Monetary sovereignty, currency hierarchy and policy space: a post-Keynesian approach

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1. Introduction

- Global financial crisis of 2008 brought to light key issues for the post-Keynesians (PK)
    - o Intrinsic flaws of an international monetary system (IMS) anchored in a national currency
    - o Design faults of the EMU -> loss of monetary sovereignty (MS) and its implication for the policy space
        - Neo-chartalism or Modern Monetary Theory.

- Two issues have been discussed hitherto independently, yet both of them bring us back to Keynes's *Treatise on Money* and his proposal of the ICU (Keynes, 1930 and 1944)

1. Introduction

- Keynes discusses the relationship between the IMFS dynamics, the features of the national monetary systems and the autonomy of economic policy -> growth-oriented policies.

  - Fiduciary domestic monetary system -> control of the domestic interest rate -> rational management of national money by the State

- Issues directly linked to the concept of MS, which he didn't use

  - 1st legal definition, contemporaneous to the *Treatise*, set out by the former Permanent Court of International Justice in 1929: **a state is entitled to regulate its own currency**

1. Introduction

- MS: controversial concept, without a single and unanimous definition.

'There exists perhaps no conception the meaning of which is more controversial than that of sovereignty' (Oppenheim, 1905)

'If sovereignty is one of those concepts that generate intense debates (…) the notion of monetary sovereignty seems to double the handicap. It is rarely defined in the economic literature' (Blanc, 2011).

1. Introduction

- The notion of MS is even more disputed because underlying each concept there is:

  - Specific definition of sovereignty
    - Political sovereignty: state = sovereign
    - Supreme or absolute power or authority
    - Freedom from external control, i.e., autonomy or independence

  - Approach on money, as is the case of neo-chartalism

Aim and hypothesis

- Reassess the concept of MS and its relationship with currency hierarchy and policy space from a PK perspective .

- This perspective needs to take into account
  - PK approach on money
  - Current institutional features of CB/Tresury nexus
  - Dynamics of the current IMFS featured by a currency hierarchy and financial globalization

Outline

1. Neo-chartalist approach
2. Alternative concept of MS coherent with the PK approach
3. MS, currency hierarchy and policy space
4. Final remarks

The neo-chartalist approach

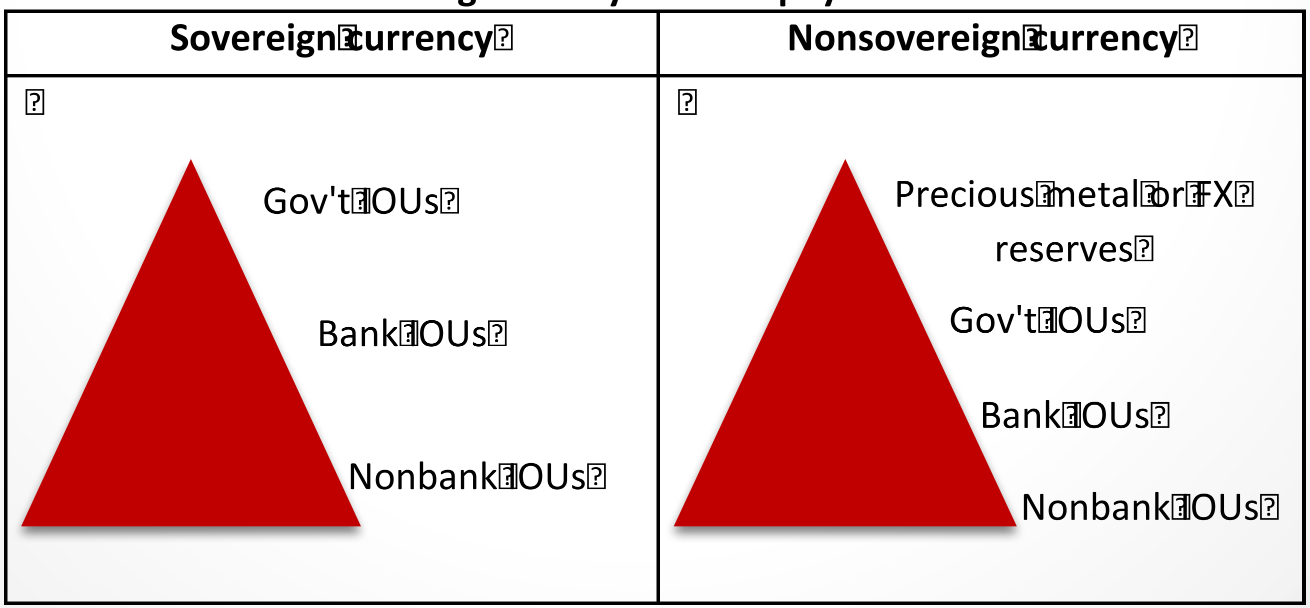
- Second edition of Wray's book 'Modern Money Theory: a primer on macroeconomics for sovereign monetary systems' (2015)

  - *'The MMT approach has been criticized for focusing too much on the case of the US, with many critics asserting that it has little or no application to the rest of the world's nations that do not issue the international reserve currency…This Primer fills that gap - it* ***explicitly addresses alternative exchange rate regimes as well as the situation in developing nations…. In that sense, it is a generalization of modern money theory****'* (Wray, 2015, p.x).

