Triffin Reloaded: Money & Mechanisms…

Lecture 2

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MPIfG
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Today’s path

RMAN
MARK

- Reprise
- Money
- Mechanisms
  - Demand
  - Balance sheets

Money (is credit with a unit of account)

1. Why a system level approach
   - Unit level approaches: Growth models, VoC, Brenner, much CPE, etc
   - System level: World Systems, economic geographers, Murau+, etc
     - Capitalism is inherently deflationary (Schumpeter, Keynes)
2. Empire as the organizing framework (Mann, Strange)
   - Heterogeneity + homogeneity (rules bind some and free others), asymmetry, resource flows, and the problem of differential growth
   - Plus some facts about the world
3. Money & Global Quasi-State Money
   - Money is credit / debt → interlocked balance sheets
   - Creditors always want higher powered (most acceptable) money
   - State establishes acceptability when it accepts tax payments
   - The state (central bank) can backstop credit creation that offsets deflation

Money… is credit / debt. Why accept it?

Everyone can create money; the problem is to get it accepted.

Hyman Minsky, 1968

Bank (‘*inside*’) money, state (‘*outside*’) money, & quasi-state money 1

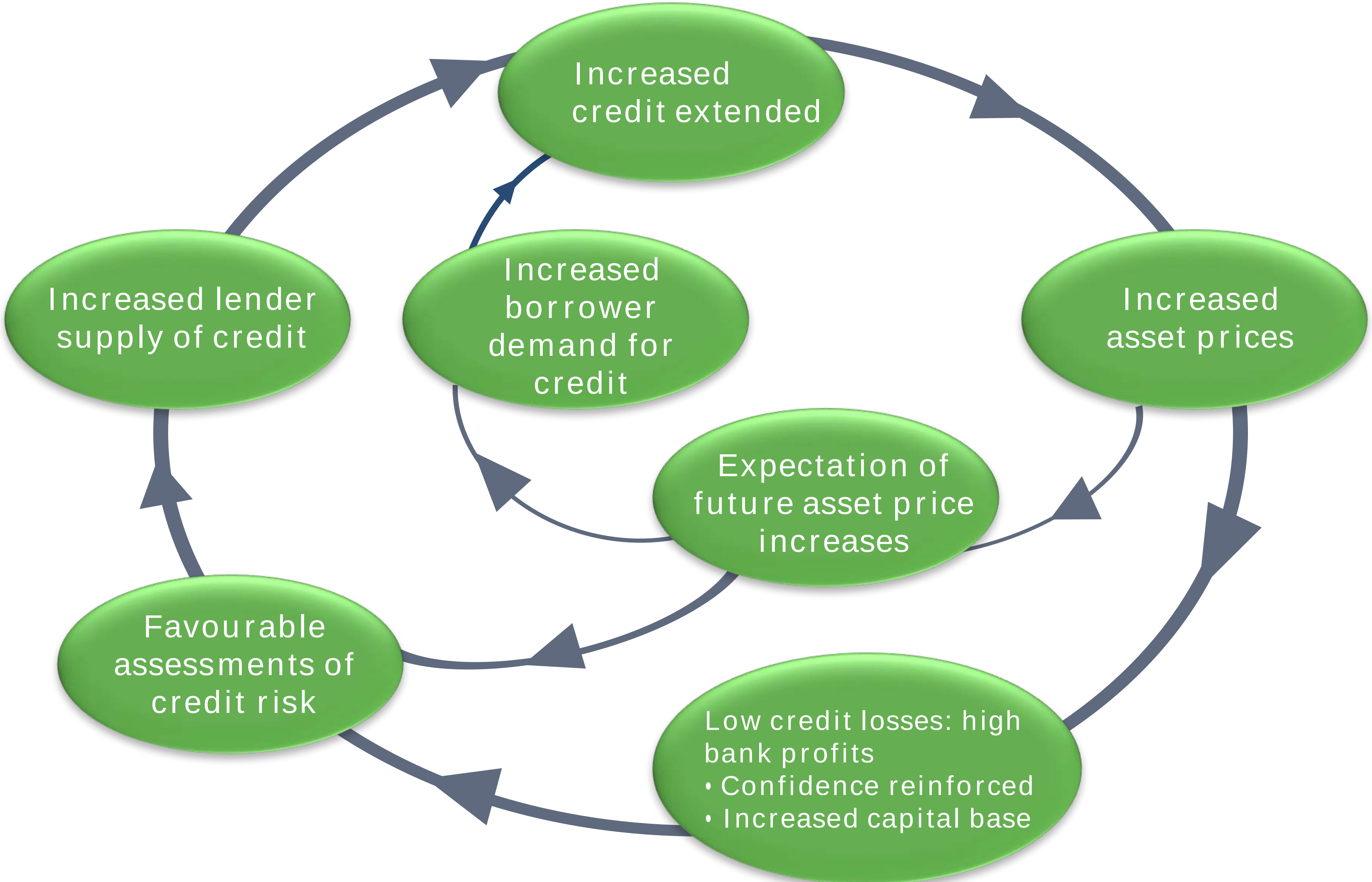
- All money is credit (& thus debt) (Ingham & Minsky)
- Varying acceptability of liabilities → hierarchy of money (debts)
- The acceptability of state money (public debt) ultimately rests on state capacity, understood as its ability to compel routinized compliance of tax payments (Mann; Bourdieu[?])
- Thus state money sits at the top of the hierarchy (Knapp, Weber, Schumpeter)
- State money functions as “outside money” for financial systems based on fiat money (Mehrling)

Bank (‘*inside*’) money, state (‘*outside*’) money, & quasi-state money 2

- Inside money: Banks *endogenously* create credit (= debt)
  - Hopefully backed by collateral
  - Shadow banking might create credit indirectly…. Collateral?
  - Crisis dynamic always present – (1) bankers must beat the average + (2) credit creation is self-validating in the medium run + (3) risky behavior is rewarded → (4) excessive risk taking
  - ❖ *Excess credit creation is always a problem because of the risk of collateral collapse → financial crash*
- Domestic level central banks and regulatory authorities can try to constrain this excess …. ‘Minsky has entered the chat’

Minsky cycle up!

Self-validating, endogenous credit expansion as collateral value grows



Bank (‘*inside*’) money, state (‘*outside*’) money, & quasi-state money 3

- Minsky cycle: stability → excess credit creation → ponzi finance → margin calls and no loan rollover → collapse of collateral values → bank reserves inadequate relative to liabilities (deposits & borrowing) → general crisis

- Enter the state: States (central banks) can revalue collateral by creating money with a diffuse corresponding liability – their ability to tax future GDP = “*outside*” money
  - E.g. 2008-2010 US Federal Reserve buys MBS from banks at par

- This assumes state capacity / infrastructural power ala Mann

Globally? "Global quasi-state money"

- Minsky is cycle more acute globally, despite Basel 1-4 but…
- Outside money? Who bails you out if your liabilities are not in your home currency?

- Dollar sits at the top of the global hierarchy of money, but…

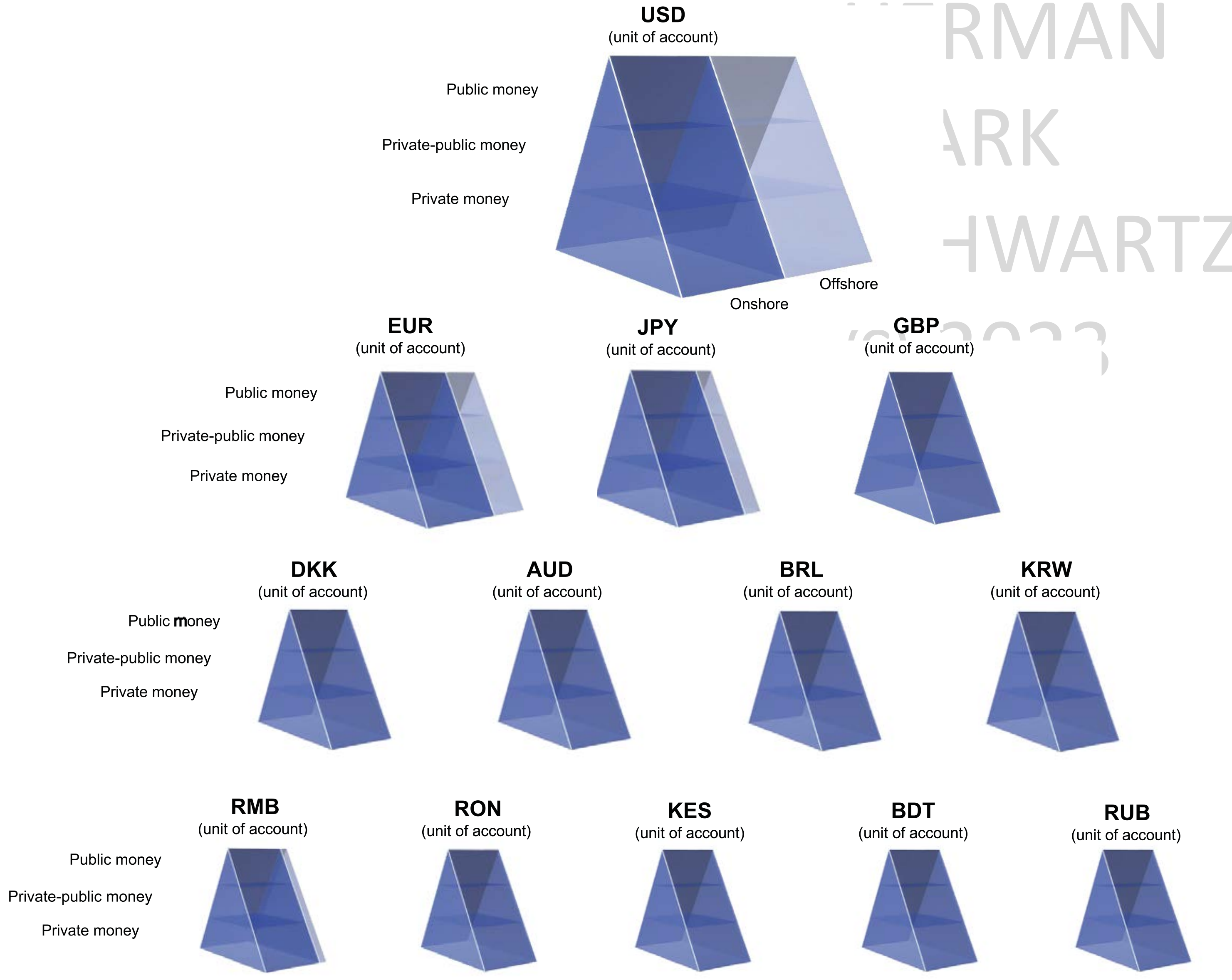
- Acceptability? Yes
- Taxation? The current account deficit (?)
- Routinization? Yes but eroding
- Lack of a true legal infrastructure & monopoly of violence → "Quasi"

