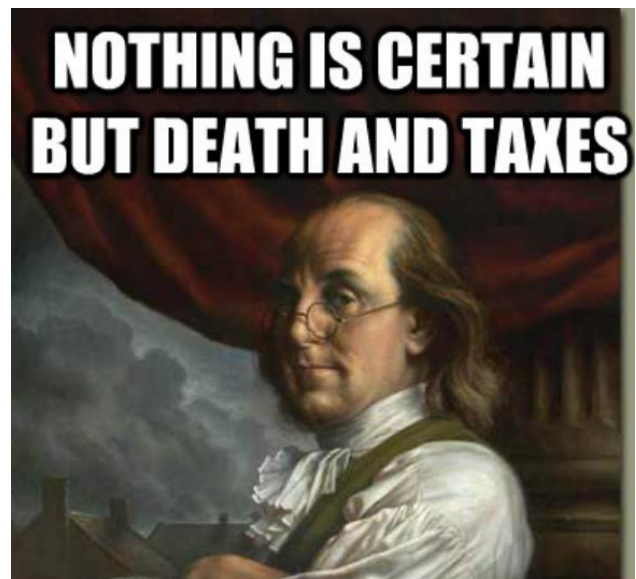
A Key distinction

- Currency **Issuers do not** have the operational threat of **default** (US, UK, Japan)
 - Dollars, Yen, Pounds are spent into existence
- Currency **Users have** the threat of **default** (EZ, dollarization, CBs)
 - Individual countries must **borrow** or **export** to 'earn' the Euro



What About Taxes?

- Taxes are **compulsory** obligations
- They create **demand** for the currency
- Are used to **launch** new currencies
 - history of monetary sovereignty
- Help **provision** the public sector in terms of **real** resources
- **Do not fund** government spending
- **Spending funds tax payments**
 - **Government cannot tax back what it has not previously provided**





The Age of Electronic Currency

- Modern governments **always spend** and **tax** via electronic keystrokes
- The difference between government **credits** (**spending**) and government **debits** (**taxation**) is the government **deficit/surplus**
- The government is the **scorekeeper** for the dollar
- Currency issuing governments cannot run out of money, the same way that I (the professor) cannot run out of As/1s

Game 2	1	2	3	4	5	6	7	8	9	10	Total								
DAVE	1	4	2	1	6	3	1	7	2	7	6	3	1	6	1	8	8	1	84
CHRIS	9	5	3	X	7	1	.	.	.	4	4	6	5	3	8	.	.	.	77
	9	17	37	47	47	47	55	61	69	77									161





Solvency Is Not the Problem

We **do not use tax money**, we use the **computer** to mark up the size of the account”

-Fed Chairman, Ben Bernanke, 2009

“A government **cannot become insolvent** with respect to obligations in its **own currency**. A fiat money system, like the ones we have today, can **produce** such claims **without limit**”

- Fed Chairman Greenspan 1997

“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.”

- STL Federal Reserve, 2012

<http://www.stlouisfed.org/publications/re/articles/?id=2157>



The Debate: *Affordability vs. Economic Impact*

- Government can spend **too much**
Inflation? Hyperinflation?
- Government can spend **too little**
Unemployment? Stagnation?
- Key Question: **How** do we spend
- The monopoly issuer can set the price for the currency, i.e.,
it can determine a conversion rate between the currency and output
- Can we devise a policy that ensures that the monopoly issuer can
emit/spend the currency by anchoring its value in a manner that secures
full employment and price stability



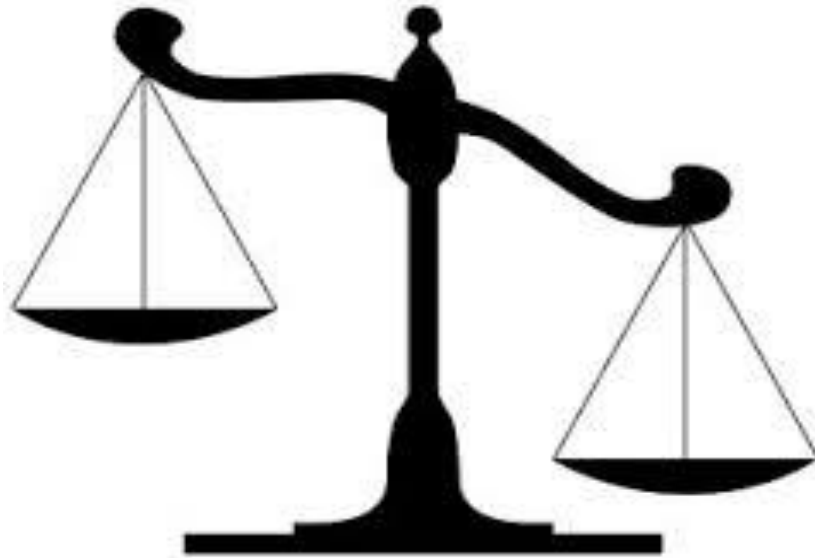


The Importance of This Approach

- Unlike most economic theory, it differentiates between the debts of the issuers of currency from the debts of the users of currency
- Offers unique perspective on the role of government deficits and their connection to the financial balances of the non-government sector



