Essays on Money, and the Asymmetries of the International Monetary System

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Abstract: This thesis argues international monetary asymmetries are largely responsible for determining the balance sheet structure, policy decisions, and behavior of all institutional sectors in the economy. That is to say, that whether or not the economy issues an international reserve currency is fundamental to economic theory and practice. Three manuscripts are assembled following the Post Keynesian tradition and the endogenous money approach, which is reviewed in the first chapter. The second develops the core thesis, and presents compelling evidence of the presence of such asymmetries. Finally, the third formalizes the argument by modeling the set of policy choices, and behavior of reserve earning economies. The methodology is based on the Post Keynesian stock-flow consistency approach, and simulations of several experiments that include a fiscal policy response to a global crisis like that of 2009.

Keywords: International Monetary Asymmetries, Stock-Flow Consistency.
Jel Classification: E12, E20, E40

* Chapter I (which is introductory) has been published in Revista Venezolana de Análisis de Coyuntura, UCV, Venezuela. Chapter II (which develops the main argument of the thesis) has been published in Spanish in Revista Investigación Económica, UNAM, Mexico, and is forthcoming in English in the Journal of Post Keynesian Economics, USA, the same journal which is currently considering for publication Chapter III (which formalizes the thesis by developing a model of reserve earning economies).

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Preface:

Two fundamental ideas have motivated this thesis. The first one is that money matters because it affects the motives of economic agents (e.g. due to liquidity preference), and the second is that international monetary asymmetries also matter for the same reason (e.g. due to foreign currency liquidity preference).

While Keynes and the Post Keynesians have explained thoroughly the role of uncertainty and liquidity preference (e.g. the preference for money and liquid assets) in determining employment, asset prices, and the balance sheet structure of both creditors and debtors, the thesis here pretends to explain the role of foreign currency liquidity preference and uncertainty within the context of an asymmetric international monetary system.

The same reasoning that applies to Keynes’s (and the Post Keynesian) theory applies to the thesis here. In the first case, the generic uncertainty about the future, market outcomes and credit crises, forces economic agents and institutions to hold money and liquid assets (causing unemployment), while here the uncertainty about net foreign currency inflows, the international monetary system, currency crises, and the access to international means of payments, forces institutional sectors to hold in their portfolios liquid assets/liabilities denominated in foreign currency (causing unemployment domestically and abroad).

The argument here, however, is that the presence of international monetary asymmetries is largely responsible for determining policy choices, the balance sheet structure, and behavior of all the institutional sectors in the economy. That is, here it is sustained that whether or not the economy issues an international reserve currency is fundamental to both economic theory and practice (e.g. it affects the motives of economic agents).
Put differently, liquidity preference, balance sheet structures, the exchange rate regime, and the flexibility of monetary and fiscal policies all depend on whether the economy is a reserve issuing (RIE) or a reserve earning economy (REE), as well as on the availability of foreign reserves (i.e. international means of payment).

The entire argument is, therefore, developed following the Post Keynesian tradition and the endogenous theory of money, as only the latter views money as a systemic need or social institution that deals with uncertainty and, hence, affects motives and decisions (money is always non-neutral), its price, the interest rate, being an exogenous variable rather than a market determined outcome. Following this reasoning, the first chapter reviews the closed economy Post Keynesian literature on banking and money, although two basic mainstream theories are briefly discussed at the beginning: the so-called industrial organization approach and the contemporary theory of financial intermediation.

The second chapter develops the main thesis, and explains the quantity and price effects that arise from the presence of international monetary asymmetries. It argues that the current international monetary system is fully asymmetric, as it divides the world among reserve issuing (RIEs) and reserve earning economies (REEs).

The latter implies economic policy is affected by whether or not the central bank issues an international reserve currency, as that largely influences its balance sheet structure, interest rate targeting procedures, the elasticity (flexibility) of monetary policy and the exchange rate regime. The reason is plain: as opposed to RIEs, the central bank in REEs must target a minimum stock of foreign currency assets, as the local currency does not circulate abroad.
The hypothesis of the presence of such asymmetries is confirmed by the findings described in the second chapter regarding the strikingly different balance sheet structures of fifteen central banks from North America, South America, Europe and Asia. Moreover, the chapter explains why the presence of such asymmetries is so relevant to monetary theory and policy, how different monetary practices can be observed and, finally, which economies tend to follow similar patterns or stereotypes.

To finish, the third chapter formalizes the above findings, while extending the argument applied to the central bank to all other institutional sectors, what is done within the context of a reserve earning economy (REE). The model is based on the Post Keynesian stock-flow consistency approach and takes full account of the balance sheet structure, transactions and revaluation processes that describe the behavior of those economies.

Further, the model is built to reflect the relevance of buffer stocks and stock-flow norms affecting the real and financial spheres, and how the availability of foreign reserves determines fiscal and monetary policies, the rate of growth of government expenditures, the issue of foreign and local currency debt, interest rate targeting, exchange rate intervention and switching mechanisms, and compensation instruments. Moreover, several different simulations and experiments are performed to understand the system, including a fiscal policy response to a global crisis similar to that of 2009.

This thesis has taken many years of work; and this is still the beginning. The hope is that the study of reserve issuing and reserve earning economies allows for a better understanding of how the international monetary system actually works, and how it should be transformed so as to guarantee the transition towards global full employment.
My supervisors have followed my thesis with great interest, and have provided invaluable comments on earlier versions of all chapters, which have been published, are forthcoming, or have been recently sent to well known journals in both the English and Spanish language, such as: the *Journal of Post Keynesian Economics* (NY, USA) and *Investigación Económica* from UNAM (México).

The work of Ernesto Screpanti (University of Siena) and his several suggestions and comments have been particularly valuable in understanding private banking and the process of money creation. Further, the contribution of Edward Nell (New School) on Transformational Growth, and his explanations of the evolution of monetary systems in mass production economies have also been fundamental, as have been his explanations with respect to the internal consistency of the Post Keynesian theory regarding the (exogenous) determination of the interest rate and the theory of distribution. Finally, the work of Luís Mata Mollejas (Central University of Venezuela) on financial crises and the Financial Pre-adjustment Theory has been instructive and clarifying, particularly regarding the role played by portfolio adjustments in determining (ex-ante) macroeconomic outcomes (observed ex-post). They have all been supportive and encouraging.

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