

# Why is money difficult?

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# What is shadow banking?

“**Money market funding**  
of  
**Capital market lending**”

- **Global (\$)** funding of **local (FX)** lending
- **Market pricing**, both money and capital
- Key role of **market-making** institutions
- Key role of **central bank as backstop**

# Shadow Banking as Global Finance

## Shadow Bank

## Asset Manager

Assets	Liabilities	Assets	Liabilities
FX Risky Asset Credit Default Swap Interest Rate Swap FX Swap	\$ Repo	\$ Repo	Capital Credit Default Swap Interest Rate Swap FX Swap

# I. Banking is a Swap of IOUs

Bank

Me

Assets	Liabilities	Assets	Liabilities
+loan	+deposit	+deposit	+loan

Central Bank

Bank

Assets	Liabilities	Assets	Liabilities
+discount	+currency	+currency	+discount

Fed

ECB

Assets	Liabilities	Assets	Liabilities
+euros	+dollars	+dollars	+euros

# Psychological Barriers

- Fetish of the “Real”: What is being “loaned”?
- Alchemy resistance: Something from nothing?
- Negative numbers: Currency a liability?

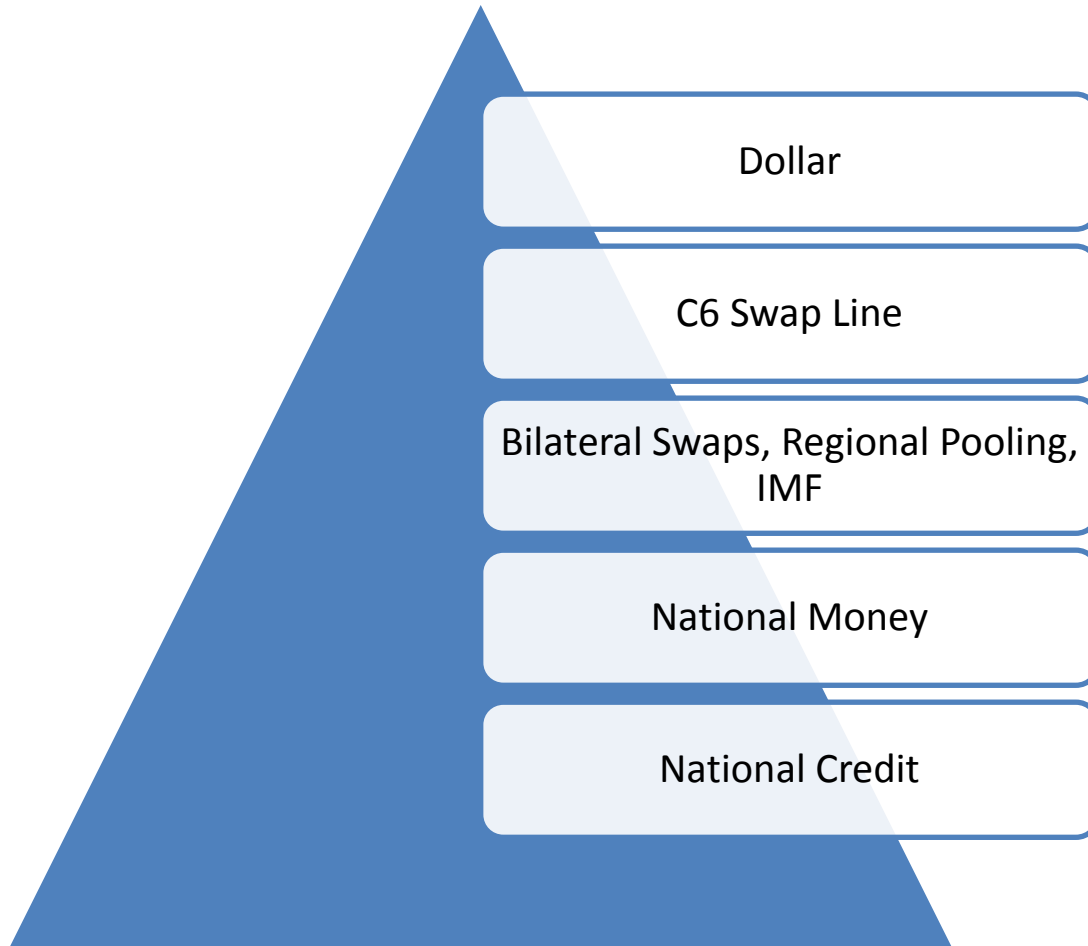
## II. Essential hybridity

- Central Bank as Bankers' bank
  - Private sector, peace time, private profit
  - Backstop for money market funding (flow)
  - Backstop for capital market lending (stock)
- Central Bank as Government bank
  - Public sector, war time, public purpose
  - Backstop for war debt issuance (flow)
  - Backstop for government debt market (stock)

# Political Barriers

- Left: Chartalism, Knapp, MMT
  - Money as creation of the state, authority
- Right: Metallism, Menger, Austrian
  - Money as creation of the marketplace, trust
- Contradictions/Dynamics of Hybridity
  - Symbiosis: Parasitism vs. Mutualism

# III. Inherent Hierarchy





# Ideological Barriers

- Westphalian ideology: sovereignty as equalizer
- Economic ideology: markets as equalizer

# IV. Inherent Instability of Credit

- Credit anticipates uncertain future
  - Mistakes are inevitable; externalities and herding
  - Money doesn't manage itself
- Older Versions
  - Hawtrey, trade credit
  - Keynes/Minsky, business investment and credit
- New Market Based Credit
