



JE KINDLE-NOTITIES VOOR:

Understanding Money Mechanics

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58 Highlights

Highlight (Geel) | Locatie 171

A formal definition for money is that it's a universally accepted medium of exchange. Menger's explanation showed how such a commodity could emerge from its peers merely through voluntary transactions and without any individual seeing the big picture or trying to "invent" money.

Highlight (Geel) | Locatie 175

Money that emerged in the process we've described would necessarily be commodity money, in which the monetary good itself is also a regular commodity. (In

Highlight (Geel) | Locatie 178

What would make a community gravitate toward some commodities but not others? Besides having a wide marketability, an individual would want a medium of exchange to possess the following qualities: ease of transport, durability, divisibility, homogeneity, and convenient size and weight for the intended transactions.

Highlight (Geel) | Locatie 253

Once the banker (such as the goldsmith) realized that his deposit receipts ("notes") were treated by at least some members of the community as being "as good as money," he could lend out some of the coins that his customers had deposited with him, even though the customers still held paper receipts entitling them to immediate redemption. The whole operation was viable so long as the banker always had enough coins on hand to satisfy whoever might show up to demand their deposits back.

Highlight (Geel) | Locatie 268

As a result of various court rulings, it is now standard to treat the deposit of money with a bank as a loan, so that the depositor becomes a creditor of the bank and the actual ownership of the money transfers to the banker, even for "demand deposits," which are payable upon notice. Rightly or wrongly,⁹ it is this legal treatment that allowed the proverbial goldsmith to lend out some of the coins that his depositors had placed with him for safekeeping, and which allows modern banks to engage in "fractional reserve banking." To reiterate, it is this practice by which banks can create (and destroy) money—a process that we will fully explain in chapter 4.

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Under a gold standard, governments don't use coercion to "fix" exchange rates between different currencies. So the policy here is nothing at all like governments setting minimum wages or maximum apartment rents, where the "fixing" is accomplished through fines and/or prison time levied on individuals who transact outside of the officially approved range of prices.

Highlight (Geel) | Locatie 361

Instead, under a gold standard, each government makes the standing offer to the world to redeem its own paper currency in a specified weight of gold. This offer is completely voluntary. No one in the community has to exchange currency notes for gold; people merely have the option of doing so.

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To say that World War I would have been "unaffordable" on the classical gold standard really just means that the citizens of the countries involved wouldn't have tolerated the huge increases in explicit taxation and/or regular debt issue to pay for the conflict. Instead, to finance such unprecedented expenditures, their governments had to resort to the hidden tax of inflation, where the transfer of purchasing power from their peoples would be cloaked in rising prices that could be blamed on speculators, trade unions, profiteers, and other villains, rather than the government's profligacy. This is why Ludwig von Mises said that inflationary finance of a war was "essentially antidemocratic."¹⁹ In light of these realities, when joining the war the major belligerents all broke from the gold standard, although the United States's deviation consisted only in President Wilson embargoing the export of gold bullion and coin in 1917.²⁰ After the war, the major powers made halfhearted attempts to restore some semblance of the international gold standard, but these were counterfeit versions (as we will detail below). The First World War thus dealt a mortal blow to the gold standard from which it never recovered. We

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Because of the severe wartime price inflation, after the 1918 armistice the major powers desired a return to gold. However, resuming specie payment at the prewar parities would have proven very painful, since their currencies had been inflated so much during the war. The United States, for its part, ended the embargo on gold export in 1919, but in order to staunch the resulting outflow of gold and maintain the prewar dollar-gold ratio, the Federal Reserve was forced to raise interest rates and massively contract credit, resulting in the Depression of 1920–21.

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The interwar gold exchange standard sought to "economize" on gold holdings: rather than storing physical gold in central bank vaults around the world, only the United States and Great Britain needed to redeem their currencies in the yellow metal, while the rest of the world could stockpile paper claims against the financial titans. Yet this system was very fragile, relying on cooperation among the central banks so as not to threaten the smaller gold reserves that were doing much more "work" than they had under the classical standard.