A Unique Deficit Perspective





A Law of Accounting

€ spent = € earned

Two sectors

1. **private** (households, firms, foreigners)
2. **public** (government)

If one sector **spends** > **earns**,
another sector **earns** > **spends**

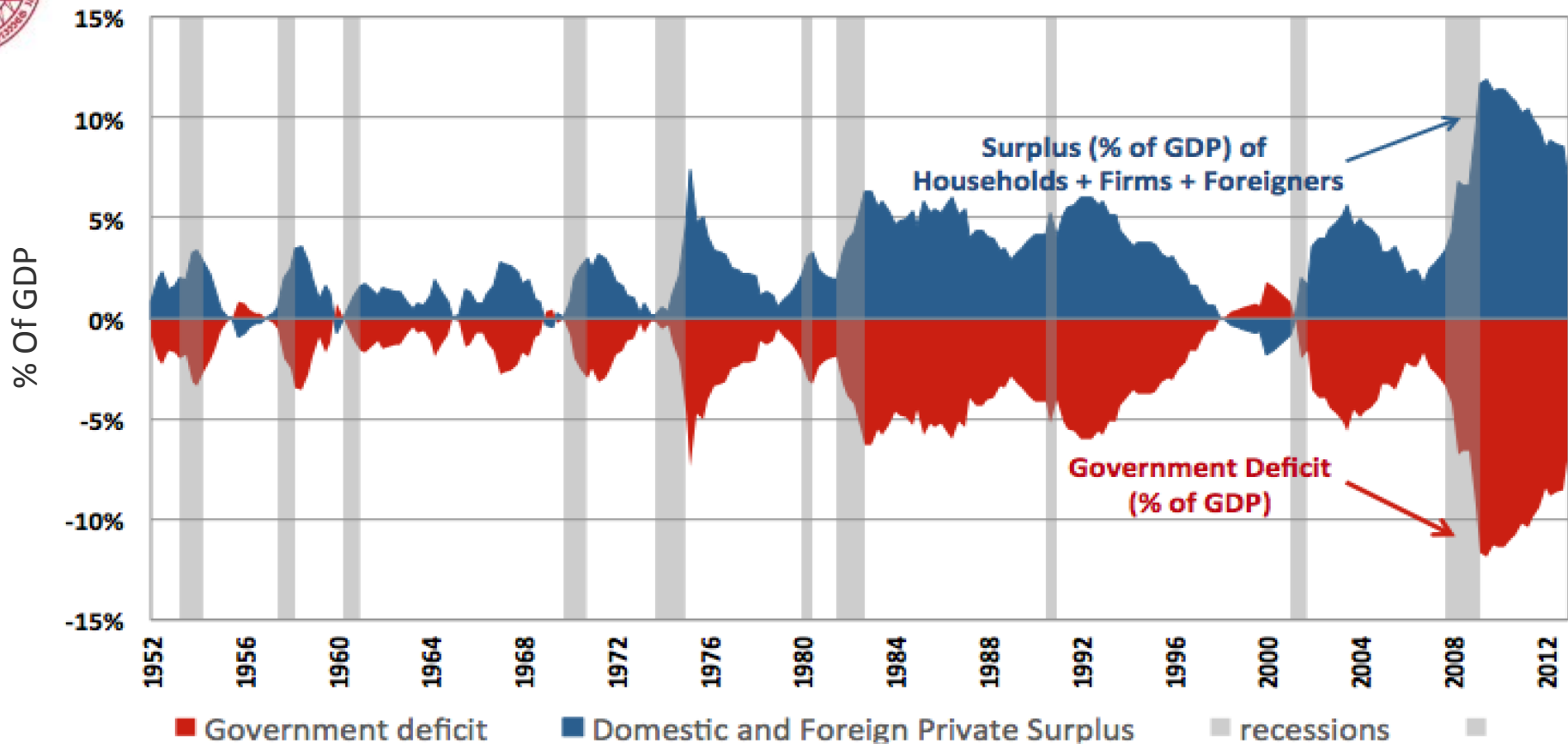
- The sectors cannot **all** be in **deficit**
- The sectors cannot **all** be in **surplus**