  - Household mortgage credit, not business
  - Capital market securitization, not bank lending
  - Global money market funding, not domestic deposits

# Equilibrium Thinking Barrier

- Prices “clear” markets, by equating fundamental supply and demand
- Time is just an additional dimension of commodity space
- Instability comes from outside, key issue is absorbing exogenous shock

# V. Economics not much help

- Technocratic management obscures politics
  - Business cycle stabilization
  - Inflation targeting
- Academic debate obscures institutional reality
  - Fiscal policy versus Monetary Policy
    - IS/LM versus  $MV=PY$
  - Active Management versus Laissez Faire
    - Discretion versus Rules
  - “New Synthesis” and “Great Moderation”
    - Taylor Rule

# Monetary Walrasianism barrier

- Marschak 1934 (Classical?)

$$q_i = \sigma_i\left(\frac{p_i}{w}\right) = \delta_i(p_1, p_2 \cdots w \cdot e),$$

$$\sum p_i q_i = w \cdot e = MV,$$

$$P = \lambda(p_1 \cdots p_n, q_1 \cdots q_n).$$

- Marschak 1938 (Neoclassical?)

$$\frac{p}{q} = \frac{U_x \frac{dx}{da} + U_y \frac{dy}{da} + \dots}{U_x \frac{dx}{db} + U_y \frac{dy}{db} + \dots}$$

# VI. Financial Globalization

- “an effective, smoothly functioning international capital market is itself an **instrument of world economic growth**, not a nuisance which can be disposed of and the functioning of which can be transferred to new or extended inter-governmental institutions....”
- “the main requirement of international monetary reform is to preserve and improve the efficiency of the private capital market while building protection against its **performing in a destabilizing fashion.**”

(Kindleberger et al, 1966)

# Triple Threat

- **Big Government**
- **Big Finance**
- **Big Wide World**

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# The Money View

- **Banking as a Payments System**

- Copeland (1952): A Moneyflow Economy
- Minsky (1957): The Survival Constraint

- **Banking as a Market Making System**

- Hawtrey (1919): Hierarchy of Money and Credit
- Hicks (1989): Centrality of the Dealer Function
- Bagehot (1873): Dealer of Last Resort

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