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As an example of the necessary coordination, when then chancellor of the Exchequer Winston Churchill in 1925 sought to resume specie payments at the prewar parity and restore the pound to its traditional value of \$4.86, in order to avoid a massive deflation in British prices, the Federal Reserve (under the leadership of Benjamin Strong) agreed to an easy-credit policy, thus weakening the dollar in order to close some of the gap between the currencies.²⁴ Economists of the Austrian school argue that the Fed's loose policies of the 1920s helped fuel an unsustainable boom that led to the 1929 stock market crash.²⁵

Highlight (Geel) | Locatie 904

M0: The narrowest definition of money, M0 refers to the actual physical items, such as \$20 bills and coins. (Note that some classifications consider M0 equivalent to the monetary base.) Monetary Base: The monetary base includes paper currency and coins, as well as commercial banks' (electronic) deposits at the Federal Reserve. Up until the change in regulations made in 2020, commercial banks in the US were required to keep some money "in reserve" in order to satisfy the demands of their customers who might show up to pull some cash out of their checking accounts. These "reserve requirements" could be satisfied by either literal paper currency in the banks' vaults, or by commercial banks' deposit balances with the Federal Reserve.

Highlight (Geel) | Locatie 913

M1: When going from the monetary base to M1, we need to be careful, because we don't merely add another component, but also subtract two. Specifically, M1 consists of official US paper currency and coins held by the general public (but not in bank vaults, to avoid double counting), plus demand deposits and other checkable deposits (e.g., negotiable order of withdrawal (NOW) accounts), plus traveler's checks issued by nonbank institutions. That means M1 does not include commercial bank reserves, whether they consist in notes and coins in the vault or electronic entries on the Fed's books. The intuition behind this classification is that M1 measures the amount of money and "very close money substitutes" held by the general public. A money substitute, as the name suggests, is an immediately redeemable claim on actual money that everyone in the market expects to be honored at par.

Highlight (Geel) | Locatie 919

M2: Everything in M1, plus most savings account balances, so-called money market account balances, the balances on retail money market mutual funds, and small denomination time deposits (including bank certificates of deposit—CDs—of less than \$100,000).

Highlight (Geel) | Locatie 921

There are other popular aggregates, such as MZM (money of zero maturity) and M3, which of course is M2 plus some additional items that are claims on actual money that are not as "economically equivalent" to money as the components in the previous categories. (For example, the implied dollar value of certain repurchase agreements, or "repos," is included in M3 but not in M1 or M2.) Fans of the Austrian school will be interested in the "true money supply" (TMS) aggregate developed by Murray Rothbard and Joseph Salerno, which corresponds to the Austrian theoretical definition of money.²

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Yet even though shares of corporate stock (especially those listed on major exchanges) are very liquid, we don't include them in the definition of money. This is because a share of stock is a claim on ownership of the corporation, not a claim on a certain amount of dollars. The price of a share of stock—quoted in dollars—can fluctuate rapidly, meaning that your “\$200,000 in stocks” could fall to zero depending on the news. In contrast, if you have traveler's checks, those are claims denominated in dollars. They are not literally the same thing as money—if you're trying to pay a cab driver, it's better to have a \$50 bill than a traveler's check entitling you to a \$50 bill—but traveler's checks are nonetheless much better money-substitutes than shares of stock.

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As before, we point interested readers to the footnotes for further reading that spells out this process more exhaustively. For our purposes here, there are two crucial takeaway messages: 1. In our current fiat money system, the Federal Reserve creates new base money when it buys assets by writing checks on itself. Going the other way, the Federal Reserve destroys base money by selling assets (or by letting its assets mature and refraining from rolling over the proceeds). These actions do not require a literal printing press, as they can be achieved through electronic operations. 2. When the Fed injects new base money into the system, it will often be deposited into commercial banks, where it will add to reserves. Under fractional reserve banking, the new reserves give the commercial banks the ability to pyramid new money (as measured by M1, M2, etc.) on the system through the process of granting new loans. Going the other way, when the commercial banks restrict their loan portfolios or the public withdraws base money from the banks, it causes the broader aggregates (M1, M2, etc.) to shrink.

Highlight (Geel) | Locatie 1471

As Figure 1 indicates, the explosion in Fed asset purchases since March 2020 dwarfs even the three rounds of QE (quantitative easing) following the 2008 financial crisis. Indeed, from March 4, 2020, through March 3, 2021, the Fed increased its assets from \$4.2 trillion to \$7.6 trillion, an incredible one-year jump of \$3.3 trillion (or 78 percent). Furthermore, as the graph reveals, the upward trajectory continues as of

Highlight (Geel) | Locatie 1475

Besides the quantitative change in the Fed's asset purchases, there has been a qualitative change in the type of asset. In particular, the Fed is now buying large amounts of private sector corporate bonds (both individually and exchange-traded funds); as of the mid-May 2021 balance sheet report, the Fed's “Corporate Credit Facilities LLC” held almost \$26 billion in assets.¹ This change in policy would have been extremely controversial (if only for the potential corruption) prior to the financial crisis, but it is now a seemingly natural out-growth of the expansion of Fed discretionary power that began in the fall of 2008.