Thank you Murau & van 't Klooster

Dark blue = domestic credit
Light blue = offshore credit

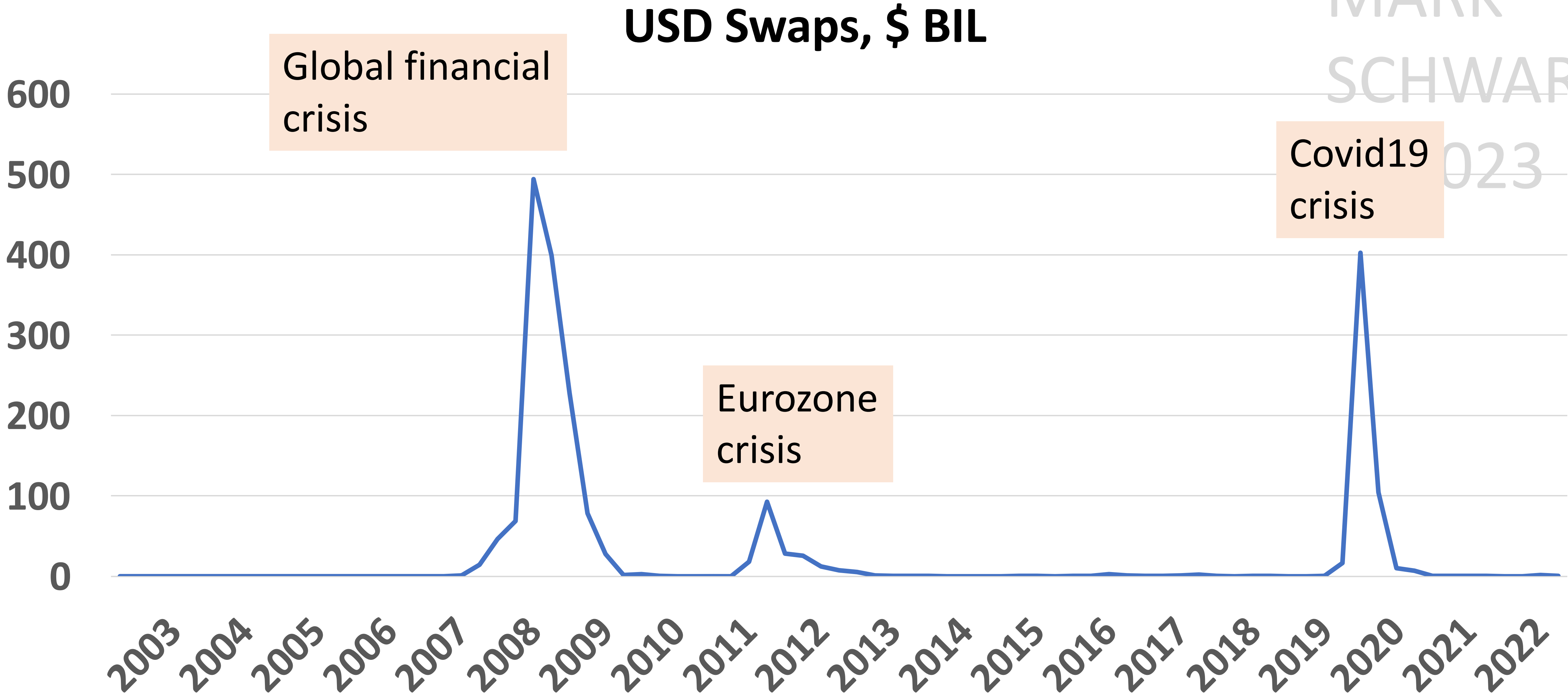
Triangles are a hierarchy internally & externally

Figure 5
The hierarchy of the Offshore USD-System



Abbreviations: AUD: Australian dollar; BDT: Bangladeshi taka; BRL: Brazilian real; DKK: Danish krona; EUR: Euro; GBP: British pound; JPY: Japanese yen; KES: Kenyan shilling; KRW: South Korean won; RMB: Chinese Renminbi; RON: Romanian leu; RUB: Russian ruble; USD: US dollar.

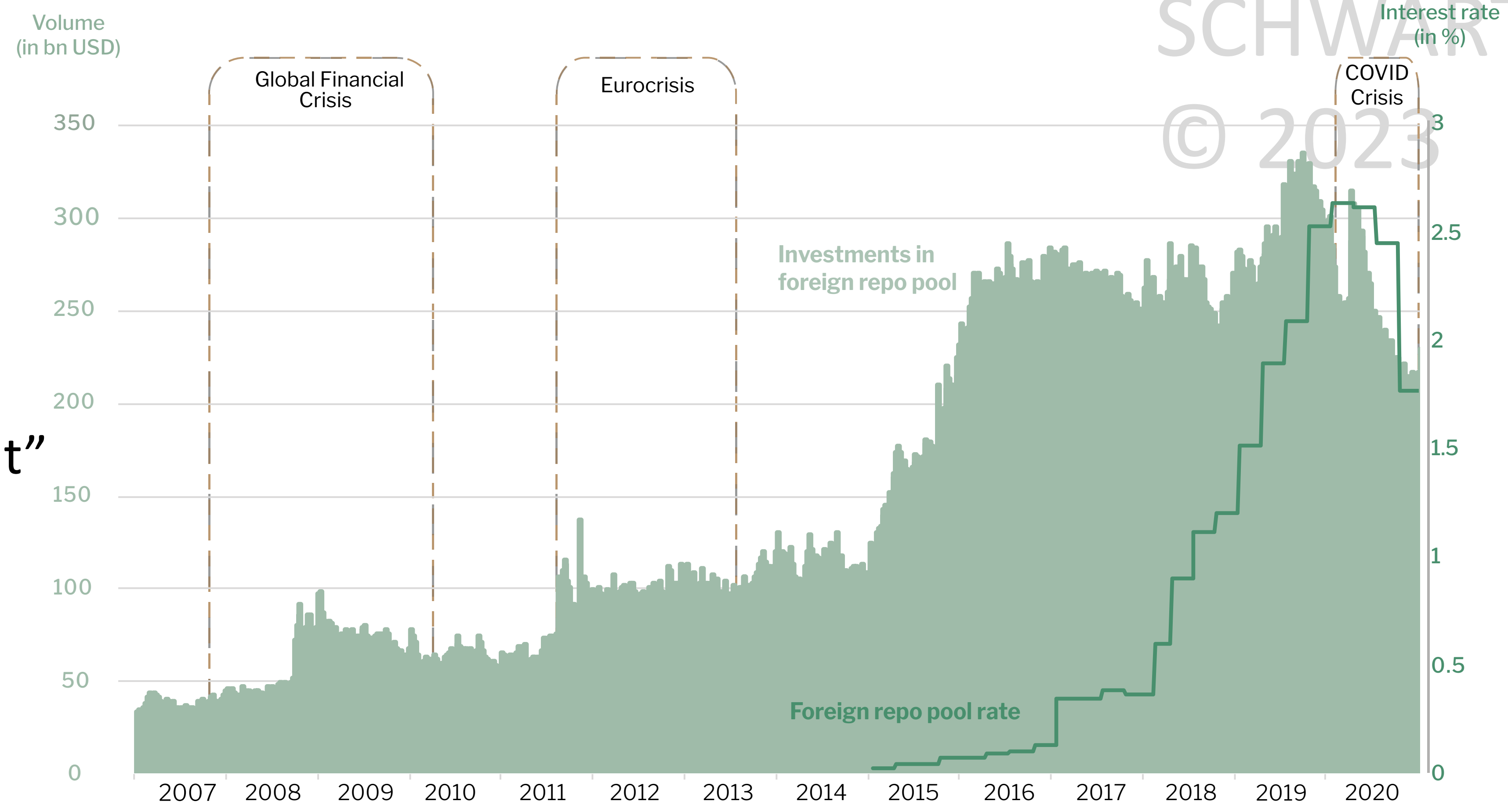
Foreign banks turn to the Fed in crisis and calm



Foreign banks turn to the Fed in crisis and calm

REPO =
"I have securities, but I need cash, can I sell you these now and buy them back later?"
=
"I'm illiquid, maybe insolvent"

Figure 5 — Investment in the Fed's Foreign Repo Pool (2007-20)



Source: Federal Reserve

Also stolen from Murau

∑: The USD as quasi-state money for a global empire

Quasi:

- No formal taxation power (but… current account deficits)
- No compulsion to use dollar (obvious exceptions)

2 symbiotic functions

1. Expansion of demand in face of persistent global deflation
2. Financial system lock in & stabilization
   - ➢Outside money backs inside money in a crisis… but why use $?

Mechanisms, or, why this is not (only) T-costs

Interlocked balance sheets & exports → lock in

‘There’s no other currency anyone wants to buy’

Kit Juckes

Global Head of FX Strategy, Société Générale

(Quoted in Beck 2022)

↓

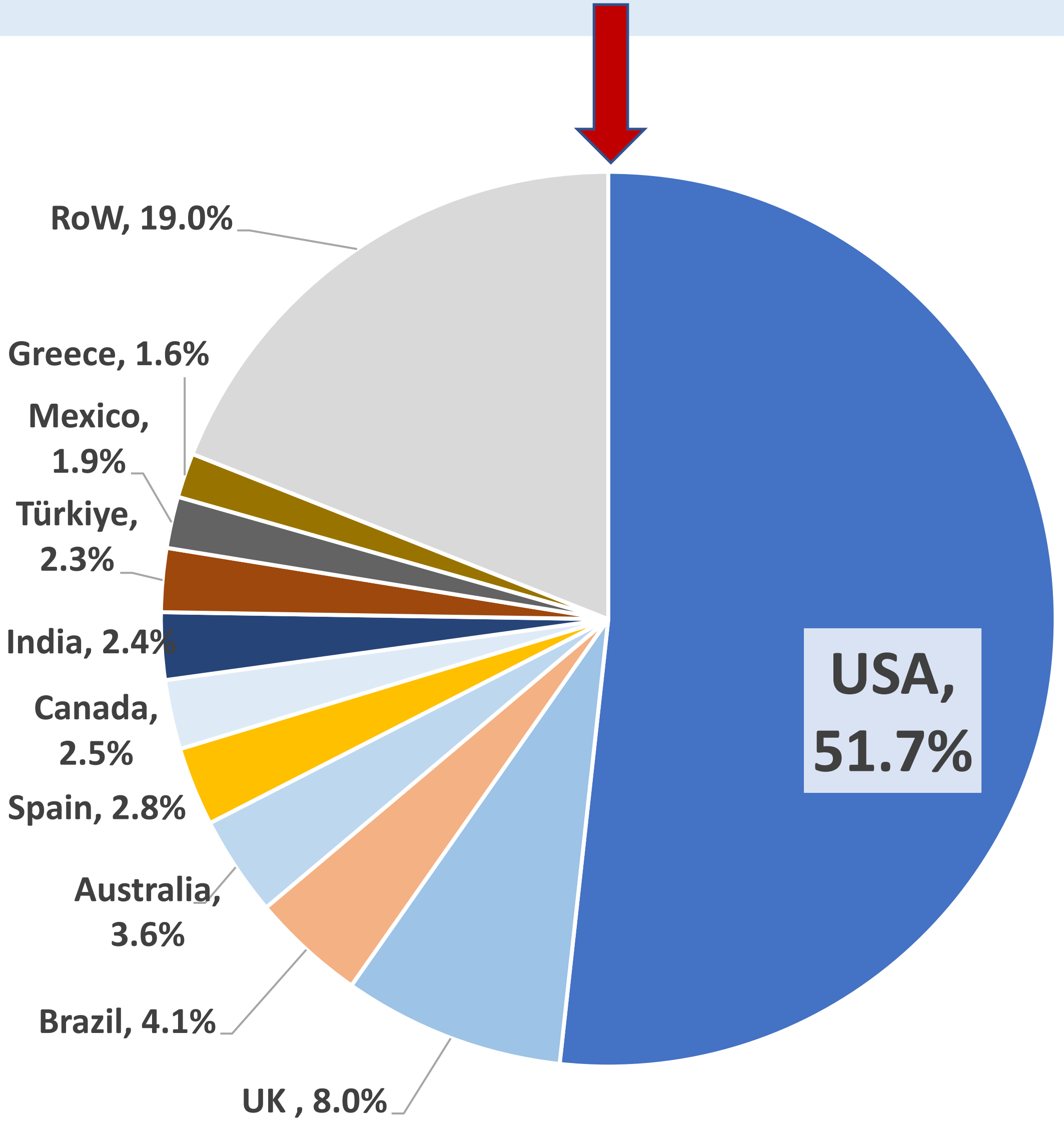
“Deep and liquid capital markets” & “lower transaction costs”