A government sector deficit = non-government sector surplus



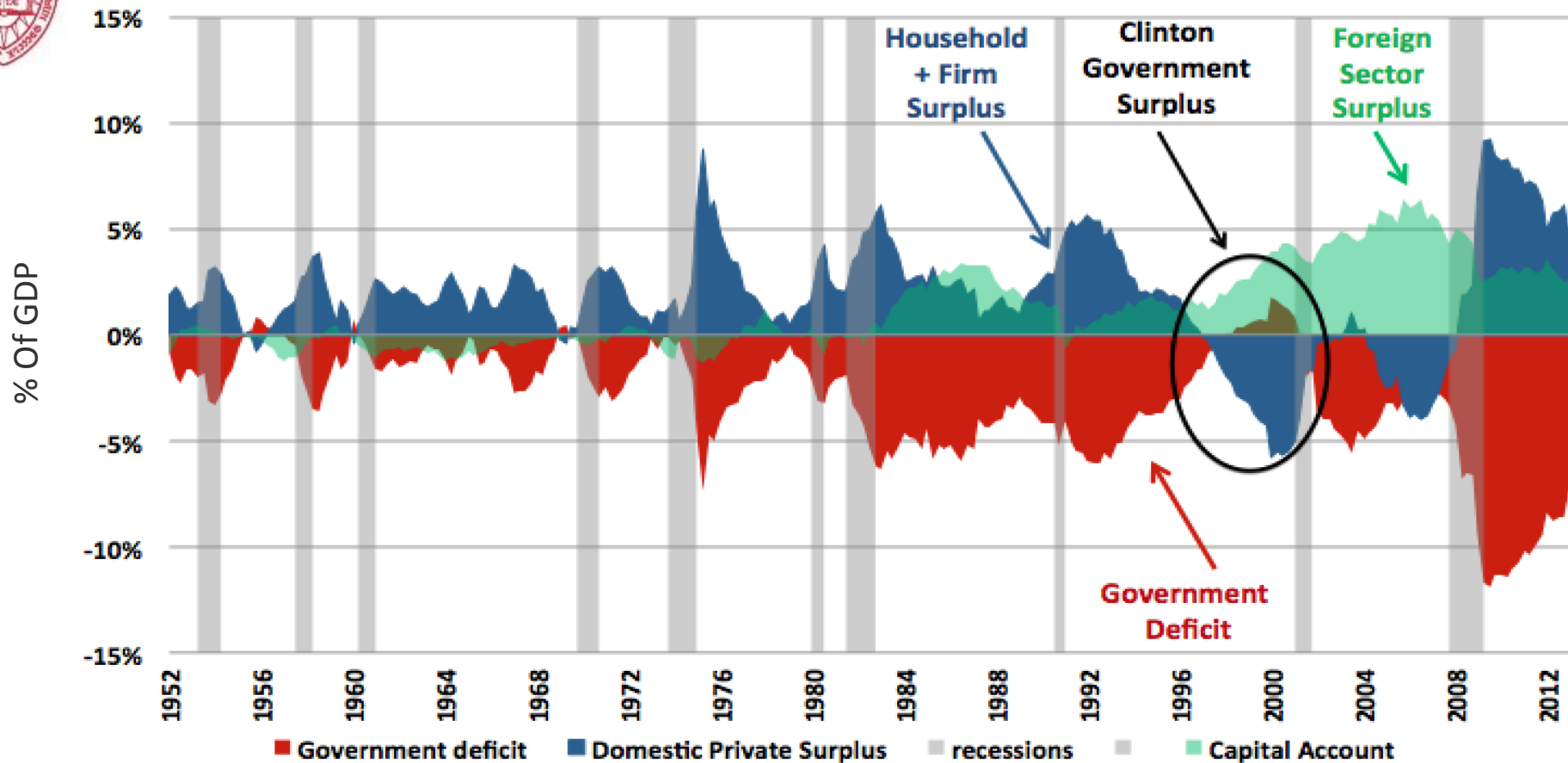


USA: Sector Financial Balances