The neo-chartalist approach

- Concept of MS
  - Sovereign government creates a money of account
  - Fiat currency issued by the sovereign government (IOU)
  - Taxes drive money: the aim of taxation is to create demand for the currency
  - Sovereign government can afford anything for sale in its own currency and faces no financial constraint and solvency risk

Figure 1. Pyramid of payments



Source: Wray (2015). Author's elaboration.

The neo-chartalist approach

- Degree of policy space of developing countries with sovereign currencies ⇔ exchange rate (ER) regime
  - Impossible trinity or Trilemma
    - Floating ER increases policy space X close current account imbalances ⇔ capital account surplus

Figure 2. Monetary sovereignty, exchange rate regimes and policy space according to Wray (2015)

Nonsovereign currency	**Sovereign currency**		
FX, convertible currency and monetary unions*	Fixed exchange rate	Managed exchange rate	Floating exchange rate
Degrees of Policy Space			
Lower			Higher

Source: Author's elaboration based on Wray (2015).
Note: *Countries' members of monetary unions (such as euro zone) that don't issue their own fiat currency.

Alternative concept of MS coherent with the PK approach

- PK scholars critics call into question the pillars of the concept of MS
  - Gnos and Rochon (2002) and Lavoie (2013) : premise of a consolidated government (Treasury and Central Bank),
  - Rochon and Vernengo (2003) and Gnos and Rochon (2002): nature of money, acceptability
- Critiques related to the concept of MS -> provide clues for devising an alternative concept
  - Dequech (2013)
  - Minsky (1986)

Alternative concept of MS coherent with the PK approach

		Post-Keynesian	Neo-chartalist
		Common pillars	
Sovereignty	**Political sovereignty**	National state is the sovereign that defines the money of account and the national fiat money that responds to this definition	
Approach on Money	**Money supply**	Endogenous money	
		Different pillars	
	Acceptability	Money as creature of the State (contracts and taxes) and convention	Taxes drive money:
	Central Bank and Treasury nexus	Different but intertwined institutions ❖ Treasury: enforces contracts and taxes' laws; issues the lower risk bonds used in monetary policy operations ❖ Central Bank: issuer of the national money, responsible for the monetary policy, lender of last resort and regulator of the monetary and financial system	Premise of consolidation ❖ Treasury spends by crediting a bank account and faces no financial constraint (taxes and securities don't finance gov. expenditures) ❖ No distinction between monetary and fiscal policies (Treasury bonds as an interest-bearing alternative to reserves)

Source: Wray (2015), Rochon and Vernengo (2003), Gnos and Rochon (2002), Lavoie (2013), Dequech (2013). Author's elaboration

Monetary sovereignty, currency hierarchy and policy space

- Besides the shortcomings of neo-chartalism point out by PK scholars, that approach have also disregarded important features of an open economy performance in the current historical setting

    - Ignores the dynamics of the current IMFS, its implications to emerging countries and the actual ER regimes adopted

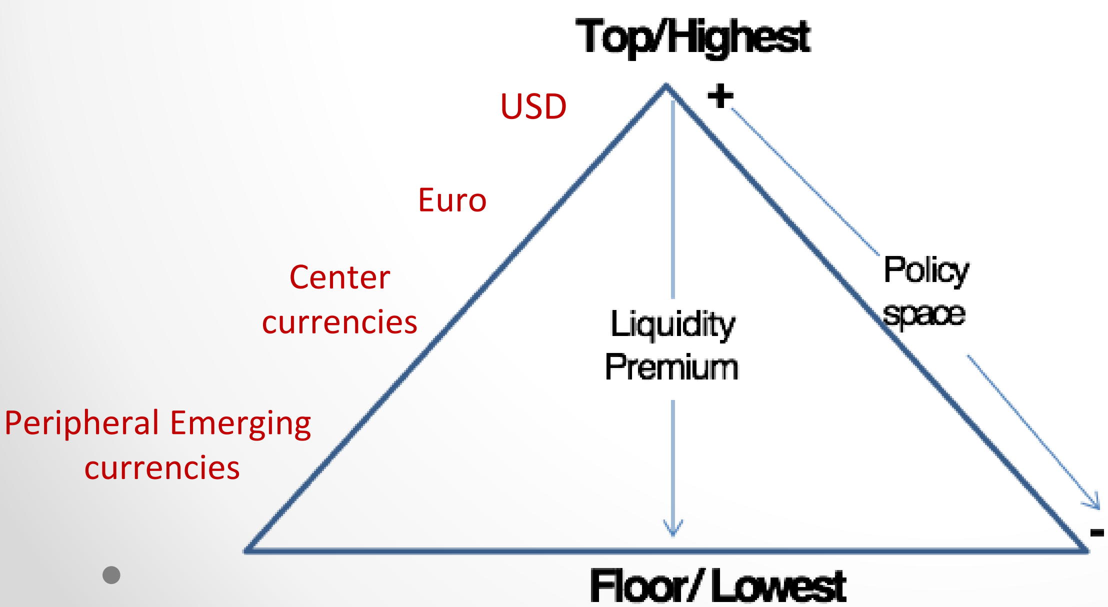
    - Lack of realisticness contradicts the PK approach (Lawson, 2009; Lavoie, 2014))

