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The Revolution of Money*

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Tamás Bánfi:
A pénz forradalma. A pénzteremtés elmélete és gyakorlata
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"Banks lent more of the deposits held with them to residential customers than usual. The increasing demand for consumption had some serious consequences: the price level increased and the level of savings dropped, which made funding investments impossible. Owing to the drop in investments, unemployment rose and tax revenues shrank, which increased the government deficit and placed government debt on a growth path. The funding of pensions was also jeopardised. The central bank, which is independent of the government, tried to control this harmful process by raising the interest rate."

The above – imaginary – quotation could be included in the case studies of any mainstream textbook on macroeconomics, although it is full of entrenched concepts and relationships that we use and teach without any serious review. And we are wrong. The book by Tamás Bánfi entitled *A pénz forradalma – A pénzteremtés elmélete és gyakorlata* (The Revolution of Money – The Theory and Practice of Money Creation), explores, considers and reconsiders the relationships between money creation, measurement of value, government finances (deficit, debt, pension financing), and the relationships between investments and savings, unemployment, fiscal and monetary policy. Each chapter can be considered a study in its own right, yet each is related to money and the creation of money.

Banks create money by accounting transactions, lending and crediting the amount of money on the account of the customer. To understand and bring others to understand this statement is not an easy task, even in academic and professional financial circles. People who are constantly faced with arguments denying or countering money creation or neglecting its importance should not be surprised that a scientific collection on money begins with a chapter introducing the creation

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of money (*The theory and practice of money creation*). One should begin reading the book with this, and we should be impressed at how simple this operation is.

Chapter two (*The measurement unit of the numéraire is the currency standard*) introduces us to the theoretical and sometimes practical (e.g. 27 July 1946 in Hungary) zero point of money creation, the time of the introduction of a new currency. In hyperinflation, money loses its functions one by one: it is no longer a store of value, a medium of exchange, and it can also no longer be used to measure prices. Therefore, upon introduction of the new currency, the fiat money, the monetary standard should be determined. The monetary standard can be determined fully arbitrarily, but it is practical to choose a standard that minimises the money circulation, information and other transaction costs.

Chapter three (*A theoretical history debate of money creation*) explores money creation from a historical aspect. The long period when monetary functions were fulfilled by substitutes for money besides and instead of commodity money connects the eras of commodity money and fiat money. Classical paper money and classical banknotes basically substituted precious metals in their functions of means of exchange and means of payment, but after some time their increasing amount started to determine prices as well, while the price-determining role of gold became questionable. And if this is so, then – having fulfilled all the functions of money – they are not merely substitutes for money, but rather are the monies themselves.

Chapter four (*Savings and investment equality does not prevail according to Keynesian definitions*) is a debate partly on definitions and partly on the history of theory, while at the same time it also has important practical, economic policy messages. The mistaken belief found in professional circles that investments require the preliminary (or at best, simultaneous) accumulation of savings, can only be verified if money creation is denied. It is possible to finance deficits in government finances or business current deficits by new, fiat money without these funds having been collected by someone previously, and without having price increases as a result of such financing. The investment-savings equation may still apply: fiat money finances investments, and thus it will still be received by someone as income. Unspent amounts will remain savings, by definition, until the income has been spent on consumption. But even if it does get spent, it will become (as yet unspent) income – and simultaneously – savings somewhere else.

Chapter five (*The blind spot* (*or badge of shame?*) *of economics: the uninterpretable and unmeasurable price level*) should be started (almost) from the end, so we can see how many authors use the concept of "price level" in so many places, without going deeper into its exact interpretation. This interpretation is not only a theoretical challenge. The measurement, forecasting, reduction and/or maintenance of inflation is a practical, defining element in monetary policy, and these activities cannot be adapted to a falsely created, inconsistent benchmark. Several alternative options are possible: on the one hand, we could select a good, whose price changes allow us to follow nominal changes of price values; on the other hand, we could use wage level instead of price level, since it measures a homogeneous type of good (or at least much more homogeneous than the world of goods), and its changes are closely related to changes of the rest of the prices.

Human communities have had an increasingly hard time controlling those harmful dynamics – increasing inequalities in income and wealth, destruction of nature, economic, social and political crises – that are generated by selfishness and the pursuit of self-interests channelled into market demand and supply. It makes the struggle for survival as a community even more difficult when we use inaccurate concepts and unclear relations to describe and model the economy, and importantly, because incorrect conclusions are drawn from the models, there is no harmony between fiscal and monetary policies (Chapter six: *Relationship between fiscal and monetary policy in the 20th century and at the beginning of the 21st century*). It is worth following the historical road that begins with the bank that finances the state and ends with a central bank independent of government finances, with the function of targeting inflation, dragging and pulling interest rates – and thereby international capital movements. And we should also consider – in light of the harmful processes mentioned above – what could function as the new basis for this relationship.

In order to reach a fiscal and monetary relationship that is more workable than at present, it is necessary to understand government deficit and government debt from a theoretical and historical (!) aspect (Chapter 7: *Government deficit–government debt*). It is widely believed that controlling government deficit and government debt is one of the important – if not the most important – keys to economic and financial stability. The endeavour to reduce the deficit and decrease the debt follows from this concept. Yet, what we can see from economic and social developments tends to imply that there is a growing need for the presence of the state, while its funding is jeopardised from several sides (demographics, migrations). In other words, the budget deficit and the resulting indebtedness are exactly the conditions for social stability and sustainability. On the other hand, the government deficit played an important role at the time of the appearance of fiat monies, and the market of government debt is still the most important benchmark of money markets.

In the 20th century, not only was the relationship between the state, and between the central bank and the economy transformed, the structure of society and the family also underwent a transformation which was not independent of the establishment of the system of state institutions (e.g. the pension system). Families became smaller, and women appeared in the labour market. One thing that has not changed, however, is the interpretation of "unemployment" in theoretical macroeconomics. Chapter eight of the book (*The necessity of revise of employment and unemployment in macroeconomics*) argues that – with the spread of the dual-income family model and single-adult households – it is no longer possible to classify persons of working age as active and inactive, as was possible at the time of the single-income family model. From that it follows that unemployment and inactivity cannot be interpreted and measured separately, instead of these, employment should be placed in the focus of macroeconomic thinking and aims of economic policy.

Pensions are the "invention" of the last two centuries, and presumably this invention has significantly contributed to the transformation of Western society; the established social and family structure makes it necessary to retain the pension systems, since neither self-care nor family care can be ensured. However, the current pension system cannot be sustained and requires major transformations. The acceptance of the proposals for change includes reconsidering the relationship between the central bank and the state, because according to the contents of Chapter nine (*A paradigm shift in the pension system*), as a temporary arrangement in a new, state-funded old age pension system the basis for later entitlements of the beneficiaries would be financed by money created by the central bank. Of all the proposals perhaps, this one is the strongest, and it would be instantly denied by economists trained to believe in the indisputable independence of the central bank. By comparison, the proposal on the termination of state support for voluntary pension funds or the statement that the old age pension system should be independent of employment are insignificant.

Each chapter of the book The Revolution of Money has some exciting contents: for economists, financial professionals, bankers, practitioners or theoretical connoisseurs of monetary and fiscal policy. I believe some readers will be not only surprised and even rather astonished by the statements and proposals set forth in this book. This is because they have learned different things using other methods: they use and read the concept of "price level" every day and they are convinced that the bank lends the deposits it holds. In fact, it is probably not easy to review these entrenched relationships and abandon them. But it is certainly worth a try: reading the book of Tamás Bánfi offers a good starting point for that.