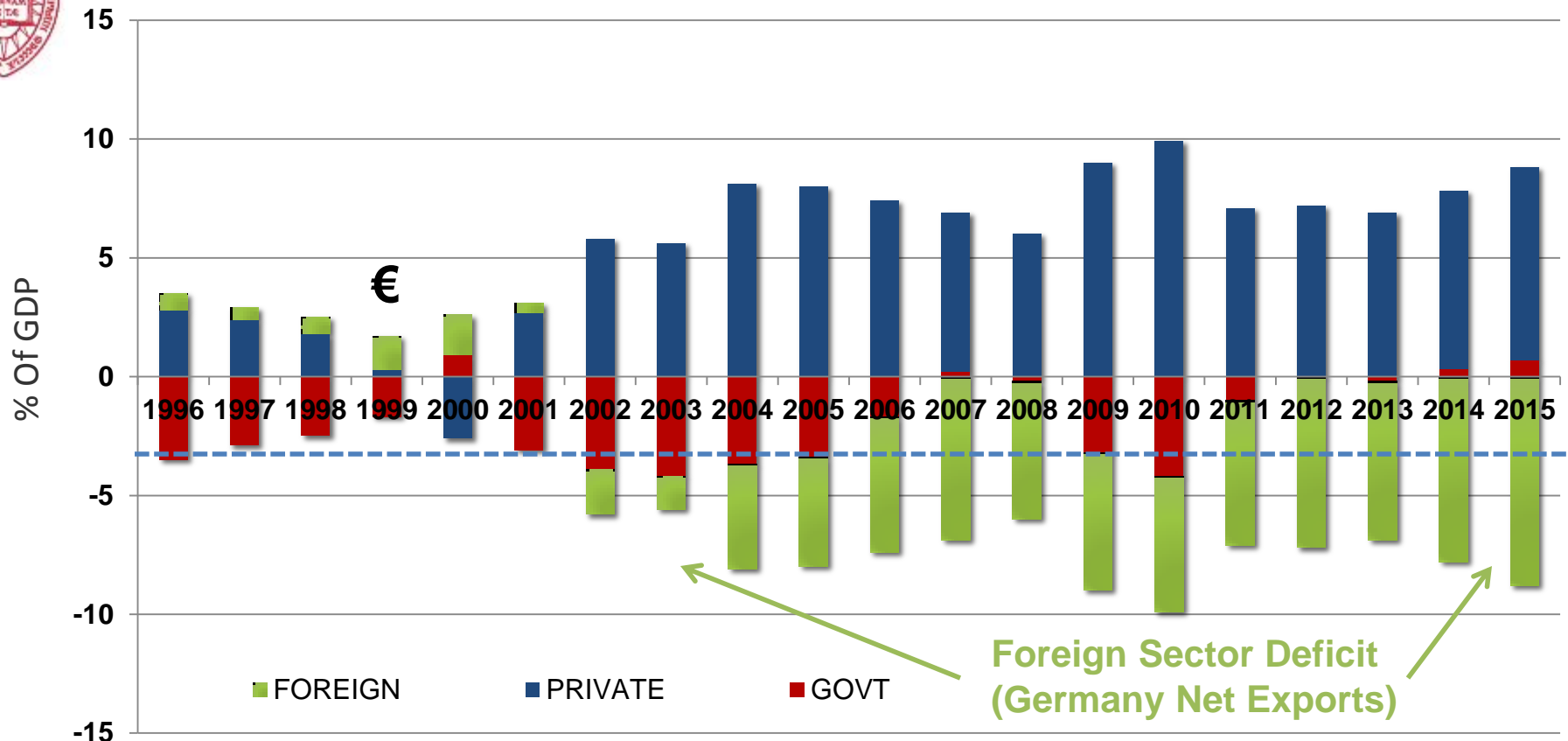


USA: Sector Financial Balances





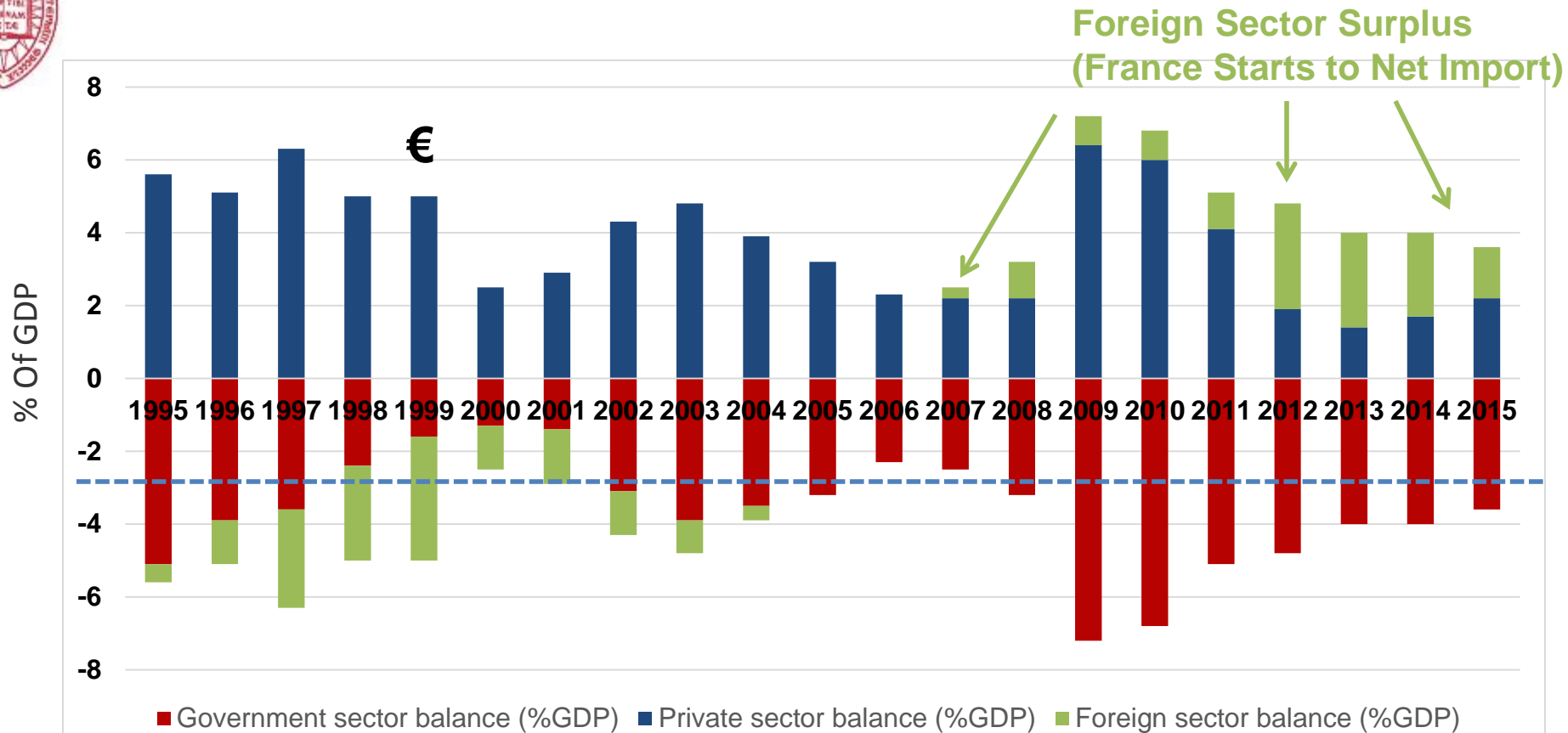
Germany: Sector Financial Balances



(source: Eurostat)