Highlight (Geel) | Locatie 1484

At the same time, the Fed announced expansions of preexisting asset purchase programs, as well as the creation of a “Term Asset-Backed Securities Loan Facility (TALF), to support the flow of credit to consumers and

businesses,” which would “enable the issuance of asset-backed securities (ABS) backed by student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration (SBA), and certain other assets.”³ At this point, the Federal Reserve now has the capability of influencing the credit markets not just for commercial banks, but for commercial and residential real estate, corporate bonds, commercial paper, cars, student loans, and even personal credit cards.

Highlight (Geel) | Locatie 1493

In addition to cutting the target for the federal funds rate back down to 0 percent (with a range of up to 0.25 percent) and pledging to increase the scale of its asset purchases, the Federal Open Market Committee (FOMC) statement concluded with this tantalizing paragraph: In a related set of actions to support the credit needs of households and businesses, the Federal Reserve announced measures related to the discount window, intraday credit, bank capital and liquidity buffers, reserve requirements, and—in coordination with other central banks—the U.S. dollar liquidity swap line arrangements. More information can be found on the Federal Reserve Board’s website. (bold added) The final word, “website,” contained a hyperlink to the Fed’s main website. Yet if one looked at the compilation of press releases, there was an additional item posted on March 15, 2020, titled “Federal Reserve Actions to Support the Flow of Credit to Households and Businesses,” which was alluded to in the official FOMC statement.⁵ For our purposes, we will highlight the last measure listed in this supplemental statement:

Highlight (Geel) | Locatie 1509

Since the Fed’s actions following the financial crisis of 2008, the US banking system as a whole has been awash with excess reserves (see the second chart in chapter 13). This is because following the Fed’s injections of new reserves under the various rounds of quantitative easing, the commercial banks did not create new loans for their own customers to the maximum amount legally allowed. Therefore, the immediate impact of the Fed’s 2020 decision to abolish reserve requirements should be minimal, since the original reserve requirements were not binding at the time of the change. However, even though the US banking system had more than enough reserves to cover its requirements, it is still the case that the level of required reserves rose dramatically—quintupling from about \$40 billion to more than \$200 billion—since the financial crisis, as the following chart reveals:

Highlight (Geel) | Locatie 1545

In other words, in late April of 2020, the Fed removed some of the limits on savings deposits in a way that made them equivalent to checking account deposits. As such, savings deposits from May 2020 forward are now included in M1, whereas before they had been excluded from it. Yet either way, savings deposits were always included in M2. Consequently, we can look at the Fed’s graphs of both M1 and M2 to isolate the impact of the reclassification, see Figure 3. As the figure indicates, there was a massive spike in the official M1 measure in May 2020, largely (though not entirely) reflecting the reclassification of savings deposits as part of M1. However, note that M2 also rose sharply at exactly this time, reflecting a genuine increase in money held by the public because of the coronavirus panic and Fed policy. (Also remember that the M1 chart shown in chapter 13 was made based on the original M1 numbers, before the retroactive reclassification occurred. The chart in chapter 13 shows that M1, even according to the old definition, truly did spike in the spring of 2020.)

Highlight (Geel) | Locatie 1802

Although it is important to recognize that massive price inflation is always the result of massive monetary inflation, there isn't a stable relationship between the two; it's not the case that, say, a 50 percent increase in the quantity of money necessarily leads to a 50 percent increase in prices.

