The following notes are based on Mosler 1997-98, Wray 1998, Bell 2001, and Tcherneva 2006. Full references given below:

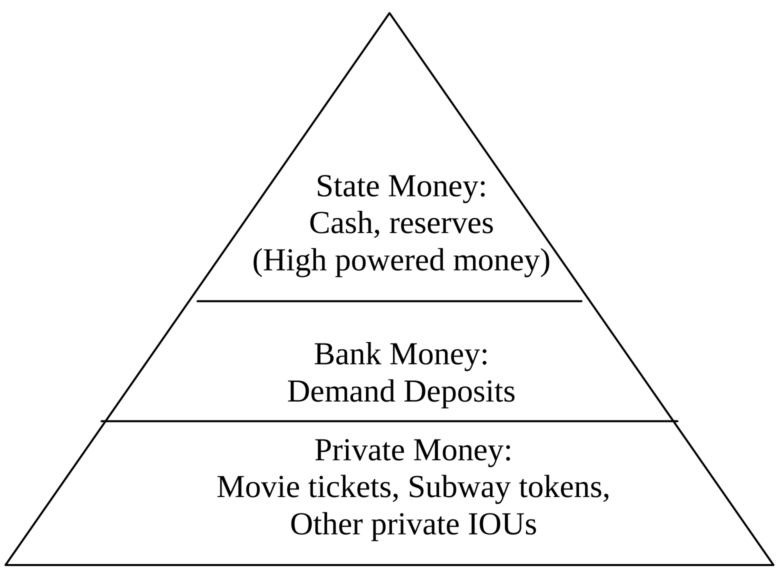
BRIEF OVERVIEW OF THE NATURE, ROLE AND FUNCTIONS OF MONEY

Money, very broadly speaking, is a social debt relationship. It is an IOU, a promise to pay, an asset to the holder and a liability to the issuer. In this sense, almost anyone can issue money by issuing their own liability. A movie ticket for example is the liability of the Movie Theater and an asset to the movie-goer. The Movie Theater is liable for accepting the ticket and granting the customer access for watching a movie. The movie ticket is an asset to the movie-goer, as s/he can claim a movie watching experience by turning the ticket in to the issuer. Alternatively, a subway token is the IOU of the Public Transportation Authority (PTA), which is liable for giving people rides on the Subway, whenever they turns in their assets (the subway tokens). However, we do not generally treat movie tickets, subway tokens, and the like, as money. Yet, in the broadly sense of the term, they are money, as they represent a contractual (social) debt relationship between two parties. In modern economies a crucial aspect of money is its acceptability. Clearly, I cannot watch a movie at the Movie Theater by turning in my subway token. The movie theater will not accept the PTA's liability. But they will accept cash or a check. The check is the liability of my bank which has issued these checks to me in exchange for my deposit at the bank. Cash on the other hand is a monopoly of the government, i.e., it is the liability (the IOU) of the State. So this gives a preliminary indication that not 'all debts are created equal' (some liabilities are more acceptable than others). So what makes them so?

Before we continue we need to explain the nature of cash as a State liability (or what we call the State's monopoly money).

Effectively, since money is debt, it is also a unit of account, i.e. the way we measure (or account for) these debts. Historically speaking, the 'thing' we use to account for these debts has always been designated (determined) by some public authority – a priest, a king, a colonialist, or a modern State. These authorities have always determined how debts in the economy will be paid. For example, a colonial governor wants to make sure the African tribe produces goods and services which he can consume. To ensure that this happens, he imposed a tax on the population, demanding that this tax is paid in British pounds. The only way the African tribe can pay their tax, is for them to organize cash crops and the sale of good and services (including their own labor) to the governor in exchange for British pounds. The tax creates a demand for the currency. The population then sells to the governor goods and services in exchange for British pounds which can then be used to pay the tax. This has almost always been the case from ancient times—some authority (be it priest, king, colonialist or the Modern State) has declared how debts in society will be paid (the most important of all debts of course is the debt to the public authority—i.e. the tax owed to the federal government, the fee owed to the priest, the dues owed to the king.)

All this is important for explaining the role of the State in defining what thing serves as money. While we can (and do) accept various forms of liabilities (the ticket of the Movie Theater, the subway token of the PTA), in the end we will always accept the dollar, i.e., that which the State has said it will accept when we pay our taxes. The dollar is the liability of the government. So what is the government ‘liable for’? It is liable to accept the dollar when we want to pay our taxes. So in a way, we can organize all of these liabilities in a hierarchical order (or in a pyramidal fashion). At the bottom of the pyramid, we find the least acceptable forms of payment: movie tickets, subway tokens (things which are accepted only between the issuer and holder, but are not exchanged widely in private markets). Once again, we cannot use movie tickets to buy groceries. At the next stage of the pyramid we find bank liabilities, as they are more acceptable forms of payment. Check are claims on these bank liabilities, i.e., the banks have issued to us checks in exchange for our deposits at the bank. These are much more widely accepted, because effectively when we buy things, we are exchanging deposits. I buy groceries and I give up part of my deposit to the grocery store, whose bank deposits in turn increase. Furthermore, bank deposits can always be converted into cash or bank reserves (or what we call high powered money). There may be places that will refuse to take checks, but will nonetheless always take cash. Because cash and reserves are the most acceptable forms of payment, they sit at the very top of the pyramid. And as we just explained, the State (with its two agents, The Fed and the Treasury) is the monopoly supplier of cash and reserves. The reason why they sit at the top pf the pyramid is because, even if not all people are indebted to the state (i.e. not everyone must pay taxes), ultimately someone, somewhere is indebted to the state and that tax obligation to the state is only extinguishable with the state’s liability i.e., with bank notes, cash or reserves. This is why all agents in the economy denominate their transactions in State liabilities and why the dollar (in the US) is the most acceptable form of payment. This is what we call *definitive* money, i.e. it is State money or that which sits atop the pyramid.



