

What is Money?

It is difficult to define what 'money' is, because the term 'money' can refer to different things in different contexts.

AUTHOR ROHAN GREY

THE STANDARD ECONOMICS NARRATIVE defines money as something that serves three functions: 1) a unit of account; 2) a medium of exchange; and 3) a store of value. However, even this simple description already conflates two distinct ideas – money-as-measurement (similar to the inch or the kilogram) and money-as-object, such as a coin, a paper note.

THE FIRST CONCEPT of money-as-measurement is inherently abstract. You cannot 'hold', or 'possess' an inch or a kilogram, you can only hold things that are a certain number of inches long, or that weigh a certain number of kilograms. Of course, as Jimmy Carter will tell you, that does not mean the question of whether to measure things in inches or centimeters, in kilograms or pounds, is an apolitical one. The choice of a society's measurement system reflects the values of that society, whether it is derived from King Henry's armspan, the temperature of the human body, or a fixed number of atoms of a common basic element.

MONETARY MEASUREMENT in particular is nearly always understood in relation to prices of actual goods and services. In other words, we understand the difference between \$2 and \$20,000 partly because we know that a bottle of water today costs around \$2, while a car costs around \$20,000. However, unlike meters or kilograms, monetary prices are not scientifically determined, but instead reflect political decisions about how we structure the economy. The fact that a car costs 10,000 times as much as a bottle of water does not mean that it is objectively 10,000 more valuable, in the way that a kilogram is objectively 1000 times the length of a metre.

MOREOVER, there is no guarantee that present-day prices will remain stable. Depending on the circumstances – say, a persistent drought, or new regulations that prohibit an old car from being driven on public roads – the relative prices of goods and services we use as referents when thinking about monetary values may change significantly. Furthermore, due to macroeco-

MONEY

66 *the government must spend into circulation more money than it later re-moves via taxation... in order for the non-government sector to run a budget surplus*

nomic phenomena like inflation (a persistent rise in the general price level), the scale of monetary measurement in daily life can also change significantly, even as relative prices of goods remain constant – think, for example, of people in Victorian England paying for things with tuppence and sixpence that we might pay 5 or 10 pounds for today.

BY CONTRAST, the idea of money-as-an-object is inherently concrete. We measure prices of things 'in dollars', but a 'dollar' itself is a thing that can be possessed and/or exchanged. This is true even in the digital age, when the 'dollars' in question are usually intangible accounting entries on a spreadsheet, or cryptographically secured files stored in a digital wallet.

AT THE SAME TIME, we must be careful to distinguish between things-which-are-money, that is, objects that exist as or were created to be money, and things with 'moneyness,' that is, objects that exhibit functional properties of money, regardless of how they came to exist. Everyone will likely agree that a dollar coin is money, for example, but not everyone is likely to consider seashells, or cigarettes, or corporate gift certificates, or your local bar tab as 'money', even though each one has functioned as money at certain times and places in history. Ultimately, while we may intentionally create certain objects to function as money, any object can function as money, regardless of initial purpose, provided we collectively agree to treat it as such.

OF COURSE, you cannot have 'a dollar coin' without first creating the idea of 'dollars' in general, and you can't have a 'cigarette money' without people knowing how much tobacco exactly constitutes one cigarette. So from a logical perspective, money-as-measurement precedes money-as-object. In other words, you cannot have a money-thing without first specifying what unit of account the 'moneything' is denominated in.

CONVERSELY, once you establish a monetary unit-of-account, it is possible to engage in economic transactions denominated in that unit of account, even when you don't possess any actual 'money-things' themselves, provided others are willing to extend you credit. Contrary to the standard economics textbook stories, the vast majority of monetary activity does not involve on-thespot, instantaneous transactions of a good in exchange for a 'money-thing.' Rather, most economic transactions have a temporal dimension - they involve a relationship between actors that endures over time, even if that time is as short as the difference between sitting down at a restaurant to eat a meal, and paying the check at the end. Sometimes, even on-the-spot transactions can transform into credit/debt transactions, if there is a payment processing issue, a defect in the good purchased, or if the good/service turns out to be something other than what was advertised at the point of sale.