Highlight (Geel) | Locatie 1884

Economists in the Austrian tradition have criticized the equation of exchange.¹³ In the first place, it seeks to explain economic phenomena in a mechanistic fashion, the way an engineer might write out an equation describing the flow of water through a pipe. In contrast, the Austrians typically follow the approach of Mises by using the subjective preferences of an individual to explain his or her demand to hold a cash balance of a certain size. At any moment, there is no such thing as "money in circulation," as the equation of exchange leads us to believe. Rather, every unit of money is always held in an individual or organization's cash balance, and the Austrians typically use this perspective when tackling problems of monetary and price inflation. This "micro" method can then be scaled up to arrive at the market demand to hold money, which interacts with the total supply in order to explain the purchasing power of money. In this respect, the Austrian approach to explaining the "price" of money is the same subjective value theory used to explain the price of apples. In light of the Austrian method, the variables of the equation of exchange are unhelpful or even nonsensical. No individual ever relies on the "average velocity of circulation" (V) of money when making decisions. The notion of a price level (or index), P , is also dubious, because it invites the false notion that changes in the quantity of money affect all prices uniformly. Yet in fact, when new money enters the economy in the real world, it isn't "neutral," but instead causes some prices to rise faster than others and in a sense transfers wealth from the rest of the community into the hands of the early recipients of the new money. The impact of this uneven process of price changes is called the Cantillon effect.¹⁴

Highlight (Geel) | Locatie 1898

Putting aside Cantillon effects, there is no reason for monetary inflation to necessarily have the same proportional impact on even the average index of prices. As Mises observed, once a hyperinflation is underway, injections of new money may lead to greater than proportional increases in "the price level" (if such a concept made sense), as the community seeks to rid itself of the cash as quickly as possible in exchange for other goods.¹⁵ For example, once a hyperinflation is underway, if the government doubles the quantity of money, then this action may result in more than a doubling of the typical price of a consumer good.

Highlight (Geel) | Locatie 1903

On the other hand, as the advanced economies experienced after the financial crisis of 2008, sometimes large injections of new base money do not correspond with comparable increases in consumer price indices. (We will cover this topic in greater detail in chapter 13.) Even if we restrict our attention to money in the hands of the public (using the aggregate $M1$ rather than the monetary base [$M0$]), it is still the case that there is no automatic connection between money and consumer prices: Figure

Highlight (Geel) | Locatie 2009

To reiterate, no matter what happens, the outcome can always be reconciled with the equation of exchange, because it is an identity rather than a falsifiable theory. If M doubles while prices and real output stay relatively constant, the “explanation” is that V suddenly fell in half. In a scenario like this, the objection to the equation of exchange isn’t that it’s wrong, but rather that it may mislead observers into thinking there is a simple relationship between monetary and price inflation.

Highlight (Geel) | Locatie 2008

As the above quotations make clear, Krugman argues that the yield curve flattens/inverts before a recession because investors forecast trouble ahead. There are two problems with this approach. First, why would an inverted yield curve spook investors if the reason it inverts is that investors already know a recession is coming? Second and more significant: Krugman’s explanation would make sense if yield curve inversions typically occurred when the long bond yield collapses. But in fact, as the following chart makes clear, the yield curve inverts primarily because the short rate spikes upward before a recession:

Highlight (Geel) | Locatie 2015

In the above chart, particularly for the middle three recessions, it is clear that the yield curve inverted because the three-month yield (black line) rose rapidly to surpass the ten-year yield (green line). This is the opposite of what Krugman’s readers would have expected to see. An

Highlight (Geel) | Locatie 2019

standard Austrian business cycle theory—which we explained in chapter 8—is quite compatible with the evidence presented in the above figure. In the Misesian framework, the unsustainable boom is associated with “easy money” and artificially low interest rates. When the banks (led by the central bank, in modern times) change course and tighten, interest rates rise and trigger the inevitable bust.⁵ (It is standard in macroeconomics to assume that the central bank’s actions affect short-term interest rates much more than long-term interest rates.)

Highlight (Geel) | Locatie 2029

As the chart indicates, these two series have a remarkably tight connection. Specifically, when the money supply grows at a high rate, we are in a “boom” period and the yield curve is “normal,” meaning the yield on long bonds is much higher than on short bonds. But when the banking system contracts and money supply growth decelerates, then the yield curve flattens or even inverts. It is not surprising that when the banks “slam on the brakes” with money creation, the economy soon goes into recession.

Highlight (Geel) | Locatie 2082

In the previous section we established the fact that interest rates really did fall to historically low levels as the housing bubble intensified, while the cooling off of the boom went hand in hand with rising interest rates.

Highlight (Geel) | Locatie 2096

Recall from chapter 4 that the “monetary base” consists of paper currency and member banks’ deposits at the Fed. Therefore, the Federal Reserve has absolute control over the monetary base; those rascally Asians who have the gall to live below their means can’t directly increase the US monetary base. As Figure 3 shows, when US interest rates fell sharply in the early 2000s, this occurred during a period of rapid growth in the monetary base. If the Fed didn’t want interest rates falling so low in the early 2000s, it shouldn’t have engaged in so much monetary inflation.