Now we can add more detail to our understanding of the nature, role and functions of money. Money is a 'unit of account' designated by a public authority for the settlement of social debt obligations (i.e. money is debt). In the US the 'dollar' is money, i.e. the 'thing' in which we measure all debts. More specifically, in the modern world, the debt relation of highest importance is that between the population and the nation-state (this debt relation is in the form of a tax liability, the population is indebted to the State). Thus, money is a creature of the state and a tax credit for paying this debt.

1. In its very *nature* money is a social relation of a particular kind—it is a credit-debt relationship.
2. We can rank all social debt relationships, where definitive money (the IOU of the ruling body, i.e. the State) sits at the top of the hierarchy.

Money *functions*, first and foremost, as an abstract *unit of account (1)*, which is then used as a *means of payment* and the *settling of debt (2)*. The money we use as a *store value (3)* and a *medium of exchange (4)* is that which States have <u>first</u> established to serve as a <u>unit of account</u>.

1. Modern currencies exist within the context of certain state powers. The two essential powers are:
    a. the power to levy taxes on its subjects, and
    b. the power to declare what it will accept in payment of taxes.
2. Thus, the state determines money to be that which will be accepted at government pay-offices for extinguishing debt to the state.
3. The purpose of taxation is not to finance government spending but to create demand for the currency – hence the term 'tax-driven money.'
4. Logically, and in practice, government spending comes *prior* to taxation, to provide that which is necessary to pay taxes.
5. In the modern world, states usually have monopoly power over the issue of their currency. States with sovereign control over their currencies (i.e. which do not operate under the restrictions of fixed exchange rates, dollarization, monetary unions or currency boards) do not face any *operational* financial constraints (although they may face political constraints).
6. Nations that issue their own currency have no imperative to borrow or tax to finance spending. While taxes create demand for the currency, borrowing is an *ex ante* interest rate maintenance operation. This leads to dramatically different policy conclusions.
7. As a monopolist over its currency, the state also has the power to set prices, which include both the interest rate and how the currency exchanges for other goods and services.

V. Acceptation: Legal Tender Law or the Hierarchy of Debt?

It is commonly believed that we use the dollar (or state money) because we 'trust it' or because the State administers legal tender laws. Money is 'a creature of the state' in a much broader sense than implied by legal code or trust.

Money is accepted, not because of the fact that it has been declared by law to be legal tender, but because of the stratified order of social debt relationships we explained above. Let's explain again. The power to delegate taxes and determine how they will be paid, explains why state money is the *most acceptable* form of debt.

Minsky argued that if money is debt, clearly anyone can issue money (Minsky 1986: p. 228). He stressed that as a balance sheet item, money is an asset to the holder and a liability to the issuer. The question of importance, however, is not the capacity to create debt but the ability to make someone else to hold it (ibid.). In a sense, debt becomes money only *after* acceptation has occurred (Bell 2001: p. 151). Different monies have varied degrees of acceptability, which suggests a hierarchical ordering of debts (Minsky 1986, Wray 1990, Bell 2001).

If social debt relationships are organized in a pyramidal fashion, then the least acceptable forms of money are at the bottom of the pyramid, while the most acceptable ones are at the top. Furthermore, each liability is convertible into a higher and more acceptable form of debt. What liability, then, sits at the top of the pyramid?

To settle debts, *all* economic agents except one, the State, are always required to deliver a *third party's* IOU, or something *outside* the credit-debt relationship. Since only the Sovereign can deliver its own IOU to settle debts, its promise sits at the top of the pyramid. The only thing the state is 'liable for' is to accept its own IOU at public pay-offices (Wray 2003: p. 146n9). For example, to be accepted, household or firm IOUs must at least be convertible into deposits (bank money) or cash (state money). Likewise, bank deposits must necessarily be convertible into reserves or cash (state high-powered money) to be accepted. State money is always at the end of the convertibility chain.

This stratified view of social debt relationships provides a preliminary indication of the primacy of state currency. But can agents simply refuse to take the Sovereign's money and, therefore, undermine its position in the pyramid? The answer is 'no', because as long as there is someone in the economy who is required to pay taxes denominated in the state's currency, that money will always be accepted.

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