Funding the Future

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It was recently decided on this blog that in general guest posts here were not a good idea, but that the occasional elevation of a comment into a blog post, at my discretion, was fine. I am happy to go along with that.

I am also delighted that Helen Schofield, who is one of the regulator commentators on the blog has, as I asked if she might, summarised her thinking on the relationship between Christine Desan's work on money and modern monetary theory.

Helen supplied this to me in eight comments, but I think they might become our blogs to be published over the next few days. I have not edited them. I offer them as Helen did to me, in the hope that they might stimulate discussion. These are the first two.

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Christine Desan's Work In Relation To MMT

Instalment One

Richard asked me to write about the relevance of Christine Desan's work to furthering MMT knowledge. Desan's first degree involved her in the Sociology of Religion and her second degree was in Law. The main message of her work as I see it is to point out to us that the design of money is continuously evolving in its design. I suspect her involvement with the Sociology of Religion made her aware of the fact the cooperative endeavour embedded in nature, of which we're part, is very much part of the evolutionary design of money.

The recognition "evolutionary design" was going on made Desan pay attention to history but I think it helps before you start looking at money's history to ask "What are the key tasks we're asking money to do for us?" It seems reasonable to narrow these tasks down to three; firstly, to overcome the "coincidence of wants problem" in private exchange, secondly, to enable the government, or chief stakeholder in a society or country as Desan calls this agency, to easily obtain resources from members of the society or country to deal with collective needs including threats, and thirdly, to enable saving by society members or country citizens to deal with future events and desires.

As MMTer’s we should all be familiar with these three tasks for money, collective and private with savings, there is, however, one other very important need necessary to accompany them and that is any money created must hold its value for as long as possible. Desan like Richard argues the best promise available to achieve this is government created money. I have to tell you that it’s with this argument that historically contention breaks out and thinking gets confused but let me start with Desan’s first argument on “value holding” which is really an enhanced core MMT argument.

Desan quotes the work of Gary Gorton (also a professor at Harvard University like her) and other colleagues. Gorton asks the question what constitute safe-assets. He argues there needs to be two essential factors information-insensitivity and good collateral.

The first factor is not having to constantly check that the so called safe-asset will “honour” its promise to be reliable for medium of exchange and savings purposes. The classic case of this is the early days of private sector banking where there’d be insufficient reserves to honour a bank’s promises. So, for example, in the case of gold-smith banks who offered receipts for holding gold and silver coins and bullion in their vaults and those receipts were subsequently traded to buy goods and services then come the time an individual decided to redeem a receipt for specie coinage or bullion but the gold-smith bank had over-issued too many receipts and there’d been too many redemptions there was a problem. Once word got out there’s likely be a bank run. In the 19th century and early 20th when cheques were being used there were often problems of them bouncing at banks down the line or customers being able to withdraw savings from the bank for lack of reserves. It may, of course, been too many bad loans that resulted in lack of reserves.

The second factor that determines what is a safe-asset is having good collateral. One of Gorton’s colleagues Tri Vi Dang calls “debt on debt” the best form of collateral. This is the ability to redeem or retire a debt. Clearly contractual law applies if a bank wants to redeem a bank loan either holding the debtor to the original loan repayment agreement or a modified version of it. It can of course take action to recover money from a loan defaulter via the defaulter’s collateral but note the law might limit the amount. In the United States, for example, there is a $10,000 limit on credit card recovery. The best “debt on debt” agency is obviously government which sets the laws including its powers to impose taxation and get coercive about it if it needs to. Again this is what Richard means when he say’s “the government has by far the best promise” meaning ability to retire money so as to maintain its value as long as possible.

Instalment Two

The second argument Desan puts forward is that whilst the work of Gorton and colleagues makes sense you also have to take into consideration what the state of the society or country is in that the safe-assets are being used. To identify just how stable that society or country really is. Is it under threat from something like other societies or countries or the environment or disease, is there internal conflict with power struggles taking place. Desan tells us that the long history of societies and nations using specie money, gold and silver, is that if there’s a collapse of civilisation or another society or country takes over yours there’s always the possibility the coinage can be melted down and sold as bullion either within your own territory or abroad.

It’s believed that in the Western world coins were first invented by Greeks in Lydia (now part of Turkey) sometime in the 7th century BC. The use of silver coinage was a central part of the Roman Empire. Whilst they imposed taxes in kind on some countries in the Empire (wheat from Egypt, for example) generally speaking they preferred taxes paid in their coinage. Notably they made sure that silver mines were firmly controlled and coins were struck by “mint magistrates.” Italy itself contained few silver mines and the creation of the Roman Empire would have been driven in part by the desire to obtain more silver for coinage. It should be noted the Romans traded with Greek colonies in Italy which used silver coinage. Clearly taxing in coinage although thought of as tribute from non-Italian countries in the Empire had the effect of maintaining the value of the coinage as long as possible from the ravages of inflation. However, the Romans minimised taxation on Romans in Italy unfairly distributing the tax burden to the non-Italian countries, ultimately this was probably one of the drivers that led to the collapse of the empire. It would also seem unclear whether the Romans understood the concept of monetary inflation or indeed deflation by issuing too many or too few coins but emperors did engage in debasing the coinage in order to make government spending money go further.

As we know in the UK the Romans left here but they also left other countries in Europe and yet the use of specie money continued. In the UK it continued for over 1600 years although there was a two hundred year break after 400AD where little specie money was used except probably for trading with other countries. Since we don’t know if the Romans understood the dangers of monetary deflation and inflation we don’t know if that knowledge was lost in the UK when they finally left in 400AD. I suspect the British learned the lesson of inflation for the simple reason European countries were often at war internally or with each other with the collapse of the Roman Empire and Kings and Queens, ultimately Parliaments, were almost constantly looking for money to fight these wars and debasement of the currency was one way to do this. Indeed in England for all but three years in the 17th century the country was involved in fighting one war or another!

Specie money was therefore both a hedge against uncertainty particularly war outcomes but even in interludes, periods of peace, there was always the potential for it to have a deflationary effect because merchants could sell coins at a higher price often abroad for melting down for non-coinage and coinage uses. It seems reasonable to argue that once the tight empire control grip of the Romans had gone England never really succeeded in getting a tight control of its species money right up until the end of the 17th century. Indeed unlike the Romans England allowed private citizens to bring silver or gold bullion along to Royal mints and have coins created. The government exercised seigniorage by keeping some of the coins created for its own use. Of course if a higher price could be obtained for selling silver or gold as bullion private citizens wouldn’t bother having coins created which ultimately meant government hadn’t very good control over the amount of currency in circulation and therefore demand in the economy. It could only increase its control by securing silver or gold from abroad and it could be said this was a driver of imperialism.