Highlight (Geel) | Locatie 2439

The danger in this type of explanation is that it often misconstrues what actually happens when new money is injected into the economy. In reality, it is not the case that some money is “in” the stock market, while other portions of the money stock are “in” consumer goods. At any given time, all units of physical currency are held in cash balances, located in people’s wallets (or home safes), or inside of commercial bank vaults. If someone buys one hundred shares of a stock at \$10 per share, it’s not that money “goes into the stock market.” Rather, what typically happens is that \$1,000 is debited from the checking account of the buyer, while an equal amount is credited to the checking account of the seller. If the buyer and seller are clients of different banks, their transaction might cause some reserves to transfer from one bank to the other, but nobody looking at the money after the fact would be able to tell that it “had gone into the stock market.”

Highlight (Geel) | Locatie 2725

Not only did Bernanke’s Fed engage in a jaw-dropping injection of base money in response to the panic, but the admittedly tepid base growth in 2007 is not something that most observers would have predicted would lead to a global financial panic. (Although not shown on this chart, the monetary base actually shrank in the early 1960s—in contrast, its twelve-month growth never went negative in 2007 or 2008—and yet this didn’t lead to the worst crisis since the Great Depression.

Highlight (Geel) | Locatie 2728

Notwithstanding the Fed’s handling of the monetary base, one might suppose that M1 and M2 collapsed on Bernanke’s watch—just as Friedman and Schwartz pointed out happened in the early 1930s. Yet on the contrary, both the M1 and M2 measures of the money stock continued to grow after the crisis struck, particularly M1:
Figure 2: M1 Money Stock Source: Board of Governors of the Federal Reserve System (US)

Highlight (Geel) | Locatie 2739

The above chart shows the twelve-month percentage change in the M2 monetary aggregate. It clearly shows that there was nothing unusual about the “growth rate of money in the hands of the public” before or during the crisis, with the M2 growth rate only dropping sharply after the Great Recession had officially ended (i.e., to the right of the gray bar). Furthermore, the above chart shows that the M2 growth rate really did fall substantially in the early 1990s. If one were to adopt the Friedman and Schwartz framework—which explained the Great Depression as a collapse in M2 growth—then this modern chart would lead to the “obvious” conclusion that the financial crisis and ensuing Great Recession began in 1995. And yet, that obviously didn’t happen.

Highlight (Geel) | Locatie 2745

As the above charts indicate, Scott Sumner's explanation for the financial crisis and Great Recession shouldn't be labeled "monetarist" at all. There is no sense in which these events can be blamed on Bernanke's unwillingness to boost the money stock, however measured. (And for what it's worth, in 2008 Anna Schwartz herself blamed the financial crisis on the Fed for blowing up the housing bubble!

Highlight (Geel) | Locatie 2753

One of the very issues under dispute is whether aggressive monetary expansion by the central bank is medicine or poison for an economy entering recession. If the Austrian analysis of boom-bust cycles (given in chapter 8) is correct, then the Fed's actions from 2008 onward only generated another unsustainable boom. Sumner's rhetorical device of framing inadequate NGDP growth as "tight money" by definition would make it impossible to learn whether his policy advice is simply wrong. Consider a medical analogy: suppose a patient is suffering from fever, running a temperature of 103 degrees. One group of doctors recommends injecting the patient with substance M, in order to cure the fever. Yet another group of doctors argues that past injections of substance M are what made the patient sick in the first place.

Highlight (Geel) | Locatie 2784

Yet in our hypothetical scenario, Sumner would also claim victory. He would point out that when real GDP drops 15 percent while the price level only rises by 10 percent, nominal GDP falls by (roughly) 5 percent. Since Sumner recommended that the Fed keep NGDP growing at 5 percent, this horrible fall in NGDP—so Sumner would claim—was the culprit. Once again, Sumner would argue, the Fed's "tight money" had caused another economic disaster.

Highlight (Geel) | Locatie 2789

One illustration of this problem is the tendency for market monetarists to conflate "NGDP" with "total spending," at least in the way they discuss their framework in essays for the public.¹⁰ Yet there is much more "total spending" in the economy than what is spent on final goods and services. Even if we put aside the entire financial sector—and note that the standard Sumnerian model doesn't have a stock market or even banks, with Sumner actually arguing that putting banks in a model of the business cycle will only confuse matters¹¹—the bulk of "total spending" in the economy is actually on intermediate purchases of goods, which are ignored in calculations of GDP in order to avoid "double counting."