not wrong, but not the key mechanism, & misleading

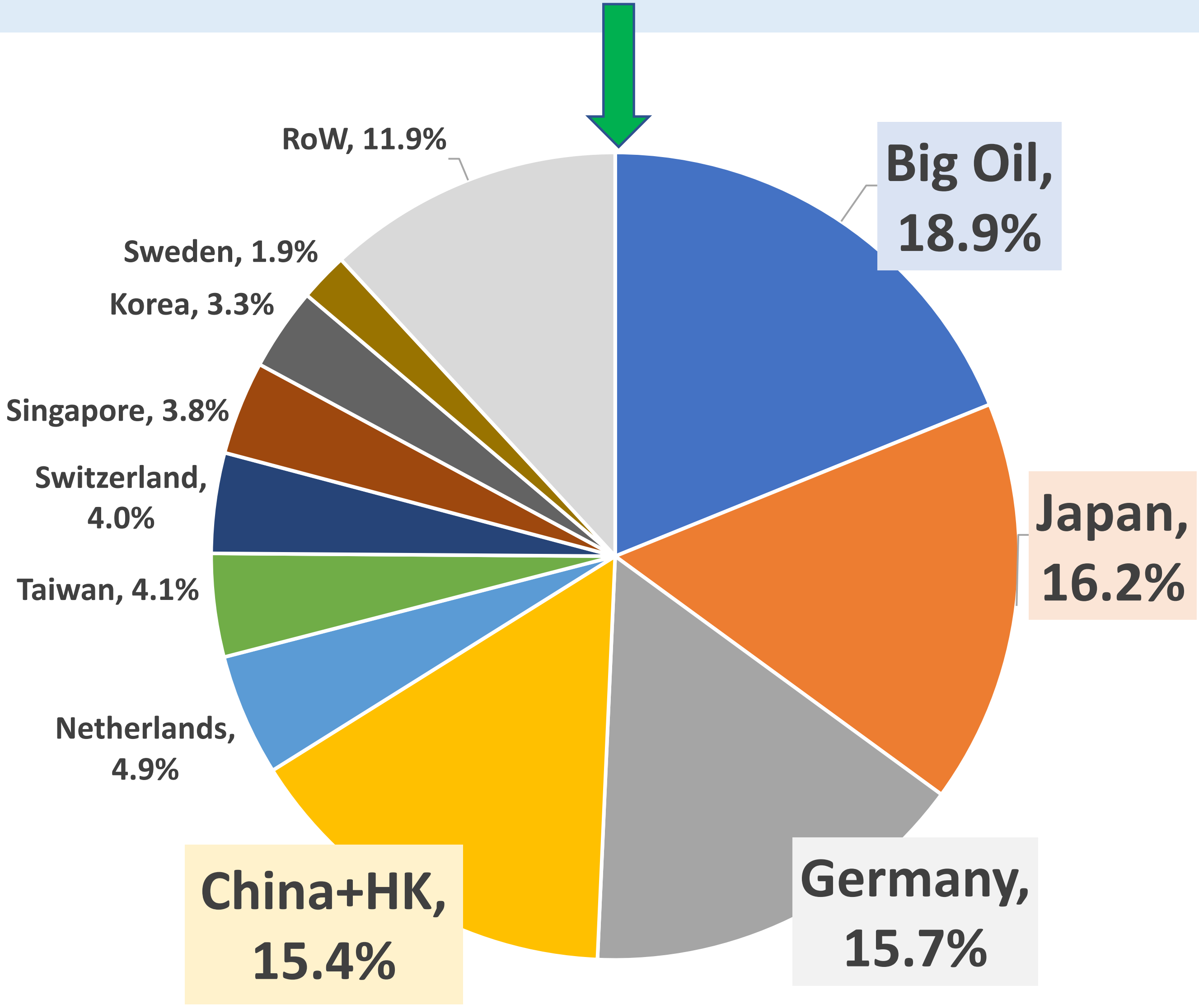
Coins have an obverse and a reverse

Share of cumulative (1992-2022) global

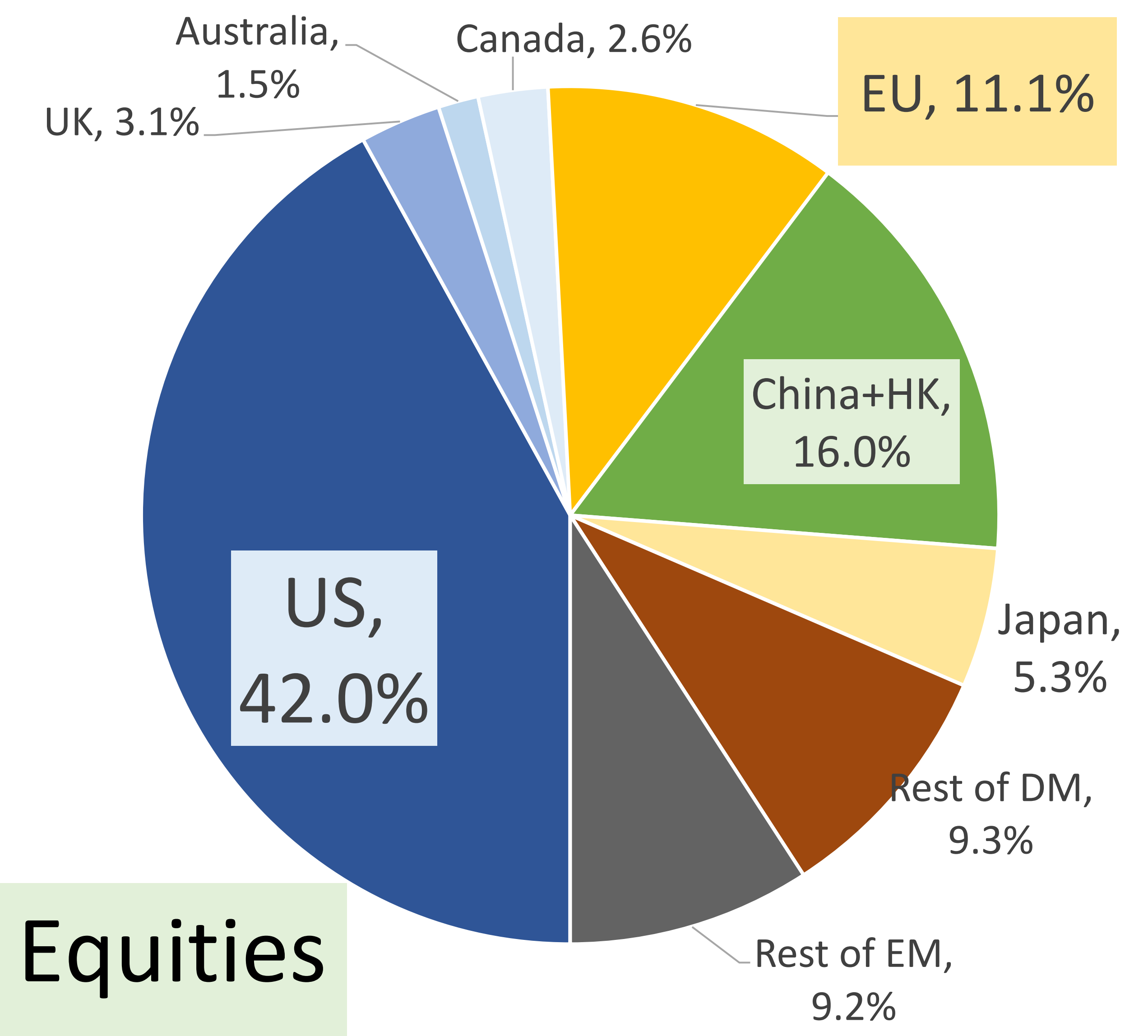
Current Account Deficit

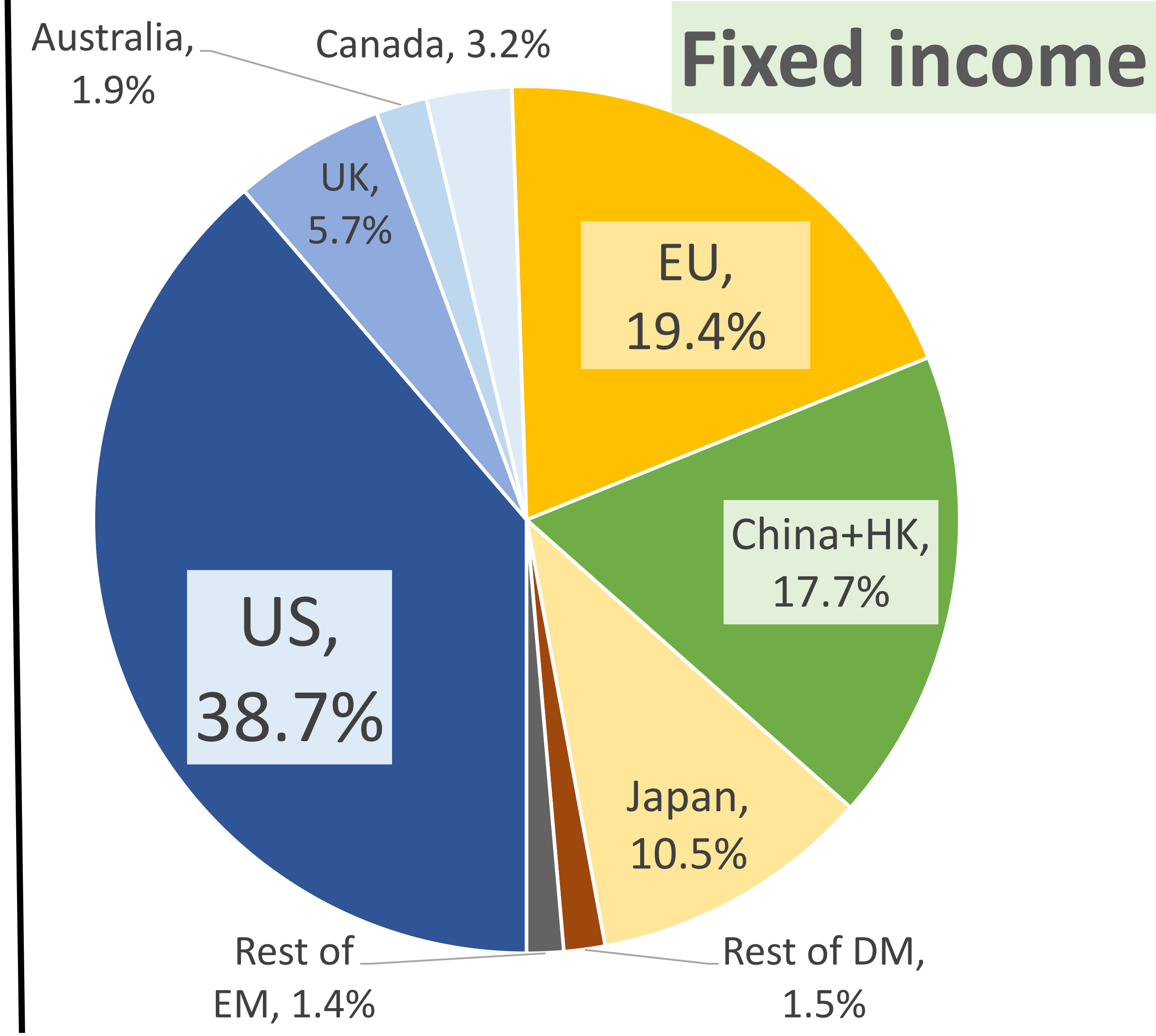


Current Account Surplus

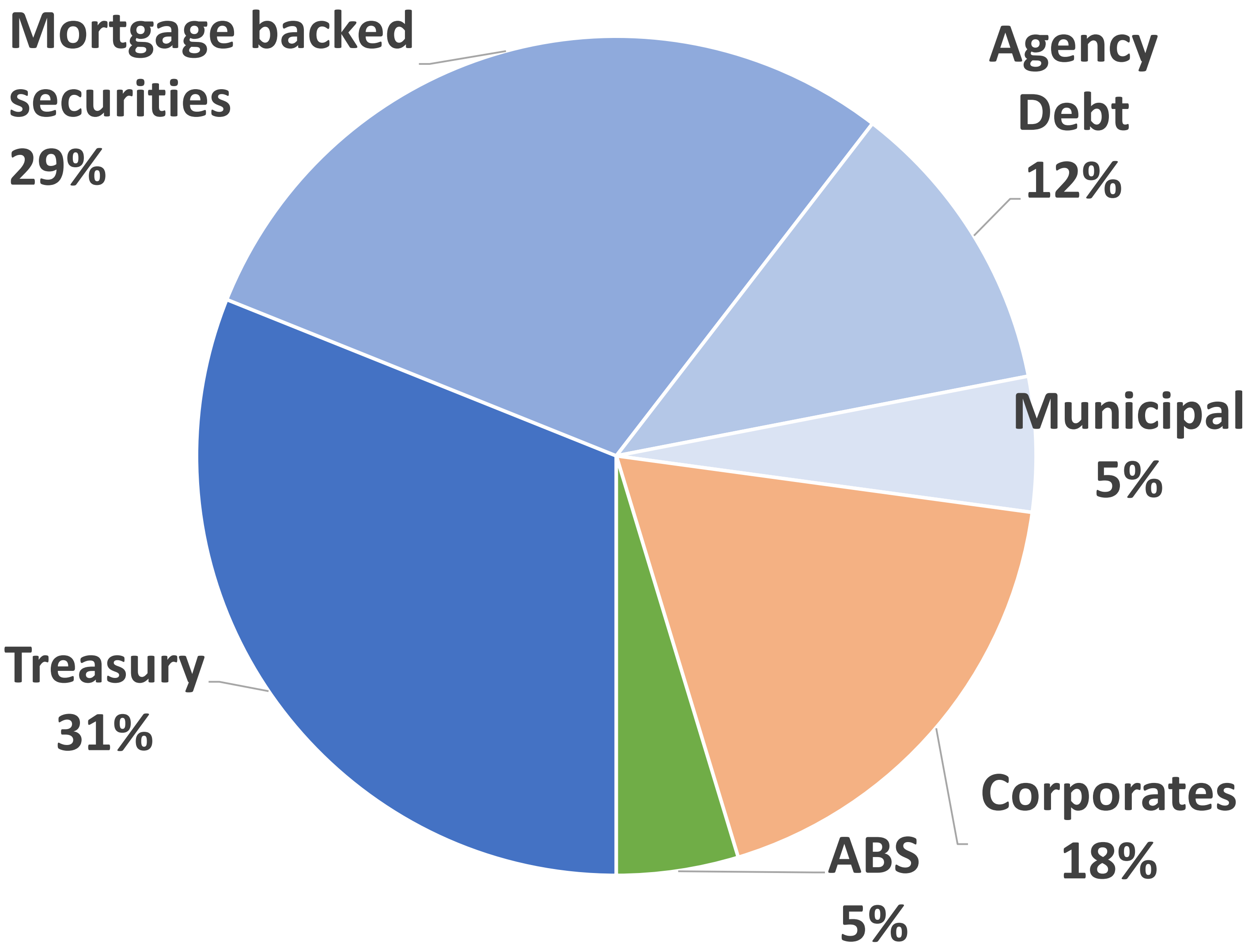


"Deep and liquid capital markets…" 2021 % of global:





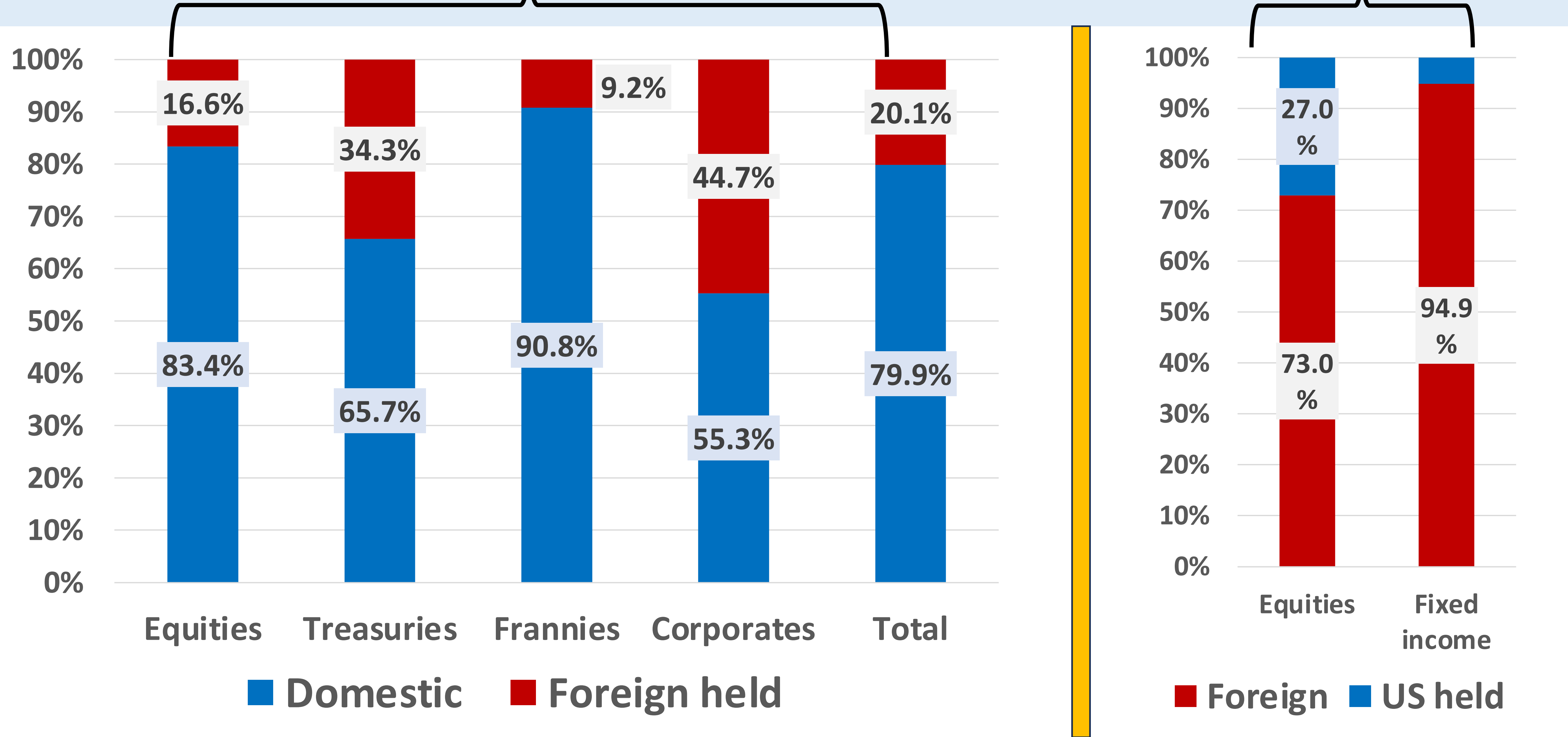
What are those fixed income securities?



- Average share 2007-2021
- Government, government guaranteed, & Munis = 77%

- MBS = Fannie & Freddie guarantee
- ‘Agency’ = Fannie & Freddie debt
- ‘Municipal’ = State and local debt
- ABS = private asset backed securities

‘Foreign’ holdings of US securities, 2021, and reverse



Why use quasi-state money (i.e. dollars)? 1

- Klein and Pettis (2020) are closest to a system level answer
- Structurally:
- Successful late developers (Germany, Japan, Korea, China, etc) end up with repressed domestic demand →
  - Inadequate local demand →
  - Inability to hit economy of scale without exports →
  - Inability to get growth without net exports
- Net exports → either / or choice
  - Either: Currency appreciation – bad for future exports →
  - Or: Asset accumulation – maintains currency undervaluation & 'productivity ratchet'

Why suppressed domestic demand?

- Export surplus economies (except oil exporters) are successful (Gerschenkronian) late developers
- Successful late development
  1. State suppresses domestic consumption →
  2. accumulation of investment capital →
  3. invest in latest, greatest production technology to compete →
  4. high output to attain required economies of scale for profitability →
  5. high output + weak domestic demand →
  6. export surges & export surpluses →
  7. global deflation … now what?
- NB: WW1 and WW2 reset the development clock in Germany, Japan

“Quality work conquers the world market”
1960s poster

Plus ça change…

‘We must export. Either we export goods or we export men. The home market is no longer adequate.’