IN OTHER WORDS, most economic transactions involve people buying goods and services on credit, and settling their debts later. Furthermore, there are many kinds of social activities that we don't think of as 'voluntary exchange' that involve creating and/or extinguishing monetary debts – when governments impose taxes, fees, fines, for example, or when people borrow money, or when someone accidentally damages someone's property or hits them with their car. In previous centuries, individuals could even buy 'indulgences' from the Catholic Church, which absolved them in advance for sins they intended to commit later, reflecting the inherently close relationship between 'monetary debts' and 'moral debts' that endures to this day and is reflected in our common law approach to personal damages and compensation.

66 not everyone is likely to consider seashells, or cigarettes, or corporate gift certificates, or your local bar tab as 'money'

MONEY

66

Although we don't often think of government currency as 'debt', it is, in fact, a liability of the government...

USUALLY, we don't use our own credit, but rather rely on the credit extended to us by our bank, or another third-party. For those third-parties, the 'credit' they extend to us represents their 'debt'. Their financial liability is our financial asset. In other words, when I send you \$20 from my bank account to your bank account, I am telling the bank to cancel its \$20 IOU to me (by reducing the balance of my bank account), and to issue a new \$20 IOU to you (by marking up your bank account).

THE MOST BASIC and widespread form of third-party IOU that we use to make payments is, of course, government currency itself. Although we don't often think of government currency as 'debt', it is, in fact, a liability of the government, both in an accounting sense, and in the real sense that the government is required to accept its currency as payment for any taxes, fees, fines, court-judgments, or any other obligations it imposes on its subjects, even if that currency isn't legal tender for private debts (although most government currencies are that too).

IN THAT SENSE, we can think of government money as a transferable tax-credit. If a public authority wants to prevent people from parking in a disabled parking spot, but only sets the fine at \$50, it is going to have a hard time stopping a millionaire from parking there with impunity, because the millionaire can easily "pay" any fees that they incur. Thus, from the point of view of law enforcement, or a government seeking to influence social behavior, money can serve as a 'get-out-of-jail-free' card for whoever possesses it.

THE INHERENTLY LEGAL NATURE of both government currency, and private IOUs created via contractual debts, means that monetary design, and more deeply, monetary value are questions of law. In particular, governments that issue currency are making a legal promise that the holder of that currency can obtain debt-relief equivalent to the face value of the obligation. A 100 Krona bill means 100 Krona of debt-relief. This promise is very different to the idea of promising that currency must maintain a stable value in terms of its ability to purchase goods and services. Indeed, contrary to the standard economics narrative, government currency explicitly does not promise to be a 'stable store of value'. Instead, governments going back centuries have argued that it is their sovereign perogative not to defend a stable purchasing power for their currency, so long as they honor its nominal face-value. In other words, a promise to pay 100 Krona tomorrow is just that – a promise to pay 100 Krona. If prices in the broader economy change between now and then, well, too bad for the rest of us.

CONVERSELY, the fact that any object can have 'moneyness' - if private actors agree to accept it in payment or settlement of debts with each other - means that there is no single definition of money, nor is there a single instrument whose quantity determines all monetary activity. Depending on how 'liquid' different assets are, that is, how easily we can sell them, or pledge them as collateral in a temporary loan to obtain money (like pawning goods at a pawn shop), any asset can be used to increase the 'supply' of money in circulation. Often, as with the case of housing in 2008, these dynamics can cause systemic instability as financial activity expands and contracts independently of any one single actor or decision-maker.

SO IF ANY ASSET CAN BE MONEY, why is currency in particular so valuable? The short answer is that certain kinds of obligations, such as taxes, can only be paid in government currency. And as the saying goes, there are only two certain things in life: death and taxes. The fact we are all likely to incur tax burdens at some point in our lives means that tax-credits have a stable demand across time and place.

SOMEWHAT COUNTER-INTUITIVELY, in order for everyone to earn and accumulate tax-credit dollars, the government must spend into circulation more money than it later removes via taxation. In other words, the government must run a budget deficit in order for the non-government sector to run a budget surplus.

FURTHERMORE, because the money to pay taxes must first be 'spent into circulation', as a matter of basic logic, taxes do not 'fund' spending in the general sense. Rather, the levying of taxes is what generates a demand for government money in the first place, so that when governments do want to spend money into existence, people are willing to give the government their labor, or their goods, in order to acquire it. In that sense, taxes anchor and drive the value of government currency, but they are



not its source – rather, governments create money simply by entering keystrokes on a computer, or by signing new spending bills authorizing new deficits.