Highlight (Geel) | Locatie 2795

Normally, the conflation of "total spending" with "spending on final goods and services" might not be a huge problem in terms of policy advice, though it's conceivable that a change in economic organization (perhaps with industries becoming more or less "vertically integrated") could render the Fed's stance "tight" according to one metric but "easy" according to the other. The more fundamental problem is that Sumner's model ignores the entire capital structure of the economy, which blinds him to the very possibility of the Austrians being right.

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Actually, the situation is a bit more nuanced. To truly reap the advantages unlocked by MMT, a government must enjoy monetary sovereignty. For this, being a currency issuer is a necessary but insufficient condition. There are two

Highlight (Geel) | Locatie 3121

Countries with a “high degree of monetary sovereignty” include “the US, Japan, the UK, Australia, Canada, and many more” (p. 19) (And notice that even these countries weren’t “sovereign” back in the days of the gold standard, because they had to be careful in issuing currency lest they run out of gold.) In contrast, countries today like Greece and France are not monetarily sovereign, because they no longer issue the drachma and franc, but instead adopted the euro as their currency. The insistence on issuing debt in their own currency helps to explain away awkward cases such as Venezuela, which is suffering from hyperinflation and yet has the ability to issue its own currency. The answer (from an MMT perspective) is that Venezuela had a large proportion of its foreign-held debt denominated in US dollars, rather than the bolivar, and hence the Venezuelan government couldn’t simply print its way out of the hole.¹ In contrast, so goes the MMT argument, the US government owes its debts in US dollars, and so never need worry about a fiscal crisis.

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In other words, when someone like Alexandria Ocasio-Cortez proposes a Green New Deal, from an MMT perspective the relevant questions are not, “Can the Congress afford such an expensive project? Will it drown us in red ink? Are we saddling our grandchildren with a huge credit card bill?” Rather, the relevant questions are, “Is there enough slack in the economy to implement a Green New Deal without reducing other types of output? If we approve this spending, will the new demand largely absorb workers from the ranks of the unemployed? Or will it siphon workers away from existing jobs by bidding up wages?”

Highlight (Geel) | Locatie 3144

Regardless of what happens to the “price level,” monetary inflation transfers real resources away from the private sector and into the hands of political officials. If a government project is deemed unaffordable according to conventional accounting, then it should also be denied funding via the printing press.

Highlight (Geel) | Locatie 3147

What makes MMT “cool” is that it’s (allegedly) based on a fresh insight showing how all of the mainstream economists and bean counters are locked in old habits of thought. Why, these fuddy-duddies keep treating Uncle Sam like a giant corporation, where he has to make ends meet and always satisfy the bottom line. In contrast, the MMTers understand that the feds can print as many dollars as they want. It’s not revenue but (price) inflation that limits the government’s spending capacity. I hate to break it to Kelton and the other MMT gurus, but economists— particularly those in the free-market tradition—have been teaching this for decades (and perhaps centuries).

Highlight (Geel) | Locatie 3157

To repeat, this is standard fare in the lore of free-market economics. After explaining that government spending programs merely return resources to the private sector that had previously been taken from it, the economist will inform the public that there are three methods by which this taking occurs: taxation, borrowing, and inflation. The economist will often add that government borrowing can be considered merely deferred taxation, while inflation is merely hidden taxation. And

Highlight (Geel) | Locatie 3165

Kelton and other MMT theorists argue that inflation isn't a problem right now in the US and other advanced economies, and so we don't need to be shy about cranking up the printing press. But whether or not the Consumer Price Index is rising at an "unacceptably" high rate, it is a simple fact that when the government prints an extra \$1 million to finance spending, then prices (quoted in US dollars) are higher than they otherwise would have been, and people holding dollar-denominated assets are poorer than they otherwise would have been. Suppose that prices would have fallen in the absence of government money-printing. Then in this case, everybody holding dollar assets would have seen their real wealth go up because of the price deflation. If the government merely prints enough new dollars to keep prices stable, it is still the case that those original dollar-holders end up poorer relative to what otherwise would have happened.