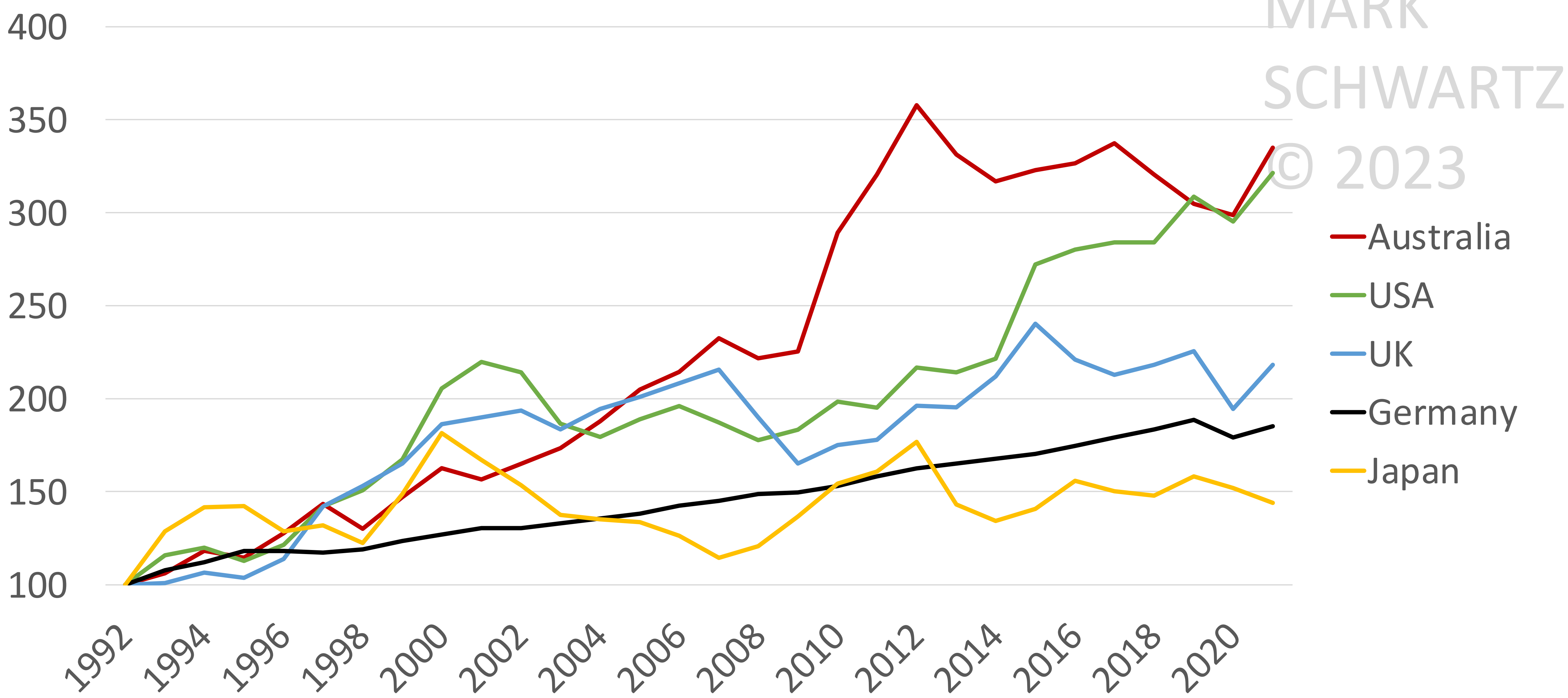
Leo von Caprivi

Domestic demand level…

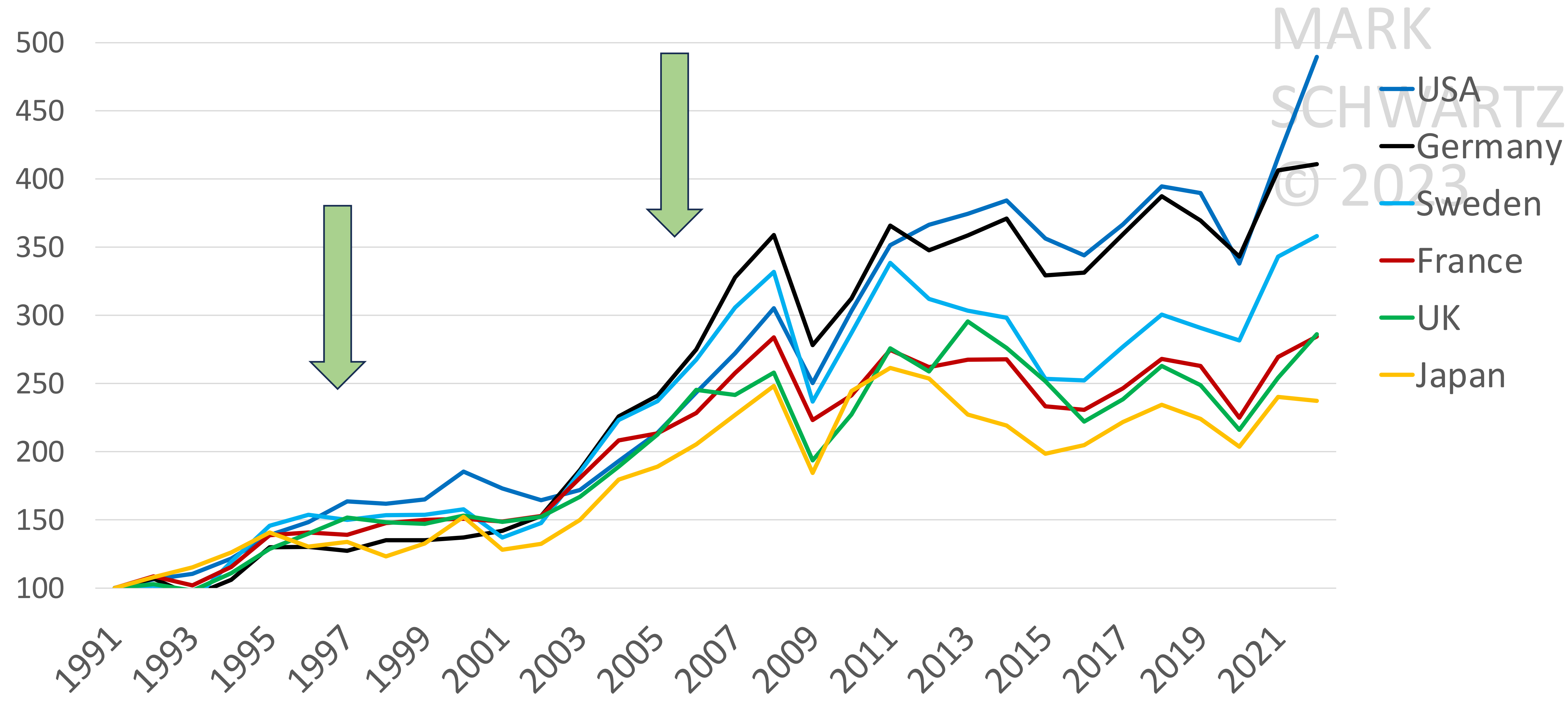
Household final consumption expenditure as a % of GDP, average 1992-2021

Top 12 Deficit countries			Top 12 Surplus countries	
Greece	67.6		Japan	54.7
Mexico	66.9		Germany	54.6
USA	66.8		Switzerland	54.5
UK	64.9		Taiwan	53.9
Portugal	64.7		Russia	51.5
Brazil	62.7		Korea	51.2
Turkiye	62.0		Netherlands	47.1
Poland	61.1		Sweden	46.7
India	60.4		Norway	43.4
Spain	58.8		China	40.5
Canada	56.2		Singapore	38.8
Australia	55.6		Gulf Oil Exporters	30.7
Unweighted Average	**62.0**			**47.3**

Private final consumption growth, index, 1992=100



Export Weltmeister ???
Export growth, index, 1991-2022, 1991 =100



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  - Asset accumulation → vested interest in supporting $

Why use quasi-state money? 2 (New EMDEs)

- Structurally:
  - Recent developing countries are net borrowers (to import capital goods) → Repayment requires net exports (principal *plus interest*)
  - Old net exporters will not lend in their own currency (requires net imports) or in developers' currency (too risky, "original sin") → $ loans
  - Only the core country can validate net exports by creating and exchanging assets denominated in its currency for aggregate net imports thus allowing repayment (or, someone makes new $ loans…)

Why use quasi-state money? 2 Unsuccessful late development → financial lock in also

- Permanently import surplus (current account deficit) countries
  - New Developing countries are net borrowers (to import capital goods) → Repayment requires net exports (principal *plus interest*)

- “Original sin”/ Soft currencies → borrow in… ???
  1. Export surplus country currencies? → declining surplus
  2. Dominant currency?
     - Key imports priced in dominant currency (and perhaps their exports too)
     - Demand meets a supply of recycled $$ from export surplus countries
     - Imperial center is a large market for exports, validates net interest payments

- Result: $$ on both sides of global balance sheets

Why use quasi-state money? 3 - Oil

- Contingently (?): Oil (Coal in C19) is a geo-strategic resource
  - Imperial center controls or wants to control oil (coal) as the key transportation energy source
  - Prices its own exports in its own currency
  - Exchange of protection for invoicing oil exports in quasi-state money

