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BOOK REVIEW

MONEY: WHAT IT IS, HOW IT'S CREATED, WHO GETS IT, AND WHY IT MATTERS

(Author: Sergio Focardi; Publisher: Routledge; Year of Publication: 2018; Price: £29.99; Pages: 188)

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Two most difficult things to understand in this world are *money* and *power*. With regard to money and how it works, a review of what are the old and dead ideas, what are the new and live ideas, and what are the worthless and worthwhile ideas and practices, is now a desperate necessity. For example, can the world say goodbye to the ravages of 'financialisation' of the neoliberal era and accept and usher in the benefits of modernisation of money in terms of 'sovereign money' as against quantitative easing?

The sovereign money idea takes the power to create money out of the hands of banks and ends the instability and boom-and-bust cycles that are caused when banks create too much money in a short period of time. It would also ensure that banks could be allowed to fail without bailouts from taxpayers. It would ensure that newly created money is spent into the real economy, so that it can reduce the overall debt burden of the public, rather than being lent into existence as happens currently.

In this backdrop, in the book under review, Focardi has done the great job of taking stock of all the ideas and practices in relation to money. This usefulness of his book is, however, not complemented by ease of understanding at once. Understandable instruction is required, possibly over a six-month semester of macroeconomics focussed on money and banking, in order to digest the tough subject matter that he, as a finance professor, has densely packed into the book by way of eight chapters by addressing the five questions: what is money?; how is money generated; how is money

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distributed?; how does money acquire value and how does that value change?; and how does money impact the economy and society?

The book, which is one among the fascinating *Economics in the Real World* series from Routledge, is an exegesis of the evolving theory of money in the developed country context. The author outlines the theory of money trying to (a) illustrate both the historical positioning of modern money as well as the present conceptual framework of money; (b) discuss the engineering problem in designing new forms of money; and (c) explore the interaction of money with the real economy.

Money developed historically through a combination of debt/credit relationships, barter, and the invention of coins. Economists tend to favour a path from barter to the coinage of money while anthropologists tend to put the accent on credit. Most likely, the two elements of barter and credit were present in ancient communities. At the time of the Roman Empire, while a sophisticated coinage system had already been developed to handle exchanges of relatively small amounts, a sophisticated banking system was developed to handle large financial transactions based on credit. After the general collapse of commerce and industry in the Middle Ages, monetary systems based on coins and credit were reinstated in the early Renaissance period and developed progressively into a system of gold-backed currencies and bank credit and finally into the present system of fiat money and bank credit.

The engineering problem of money is to create a system of tools that facilitate economic transactions. The solution that is currently adopted is to create tokens that represent the purchasing power of individual agents, either households or firms. Tokens took the form of state-issued banknotes and bank deposits. Though bank deposits are convertible into banknotes, their key function is to transfer purchasing power, thereby enabling economic transactions. The key issues are how to create and how to distribute these tokens. The current solution to creating and distributing money is based on two separate processes: commercial banks extending loans and central banks purchasing assets. Banknotes, which are printed by the central banks, represent only a small fraction of the money in circulation and can be obtained by the public in the aggregate only by debiting bank deposits. The stock of money of advanced

economies is primarily formed by bank deposits obtained either from loans or from sales of assets to central banks.

Asset purchases by central banks grew enormously in the aftermath of the 2007-2008 financial crisis, as central banks implemented quantitative easing. Deposits in commercial banks due to quantitative easing are now a considerable fraction of all bank deposits.

As for lending, the landscape has also changed significantly in the last 50 years. Households, not firms, have become the major borrowers in countries including the US and the UK as they take out long-term loans to buy homes and increasingly short-term loans to finance consumption. The share of consumption financed by wages has become progressively smaller with respect to the share of consumption financed by corporate profits and borrowing. At the same time, the margins and profits of firms have increased, creating fast-growing subsectors of the economy. The circuit of money has changed. Firms increasingly finance their operations with cash created by households' borrowing.

Economies have become progressively more complex in terms of products and commercial relationships. Growth is increasingly due less to quantitative growth and more to innovation that produces greater complexity. In complex highly innovative economies, measuring inflation becomes increasingly difficult. Inflation, as currently measured, is a concept applicable only to the most static parts of the economy. With growth concentrated in sectors where inflation cannot be measured, with an increasing fraction of the newly created money staying in financial markets without reaching the real economy, we have witnessed low inflation, economic growth in line with historical averages, and financial markets growing at a much higher speed than the real economy. But, this average picture is misleading. Growth has not been equally distributed. Recurrent crises signal the intrinsic instability of economic systems increasingly driven by the creation of money.

What theoretical models will help in gaining a better understanding of economic dynamics, in light of this, with a view to achieving the sustainable development of the real economy, is the challenge we are facing now. Are the theories of economics based

on a priori concepts not linked to observations—like utility, rational expectations and price levels—anymore useful in this regard? Focardi introduces to the reader 'stock-flow consistent models' that include all the essential features of an economy based on credit as well as the economic complexity that characterises modern economies, including the emergence of financial and/or economic instabilities.