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On this score, we simply have a disagreement about how the economy works, and in this dispute I think the Austrians are right while the MMTERS are wrong. According to Mises's theory of the business cycle,⁴ the existence of "idle capacity" in the economy doesn't just fall out of the sky, but is instead the result of the malinvestments made during the preceding boom. So if we follow Kelton's advice and crank up the printing press in an attempt to put those unemployed resources back to work, it will simply set in motion another unsustainable boom/bust cycle. In any event, in the real world, government projects financed by inflation will not merely draw on resources that are currently idle, but will also siphon at least some workers and raw materials out of other, private-sector outlets, as I elaborate elsewhere.⁵

Highlight (Geel) | Locatie 3182

In summary, the fundamental "insight" of MMT—namely, that governments issuing fiat currencies need only fear price inflation, not insolvency—is something that other economists have acknowledged for decades. Where the MMTERS do say something different is when they claim that printing money only carries an opportunity cost when the economy is at full employment. But on this point, the MMTERS—like their more orthodox cousins, the Keynesians—are simply wrong.⁶

Highlight (Geel) | Locatie 3199

In short, the reason most governments (including state governments in the US) in the world aren't "monetary sovereigns" is that members of the financial community are worried that they would abuse a printing press. The Greek government knew its economy would receive more investment, and it would be able to borrow on cheaper

terms, if it abandoned the drachma and adopted the euro. The Venezuelan government knew it could obtain much larger “real” loans if they were denominated in a relatively hard currency like the USD, rather than the Venezuelan currency which could so readily be debased (as history has shown). And I personally can’t interest anybody in financial transactions involving my authentic RPM notes, and so reluctantly I have to join the dollar-zone.

Highlight (Geel) | Locatie 3205

Now that we’ve covered this basic terrain, I have a follow-up question for the MMT camp: What would it take for a government to lose its monetary sovereignty? In other words, of those governments that are currently monetary sovereigns, what would have to happen in order for the governments to start borrowing on foreign currencies, or tie their own currency to a redemption pledge, or even to abandon their own currency and embrace one issued by a foreign entity? Here again the answer is clear: A government that engaged too recklessly in monetary inflation—thus leading investors to shun that particular “sovereign” currency—would be forced to pursue one or more of these concessions in order to remain part of the global financial community. Ironically, current monetary sovereigns would run the risk of forfeiting their coveted status if they actually followed Stephanie Kelton’s policy advice.

Highlight (Geel) | Locatie 3247

Yet, to reiterate, at least going back to 1981 the Treasury hasn’t spent money that it didn’t already have sitting in its checking account. The MMT camp would have us believe that there is something special occurring day in and day out when it comes to Treasury spending, but they are simply mistaken: so far at least, the Treasury has never dared the Fed by overdrawing its account.

Highlight (Geel) | Locatie 3292

I have included these lengthy quotations to be sure the reader understands the superficial appeal of MMT. Isn’t that intriguing—Mosler argues that the government funds the taxpayers! And when you think through his simple point about debits and credits, it seems that he isn’t just probably correct, but that he must be correct. Again, it’s a tidy little demonstration; the only problem is that it’s demonstrably false. It is simply not true that dollars were invented when some autocratic ruler out of the blue imposed taxes on a subject population, payable only in this new unit called “dollar.” The MMT explanation of where money comes from doesn’t apply to the dollar, the euro, the yen, the pound...Come to think of it, I don’t believe the MMT explanation applies even to a single currency issued by a monetary sovereign. All of the countries that currently enjoy monetary sovereignty have built their economic strength and goodwill with investors by relying on a history of hard money.

Highlight (Geel) | Locatie 3306

Furthermore, other things equal, if the government lowers tax rates, then it strengthens the currency. That’s surely part of the reason that the US dollar rose some 50 percent against other currencies after the tax rate reductions in the early Reagan years.¹⁴ So the MMT claim that taxes are necessary, not to raise revenue (we have a printing press for that), but to prop up the value of the currency, is at best seriously misleading.

Highlight (Geel) | Locatie 3345

It is a contrived and seriously misleading use of terminology when MMT proponents argue that government deficits are a source of financial wealth for the private sector. Forget the accounting and look at the big picture: Even if the central bank creates a new \$1 million and hands it to Jim Smith, it hasn't made the community \$1 million richer except in the sense that we could all be millionaires with this practice. There aren't any more houses or cars or acres of arable farmland available. Printing new money doesn't make the community richer—at best it's a wash with redistribution—and in fact in practice it makes the community poorer by distorting the ability of prices to guide economic decisions.