But contingency has structural characteristics

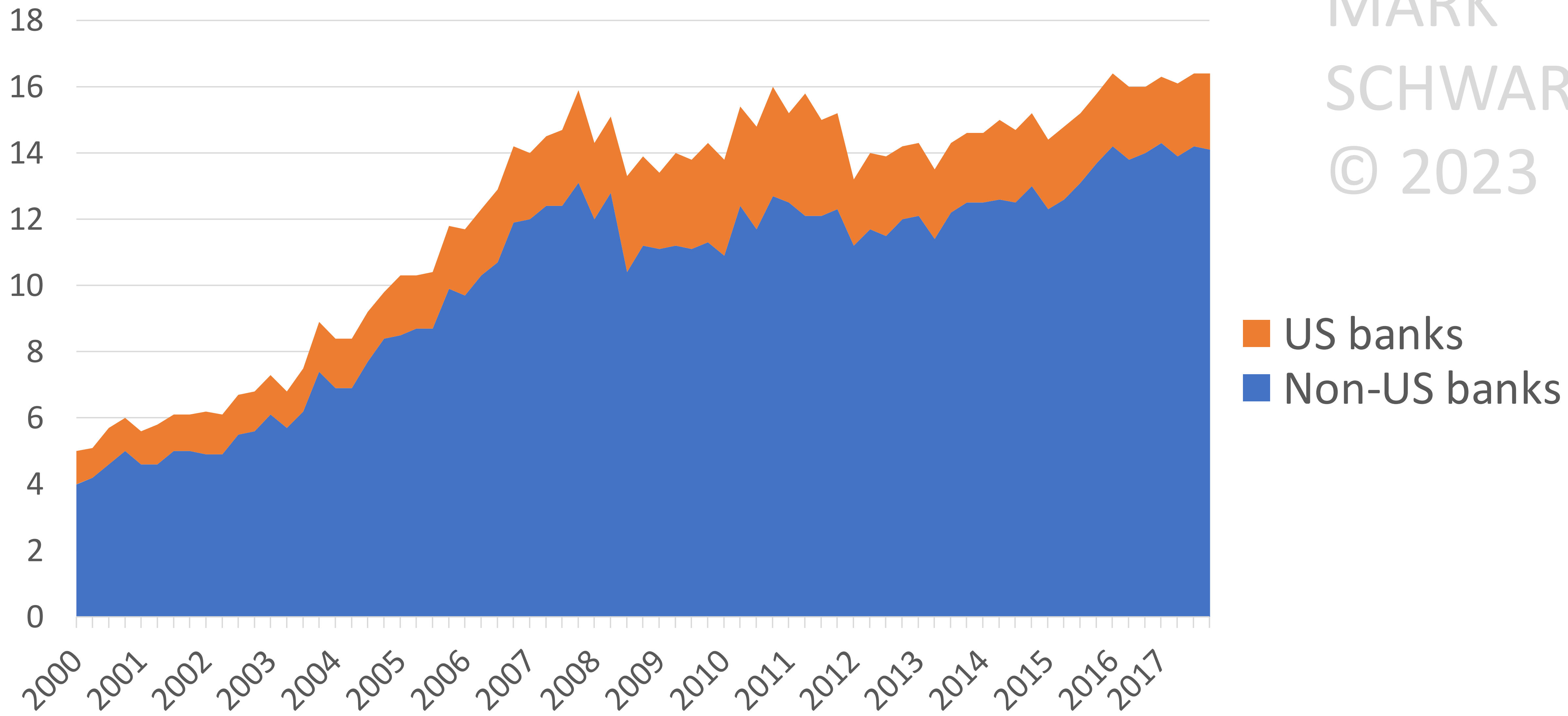
- Oil imports typically → BoP deficit which has to be financed; lenders finance in dollars per prior slide → repayment in dollars…
  - 10 biggest EME net oil importers = 14.2% of cumulative global CAD
- Oil exporters: transform illiquid ricardian rent into an asset…. $? €? ¥?

Result:

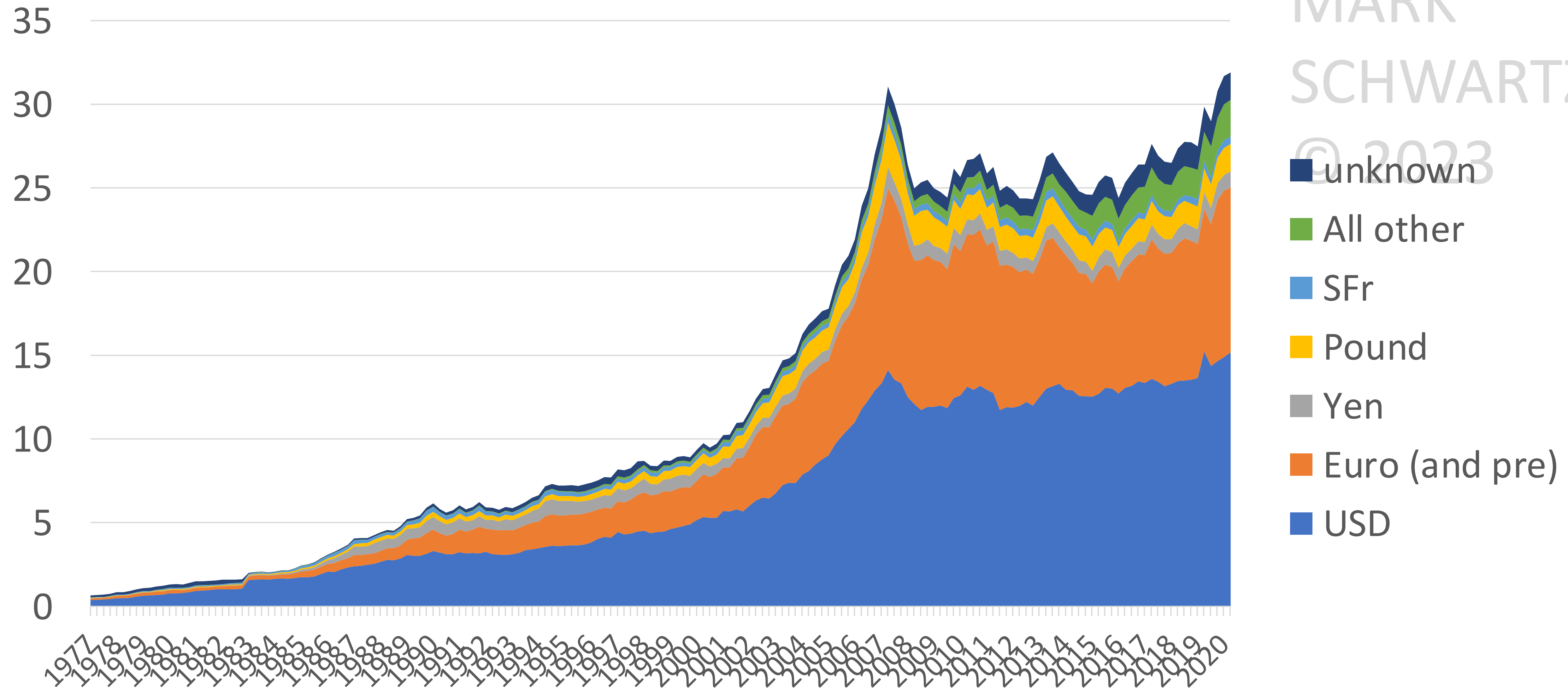
- Non-US banking systems are locked into a USD world in normal and crisis times (as above).

- Why? Balance sheets end up populated with dollars.

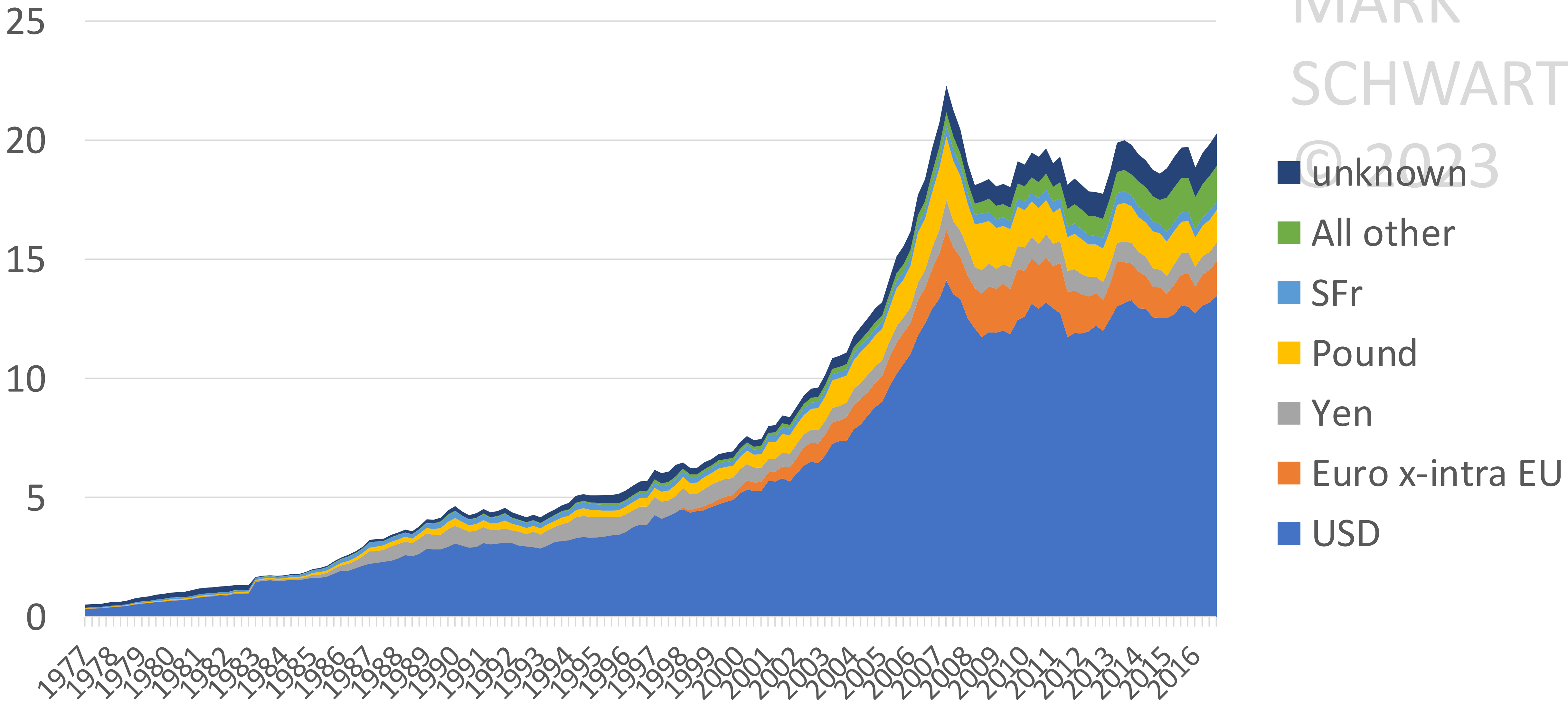
Who originates most non-domestic USD loans? Not US banks… (US$ trillions) (IMF data)