Monetary sovereignty, currency hierarchy and policy space

- PK approach : volatile exchange rates
- Central banks need to intervene in currency markets to curb volatility, undermining monetary policy autonomy (except US)
  - o 'Impossible duality' (Flassbeck, 2001) or 'dilemma' (Rey, 2013)
    - Emerging economies; greater loss of monetary policy autonomy under free capital mobility, regardless of the exchange-rate regime,
      - o Higher K flows' instability => greater ER volatiity
        - Fear of floating and precautionary demand for reserves

Monetary sovereignty, currency hierarchy and policy space

- Currency Hierarchy in the current IMFS (Andrade & Prates, 2013; Paula, Fritz and Prates, 2017; Kalterbrunner, 2016)
  - Keynes: IMS based on a key-currency => hierarchical institutional arrangement
  - Center-periphery dimension (ECLAC): a system of uneven partners => monetary and financial asymmetries between center and peripheral currencies



Keynes (1936) TG, cap. 17

Total expect return

$$r_a = a + q - c + l$$

l = liquidity premium

Monetary sovereignty, currency hierarchy and policy space

			Monetary Sovereignty (MS)	
			*Nonsovereign currency**	*Sovereign currency*
			Degree of Policy space – → +	
Currency Hierarchy (CH)	*Key currency*	**Degree of Policy space** + ↓	n.a	**1** United States
	Center Currencies		**3** Eurozone countries (e.g. German, France, Grece, Spain, etc.)	**2** e.g. Canada, UK, Japan, Suiça, etc.
	*Peripheral Emerging Currencies***		**5** e.g. Ecuador	**4** e.g. Brazil, Mexico, India, China, Indonesia, Thailand, Turkey, etc

Author's elaboration.

Note: * Countries that use a foreign currency, have a convertible currency or are members of monetary unions; ** Based on the sample of Emerging-market countries of the Institute of International Finance (IIF): Argentina, Brazil, Bulgaria, Chile, China, Colombia, Czech Republic, Ecuador, Egypt, Hungary, India, Indonesia, Korea, Lebanon, Malaysia, Mexico, Morocco, Nigeria, Peru, Philippines, Poland, Romania, Russia, Saudi Arabia, South Africa, Thailand, Turkey, Ukraine, United Arab Emirates.

Monetary sovereignty, currency hierarchy and policy space

- **Situation 3** (Eurozone countries)
  - Inside hierarchy, in which German is positioned at the top level and the peripheral economies at the bottom -> smaller policy space
  - Decrease in the policy space depend on the institutional framework of the Monetary Union, as already pointed out by many PK scholars (e.g., Arestis and Swayer, 2011; Lavoie, 2013).

Monetary sovereignty, currency hierarchy and policy space

- **Situation 4** (Peripheral emerging countries that have MS)
  - Macroeconomic constraints -> external one
  - Macroeconomic regime = interaction between the macroeconomic policies within an institutional framework.
    - Exchange rate regime: one lynchpin of this regime.
    - Degree of financial openness:
    - Specific institutional framework of the monetary policy

Final remarks

- Concept of MS coherent with the PK approach on money and other key presuppositions -> realism, historical time and the crucial role of institutions
- Realistic analytical framework on the relationship between MS, CH and policy space
  - Useful to analyze the challenges and dilemmas currently faced by center (mainly, EMU members) peripheral emerging economies and, hence, to draw policy recommendations to mitigate them

Final remarks

- Hidden concept of MS in Keynes's writings
  - Synonymous of 'rational management of the national money by the state' or 'domestic currency management' (Skidelsky, 2000)
    - fiduciary domestic monetary
    - central bank with the task of determining the policy rate
      - Effective in a non hierarchical and financial regulated IMS -> regular distribution of reserves from creditor to debtor countries

Thank you

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