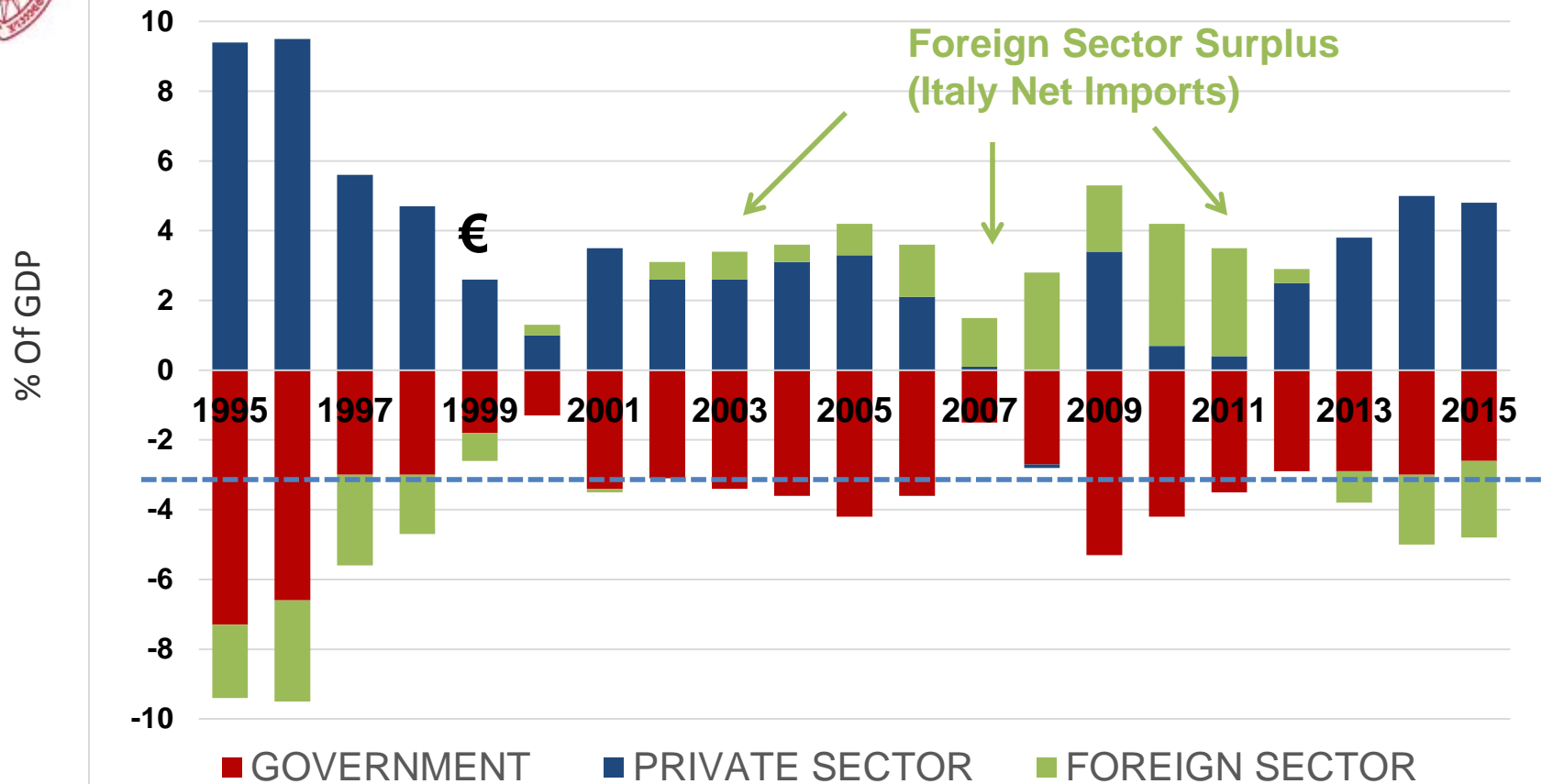


France: Sector Financial Balances



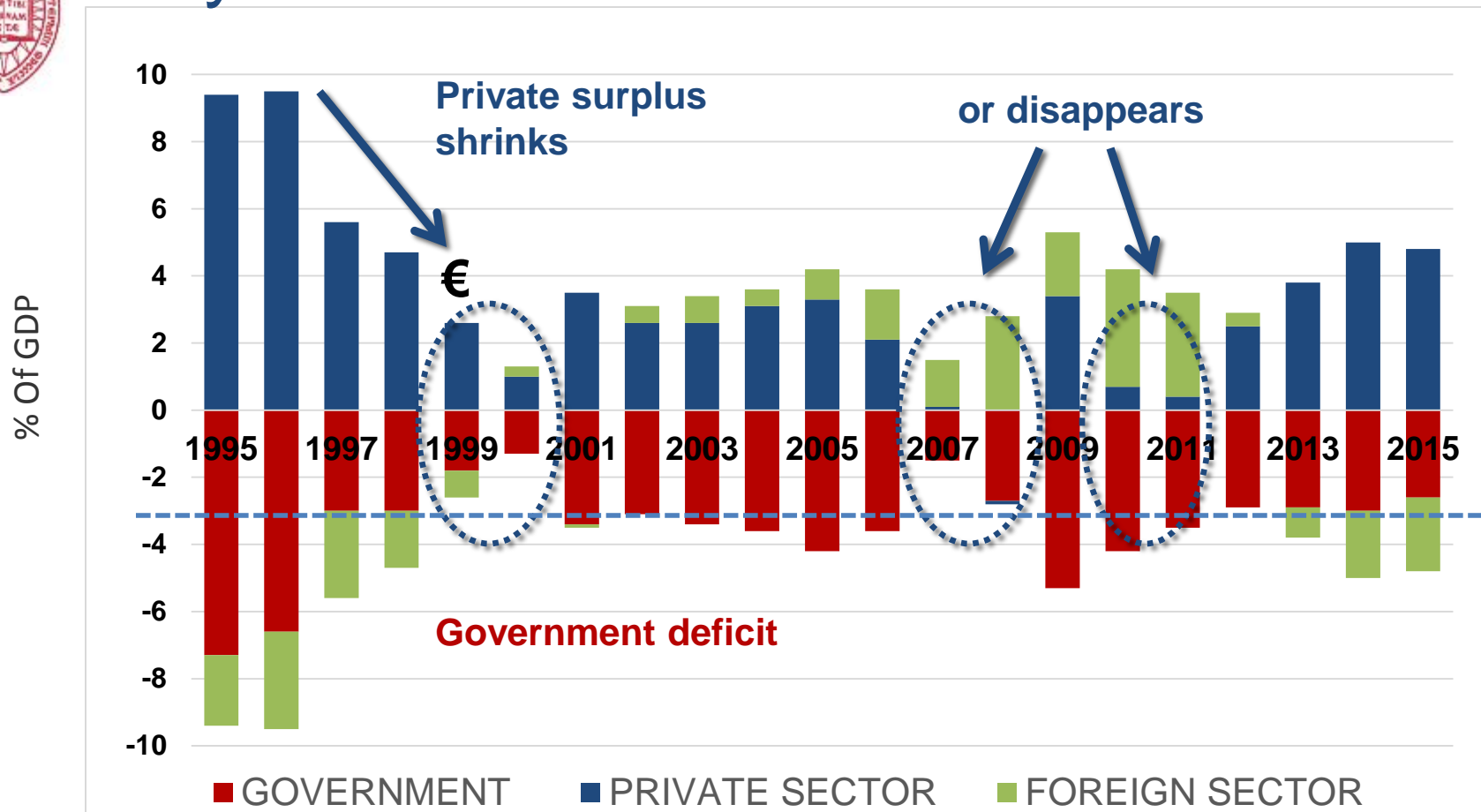


Italy: Sector Financial Balances



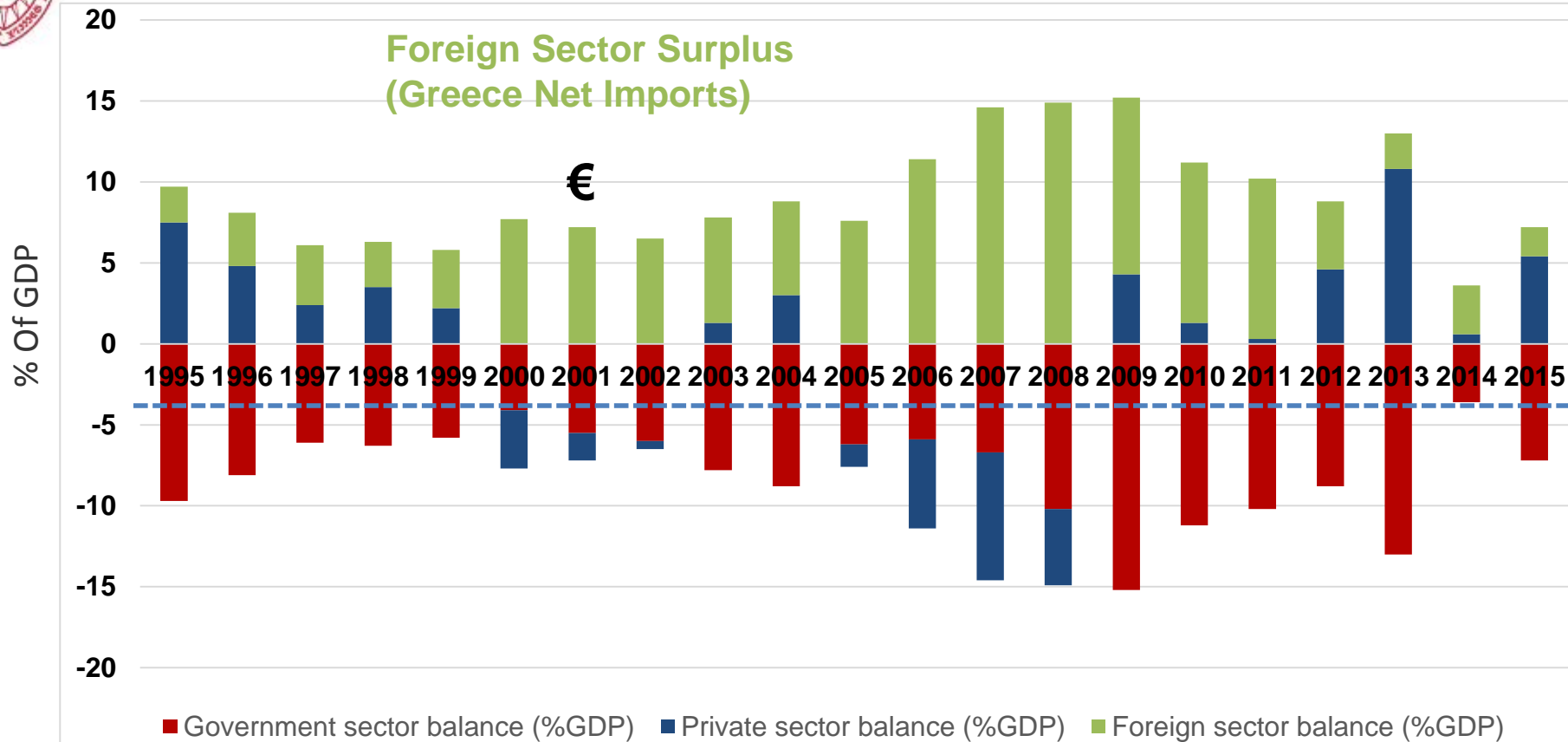


Italy: Sector Financial Balances



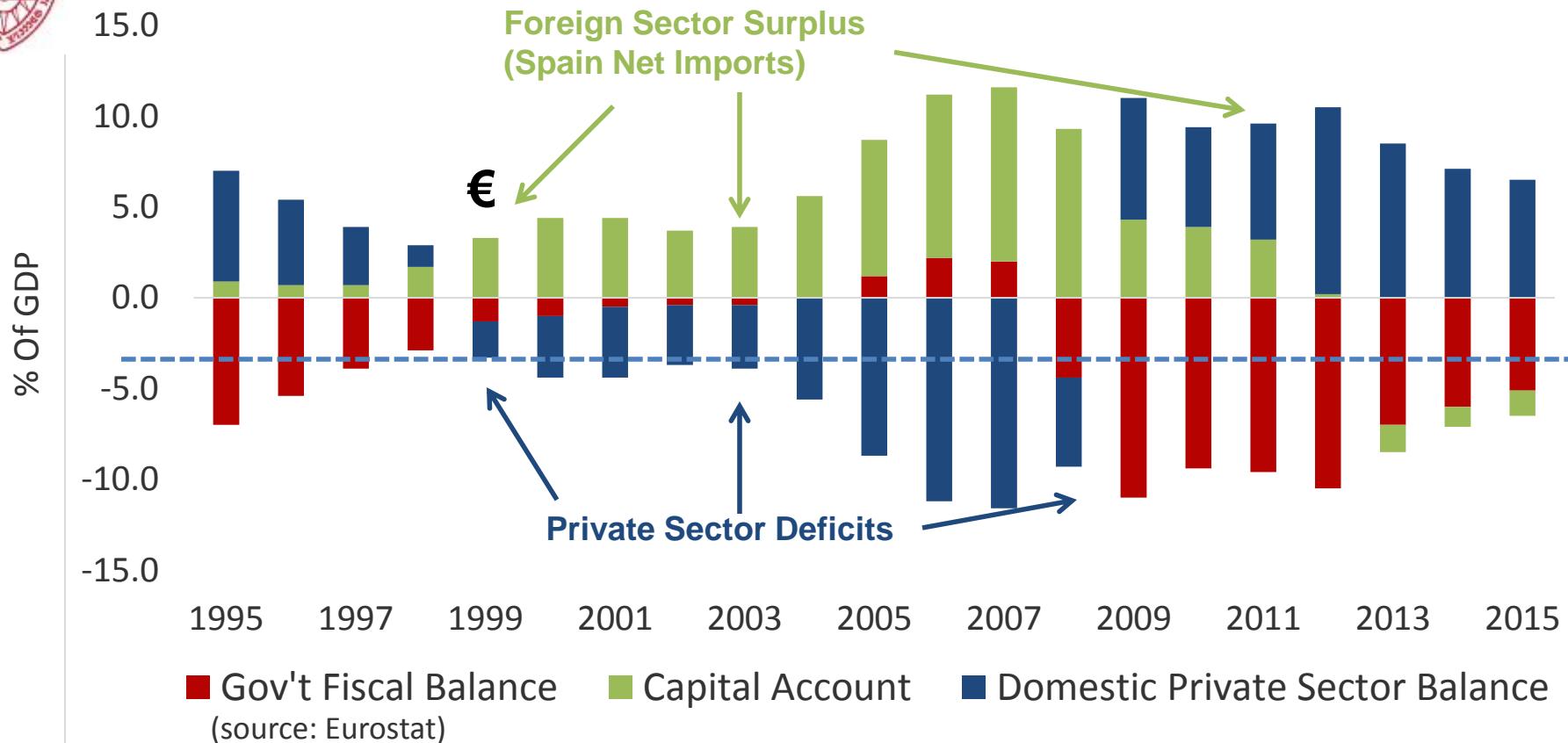


Greece: Sector Financial Balances



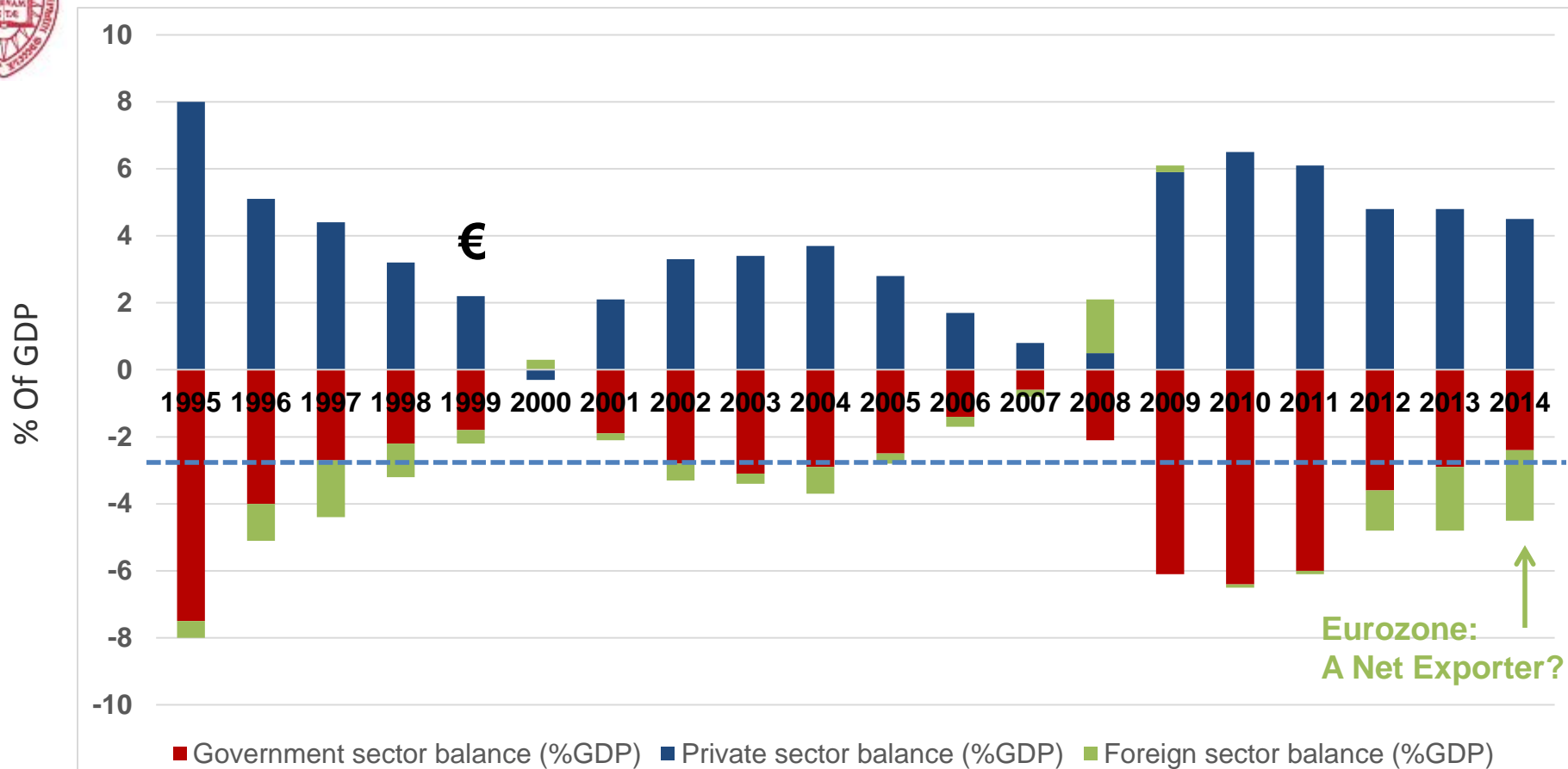


Spain: Sector Financial Balances





Eurozone: Sector Financial Balances





Only the government sector can act counter-cyclically

CURRENCY REGIMES

- Free float
- Managed float
- Exchange rate targets
- Pegged but adjustable
- Crawling peg
- Hard peg
- Currency board
- Dollarization
- Monetary Union



Largest operational
policy space

Most restrictive
operational policy space



Claims I made and claims I didn't

- **YES** “the monopolist is **always** solvent, but it can only buy what is for sale”
- **NO, I did not say that** “the government should buy everything that’s for sale?”
- **NO, I did not say that** “deficits are never a problem and do not matter”
- **YES** deficits can cause inflation; they can impact the value of the currency
- **YES** deficits are ‘necessary’ to allow the private sector to be in a surplus
- **NO, I did not say that** “deficits are “good” or “bad”; they are simply a reflection of how the economy works
- **YES** taxes and bonds do NOT finance governments with sovereign and freely floating currency
- **NO, I did not say that** “taxes do not matter.” They do.
 - Taxes drive money, they transfer real resources to the public sector and are powerful incentives
- **YES** the monopolist can determine the prices it pays for real resources
- **NO, I did not say that:** “the monopolist must set all prices”
 - One price is enough (tomorrow’s talk!)
- **YES** monopolist can anchor some basic terms of exchange between its currency in relation to some real resources that are being offered to get the currency



Thank you