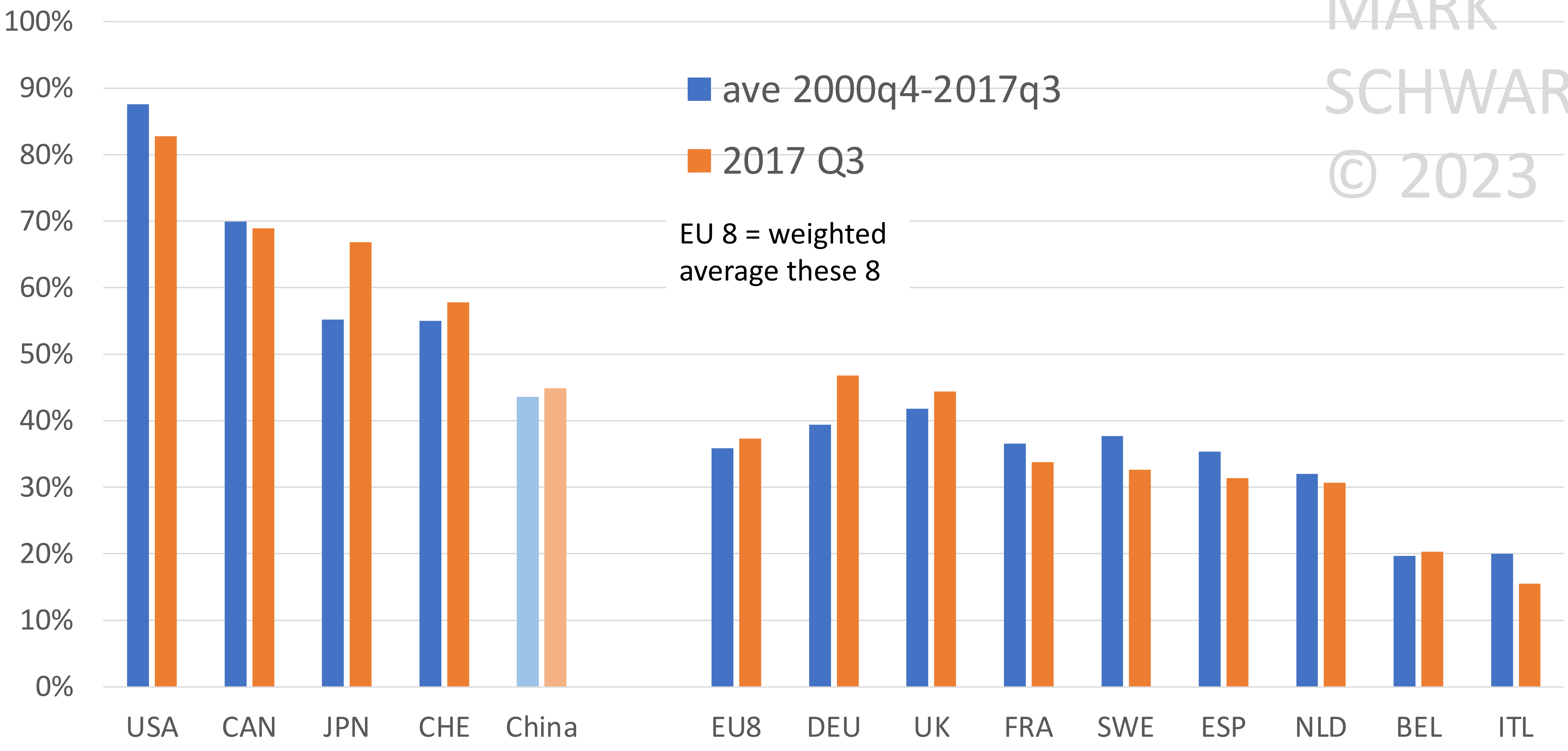
Cross border banking liabilities by currency, USD trillions, 1977-2020q1 (BIS data)



Cross border banking liabilities by currency, USD trillions, 1977-2017, **net of intra-EU euro lending**

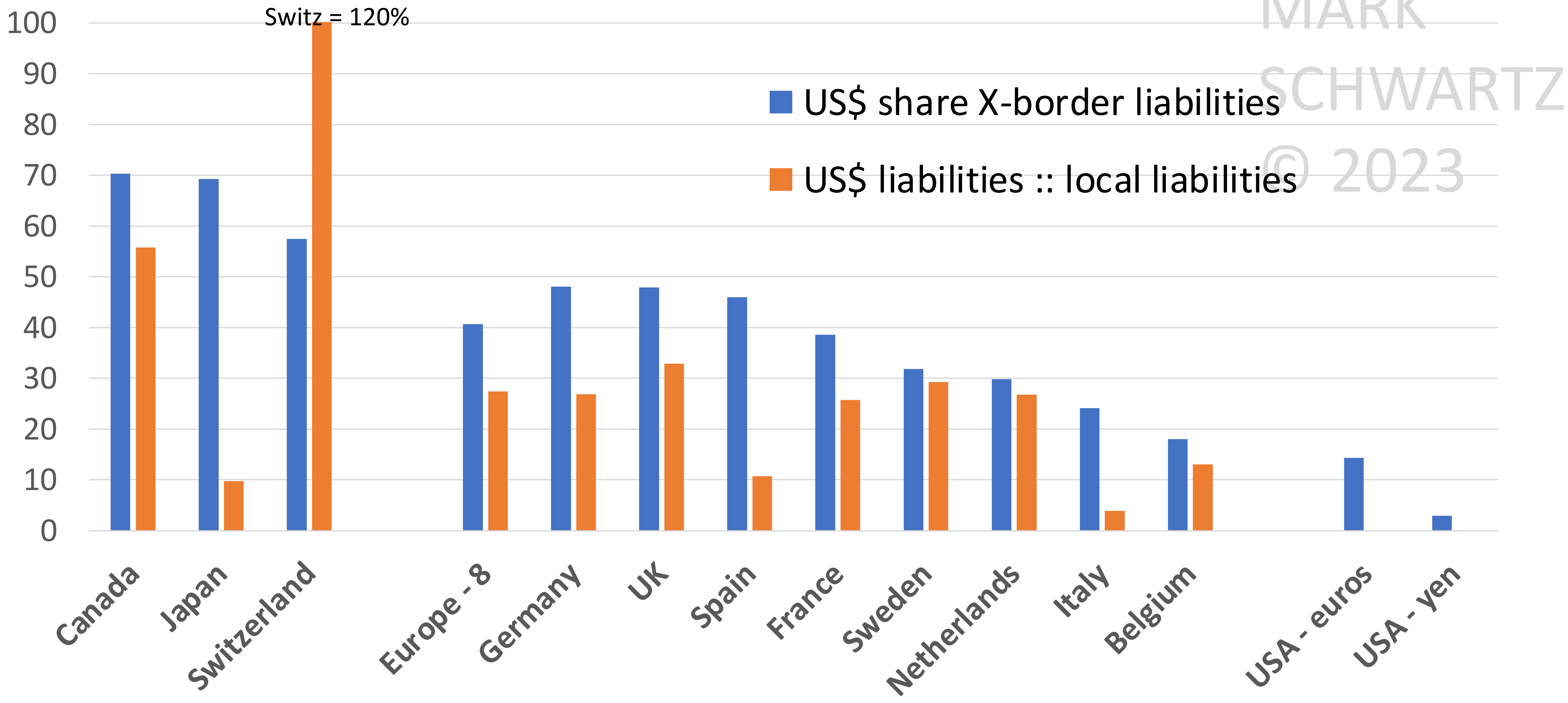


USD Share of x-border liabilities, average 2000q4-2017q3 and 2017q3 (except China, 2015q4-20182q)



USD share of cross-border and all liabilities for banks, %, Q3 2016

source: BIS; Europe 8 = aggregation of absolute values for 8 European countries here



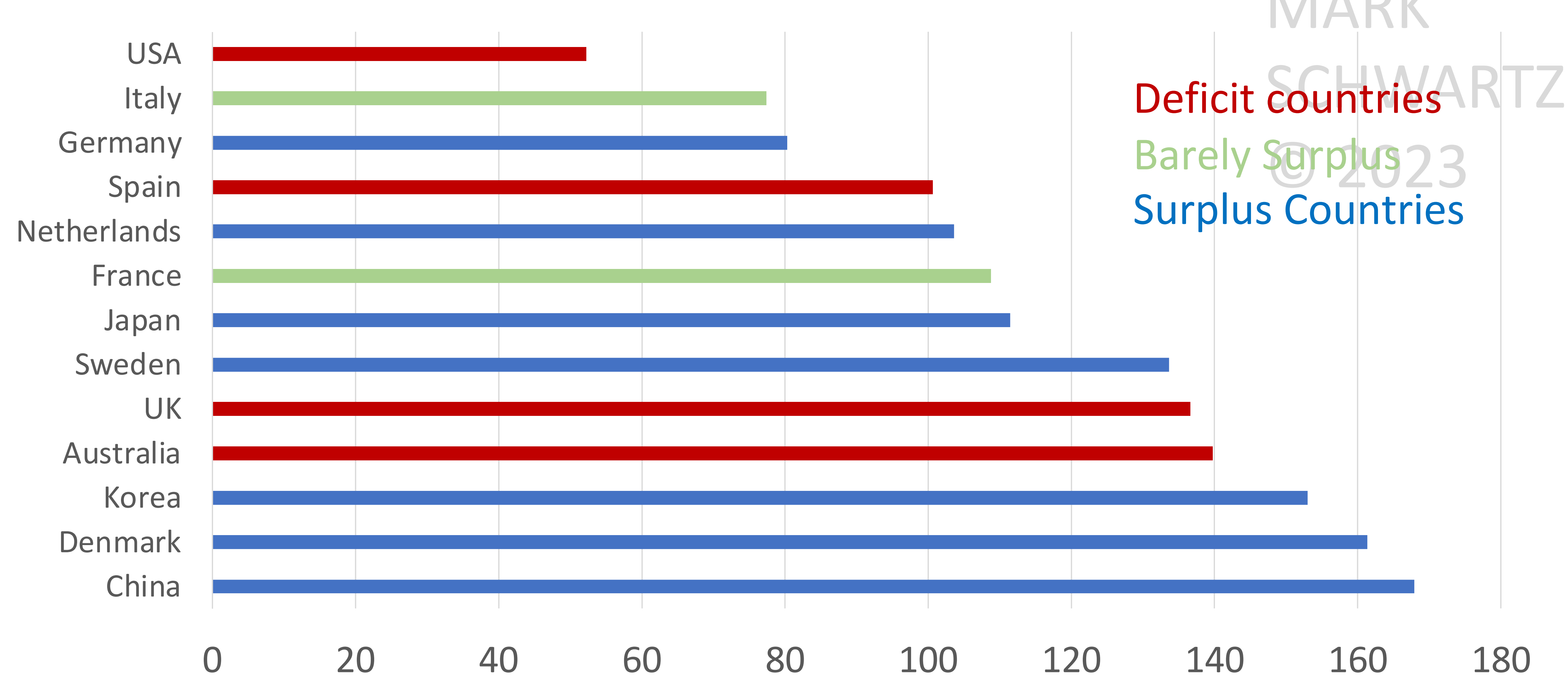
Result: financial system lock-in

- At the micro-level:
  - Competition → must enter global markets & compete for deposits → faster growth & larger market share
  - Bank liquidity management (Beck, Knafo) → short term dollar deposits from MMFs funding medium term lending → management via REPO (Gabor, Braun)
  - ➢High proportion of cross-border currency exposure
- At the macro-level
  - In the aggregate, banking systems of major economies have dollar liabilities exceeding national FX reserves
  - Some smaller system effectively dollarized internally and externally
  - ➢Financial systems depend on swaps in a crisis