SOMETIMES, GOVERNMENTS CHOOSE to issue other forms of financial instruments in addition to regular currency, such as government securities (also known as treasury debt). When these instruments are issued instead of newly issued currency to finance a budget deficit, we colloquially call this 'borrowing'. We call it as such because we are used to think of people issuing debt in order to obtain something they don't already have. But because money itself is a debt of the government, it **makes no sense to think of issuing government securities as 'borrowing' in the conventional sense.** Functionally, it is like issuing an a \$10 IOU that promises to pay ... a \$10 IOU.

OF COURSE, SOMETIMES GOVERNMENTS, or their central banks, will choose to pay a positive rate of interest on various kinds of government instruments, including government securities, and central bank reserves. This can be confusing for some people, as it appears that we are paying private 'lenders' interest as compensation for lending the government funds it otherwise would not have. However, central banks, who are statutorily responsible for implementing monetary policy, in fact have the power to determine the interest rate paid not only on government debt, but also central bank debt, such as the settlement balances (or reserves) that banks hold in their accounts at the central bank. Today, most central banks around the world pay interest-on-reserves, just like treasury departments pay interest-on-government-securities. We call the former "monetary policy" and the latter "government borrowing", but they are functionally the same, and are done for similar purposes of influencing interest rates in the economy more broadly.

SO IF WE DON'T NEED to issue treasury securities in order to finance spending, why do it at all? Well, treasury securities circulate in different ways, and serve different financial purposes, than other forms of government monetary instruments, such as coins, notes, or central bank reserves. Big financial investors and pension funds who may not be able or willing to store hundreds of billions of dollars in physical cash, prefer to store their money in safe, interest-earning securities rather than

66 Because the money to pay taxes must first be 'spent into circulation'... taxes do not 'fund' spending in the general sense.

MONEY

66 In a way, banks can be said to function as franchisees of the government

risk storing them at a bank whose government-backed deposit insurance may only cover a few hundred thousand dollars per account. Indeed, some large investors are legally prohibited from holding their clients' 'cash' in bank accounts due to the fact that doing so would expose them to the risk of the underlying bank collapsing.

OF COURSE, it is difficult to pay for groceries, or even to pay taxes, using treasury securities. Thus, when investors want to move their funds back into cash or bank deposits, they simply sell the securities in the money markets, or in the last instance sell them to the government's central bank. In this way, government securities accounts function like a savings account – it's not easy to make payments from it, but it is easy to transfer funds into your checking account on demand.

IN ADDITION to issuing its own monetary IOUs, the government can also influence the 'moneyness' of other actors' IOUs via the degree of support or recognition they choose to extend to them. The most obvious example of this is in the case of commercial banks, whose IOUs – bank deposits – are typically insured by the government (up to a certain amount per account), and can be used by individuals to make tax payments directly, without needing to first obtain government currency (the bank and the government typically settle up on their own afterwards).

IN A WAY, BANKS can be said to function as franchisees of the government, extending the government's full faith and credit to individuals by proxy, in a sort of publicprivate partnership arrangement. From an accounting perspective, an individual gives its IOU (the loan) to the bank, who accepts it in exchange for the bank's own IOU (a deposit), which in turn is guaranteed to be convertible into the government's IOU (currency). Effectively, therefore, banking involves a form of credit-laundering, whereby an individual's IOU, which does not have a particular high degree of moneyness, is converted, via the bank, into an IOU with the highest degree of moneyness – that of the government itself.

AT THE SAME TIME, commercial banks engage in a range of activities with other financial institutions, including investment banks, mutual funds, hedge funds, and insurance companies. These activities generally lead entanglement between institutions, and between the liabilities issued by those institutions, aided by creative lawyering and contractual arrangements.

CONSEQUENTLY, when thinking about what money is and how it works, we must look at the legal architecture not only of commercial banks, but of all financially significant institutions (including individuals like us!), and all of the various financial products and instruments that we produce.

MONEY IS THUS NOT MERELY A THING, or a unit of measurement, but an ecosystem. It is a layer of social infrastructure, a language, and a source of power. Understanding money provides us with a framework for understanding the economy more broadly, and hopefully, illuminates new ways of changing it for the betterment of all of us.

ROHAN GREY is a lawyer and president of Modern Money Network, a student-driven, non-profit organization dedicated to promoting public understanding of money and finance. He is also a research fellow at the Global Institute for Sustainable Prosperity, a director of the National Jobs for All Network, and a doctoral fellow at Cornell Law School, where his research focus on the law of money in the internet society