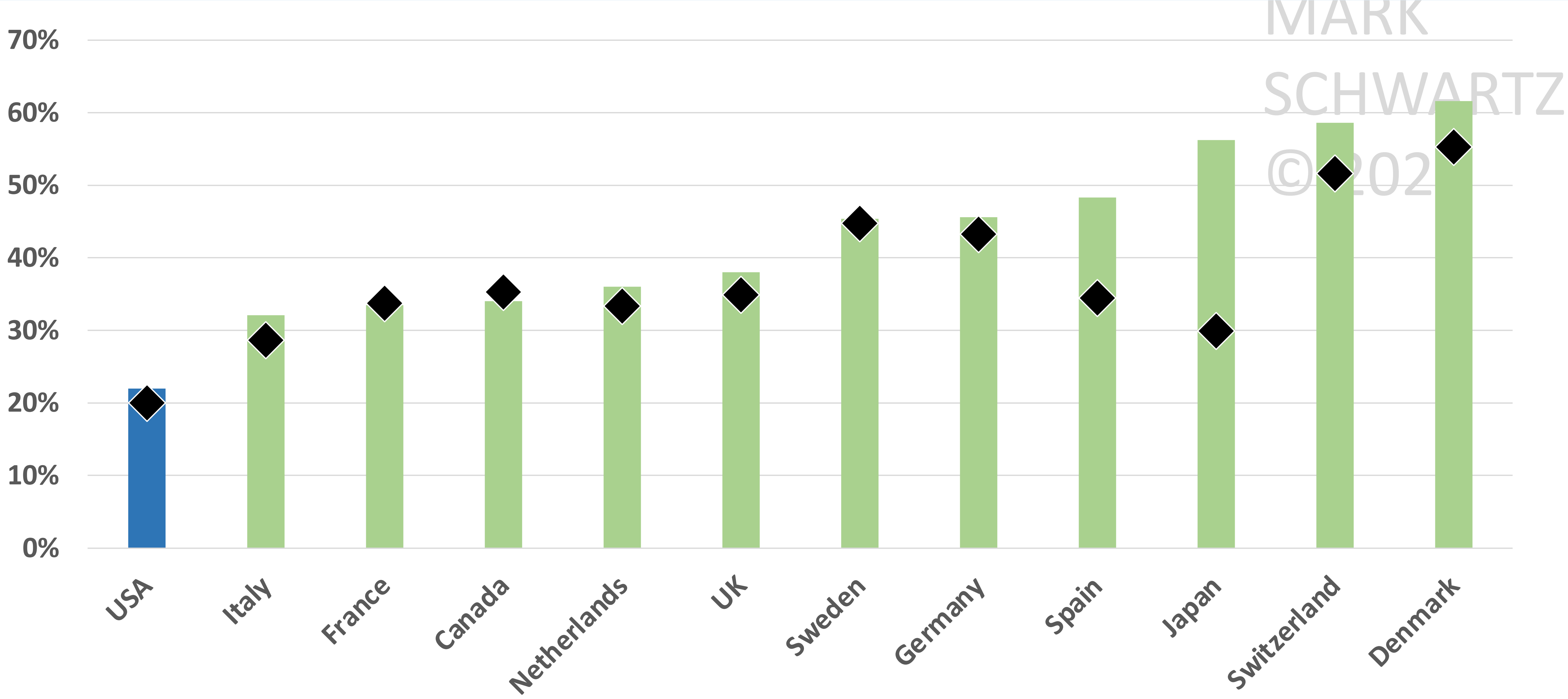
Banking system vulnerability matters …

- Because banks are the main supply of credit to non-financial firms in the the non-US rich economies
  - ➢If the banks fail, the entire economy crashes.
  - ➢This makes the local banking system ultimately reliant on the Federal Reserve Bank, as we saw in 2008-2010 with the central bank swaps
- This is a second source of structural power (the first being the US ability to run perpetual (?) current account deficits)

Banks matter more outside the USA: Domestic credit to private sector by banks (% of GDP) ave. 2017-2021



Bank credit to non-financial sector as % of all credit to entire NFS, average 2000-2022 and end 2022 ◆



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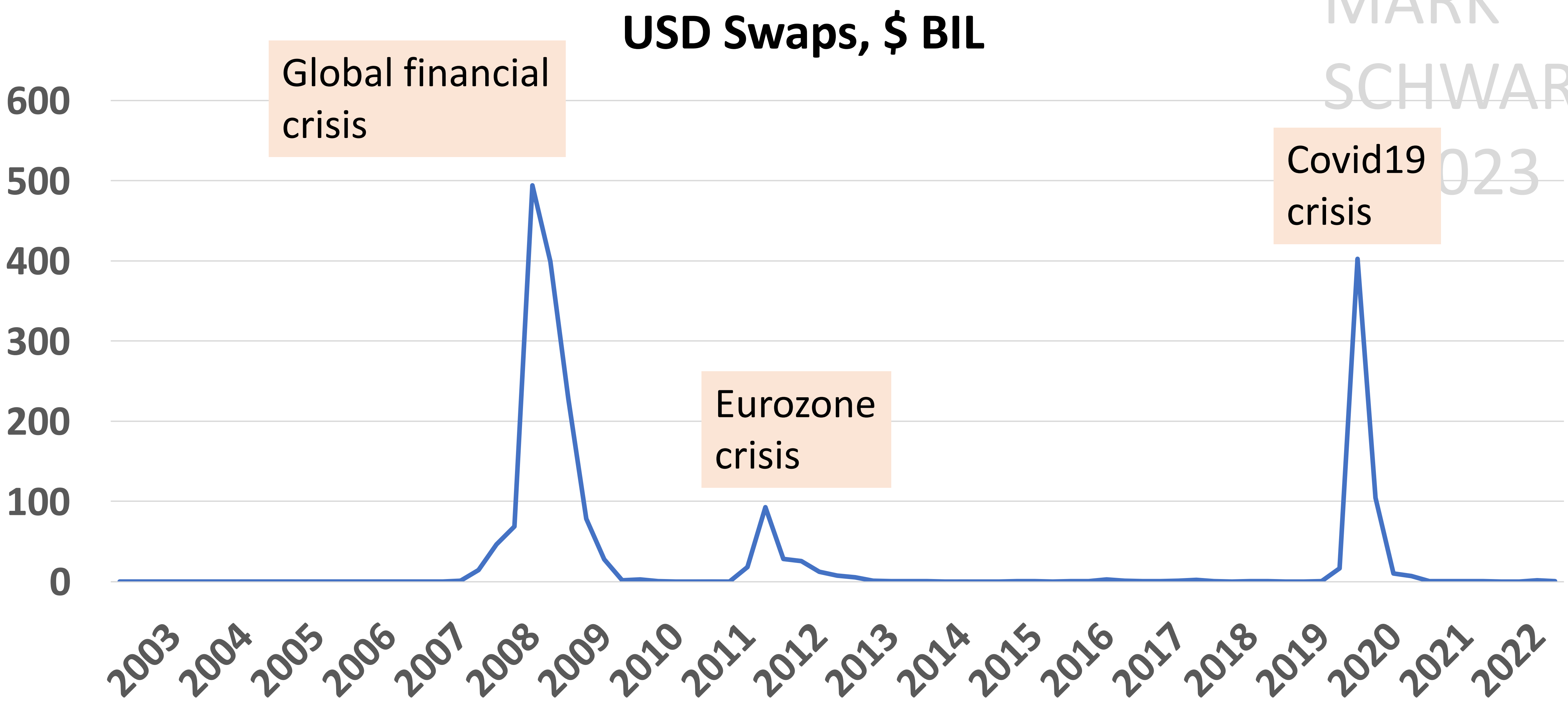

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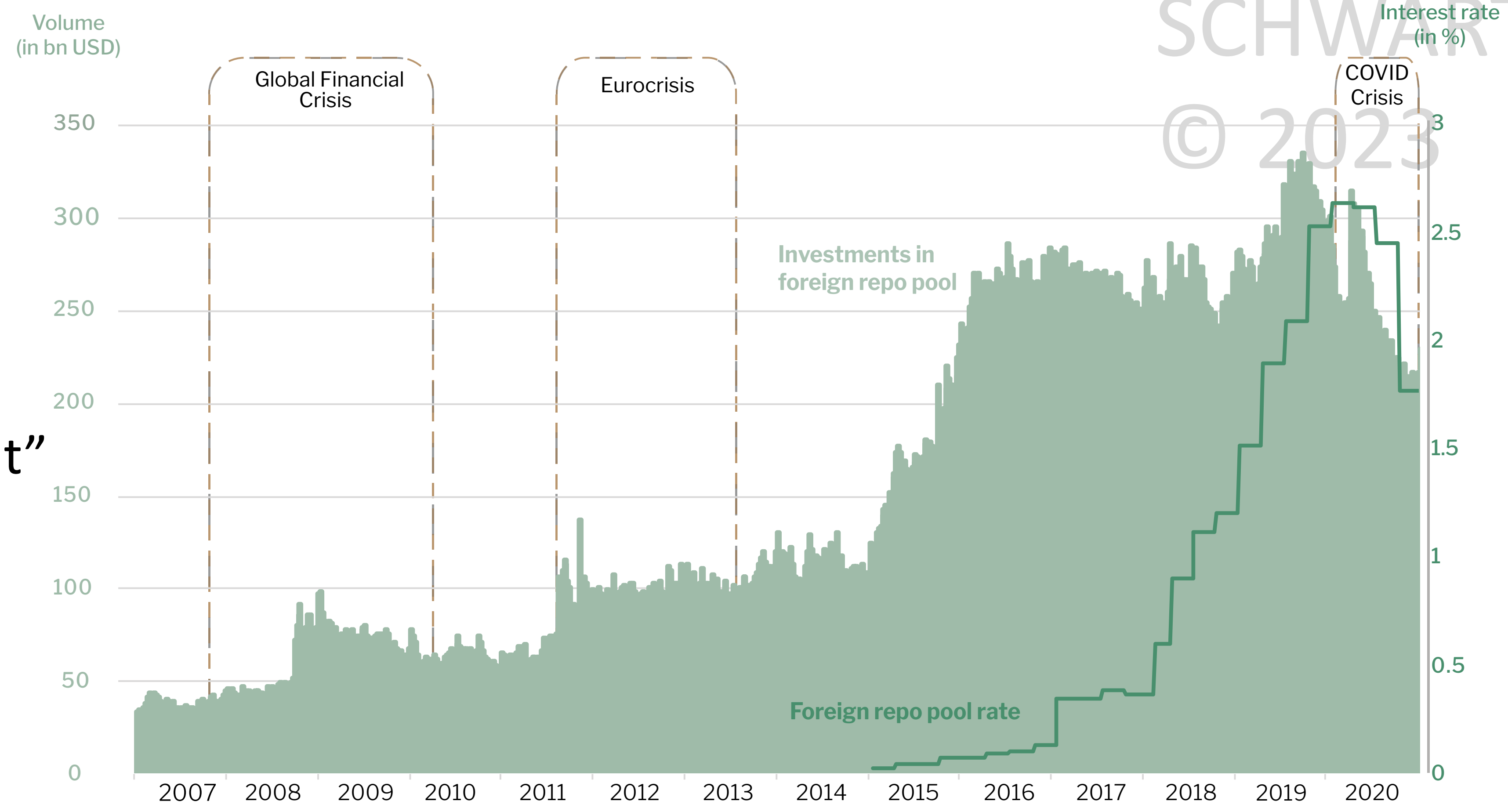

Source: Federal Reserve