Renegade INC

The Truth About Money

Ross: Welcome to Renegade Inc. The explosion of quantitative easing, the epic monetisation of debt that's gone on, rise of cryptocurrencies, frothy stock markets and furlough schemes, all seemed to imply we have an endless supply of money. But it also means that we now see money very differently. But has this got us any closer to understanding what money really is? Or does it now simply mean that we know the price of everything but the value of nothing?

Ross: Howard Nicholas, wonderful to have you here on Renegade Inc.

Howard Nicholas: Pleasure to be with you, Ross. Thanks for having me. It's an honour.

Ross: An honour, no less. Wow! Well, insofar as heightened language, when we first started talking just before this started, you claimed that you were euphoric today. Tell us the source of your euphoria because it isn't often you hear of an economist being euphoric.

Howard Nicholas: Well, I've been working for a very long time on something called the theory of money because it has bedevilled economists for a very long time. And when I've been teaching, I've noticed that this has been a black hole for me. Whenever I teach basic economics, money doesn't exist in the foundations. It's only brought in much later.

Ross: Right?

Howard Nicholas: And I was always puzzled why that happened and what damage it did. Then what happened subsequently is along came the Keynesians and said, 'no, no, we have money at the beginning.' But most of what they said also didn't make any sense to me. So I've spent a very, very long time trying to work out, firstly, what the problem was and secondly, what the possible solution might be. Actually, the starting point for me, was this: The most important thing that we learn in economics is price is determined by supply and demand. Not true. Simply untrue. Prices are set by companies before they put the commodity into the market. Now, once you say that, you turn economics upside down. But once you turn economics upside down, you have to have something to replace it with. And then the question is what they replace it with? And that's where money comes in. Money is extremely important when we look at this alternative.

Ross: So when you are now thinking about money and let's say apocalyptic event has happened, i.e. the veil has been lifted, everyone thinks apocalypse is world end. It's actually the discovery of new knowledge if you go back to the Greek. Now the veil has lifted, tell us about your theory of money, how it's created, what it is and what its function is.

Howard Nicholas: Oh, that's a long one.

Ross: And if you could do it all in about three sentences, that would be really helpful.

Howard Nicholas: Actually, what I came to as my final conclusion, what is missing in most of the studies is the fact that we use money to value everything. And the valuation is we use money to set prices, and when we use money to set prices, what we do is we assign money a certain value which is actually reflecting the real values of the real goods and services we produce. And that's why when people say we can create value by printing money, this is utterly nonsensical. And this is really my starting point by saying that we use money to value everything. And once you have that starting point, you actually come to very, very different conclusions with things like inflation, things like financial asset values, all manner of different things.

Ross: Do you make a distinction between money and credit?

Howard Nicholas: Yes, I do. I do. I know that a number of theories don't actually do this, and that is because they actually confuse what is happening when you use money to set prices. They think that you use money to set prices by using money to buy the inputs. This is actually a mistake. And those people who think that you use money to buy inputs say that actually what happens when you buy inputs is you buy everything on credit. So that's in summary. I mean, for me, this confusion has also been very destructive in economics. It's misled many of us. I know this sounds like heresy to one group of economists, but OK, that's one of the founding principles of the work that I've done.

Ross: As you're saying these words, I can hear the Keynesian school jumping up and down and screaming at various devices - televisions, etc. saying, 'Oh my God, this really is heresy. Who is this guy? Let's turf him out immediately'. So we don't get too technical for our audience, then just if you can, pithily describe the difference between money and credit and why confusing them ultimately, let's say, totally misrepresents what we use as day in, day out, money?

Howard Nicholas: Well, the whole point is what we use as money is whatever we use to value goods and services. Let me just make it brutally explicit that why is the dollar world money? Now standard people say the dollar is world money because we use it as a means of payment. No, that's not true. What we use the dollar for is to value the goods and services and also the loans that we make to one another, internationally. And it's only when a currency does that that it becomes world money. Now, the dollar actually was used as a means of payment for a very long time, but it didn't become world money until it displaced the British pound in order to set prices. So historically, you saw sole traders, business people, long after Britain was displaced by the US, as the number one economy in the world. Long after that, people still use the British pound to set prices. And it was then de facto world money. Today, as long as the dollar is used to set prices it is world money. Now when people tell me, oh, Bitcoin is world money or could be world money. I ask them, just take a look at the volatility of Bitcoin even in the last couple of weeks, you have to be insane to think anyone, including Elon Musk, is actually going price his cars in Bitcoin. Is he going to do that? I don't think so. He will price it in dollars and accept Bitcoin as payment, and that is a very, very, different kettle of fish.

Ross: The other points about Bitcoin is the miniscule nature of it when you compare it, for instance, to the dollar. Would you agree with that?

Howard Nicholas: Yes, yes. I think that's also something extremely important. Some people have in the past said, Well, we could have the Swiss Franc as world money. Look at it. It's very stable. It's in high demand, et cetera. But how many Swiss Francs are their out there? And if Switzerland were to suddenly say, Well, it's OK, we'll print vast quantities of it well beyond what they can redeem in terms of what they produce, what's going to happen to the Swiss Franc? I don't think it'll last very long. So, you know, it's trying to understand really what money is and what it does is the key to unlocking this theory of money and also world money.

Ross: One of the things that we hear a lot of at the moment because of so-called central bank printing is a comparison between Weimar Germany and the US. We often see it online in commentary that there is going to be hyper-inflation, inflation and hyper-inflation. If there is, when is it going to arrive? How is it going to work its way into the system? And with so much private debt around, how will these central banks quote, inflate away their debts?

Howard Nicholas: I'm going to split that into two parts, Ross, the question. The first part is an intriguing one because I remember in 2009 when we had QE1, there was this shout from lots of orthodox economists that we're now going to head into hyper-inflation. So this was the moment they said, and I remember one or two very well-known economists, including Kenneth Rogoff, who said quite precisely that. And I was at a private investor meeting with a good friend of mine who was a very rich investor, and he had invited me along and he said, OK, Howard, you've heard all these stories about printing money and there is going to be hyper-inflation. What do you recommend? Shouldn't we start selling our bonds now? And I told him, no, actually, on the contrary, my bet is bonds are going to be a good thing because one of the things that they announced in QE was the purchase of long-term debt. And so contrary to what everyone assumed, my argument was nowhere did they say they're actually going to fill a helicopter full of money and drop it onto people. They never said that. What they said was actually they were going to buy debt with all this money. And that meant interest rates were going to fall. That meant bond prices were going to rise. And also the benchmark which we use to assess equity values would also be falling, meaning equity prices would also rise. And that was our thinking at that time. And indeed, you know, he told me he never made so much money ever in his life because most of the markets were actually initially betting that they would be hyper-inflation. So what we had was a theory that actually fundamentally misled us and misled investors at the time, and people weren't actually thinking rationally what was the central bank precisely going to do with all this QE. What was it really fundamentally about?

Ross: And that was QE1. We're now the best part of, let's say, 10 years on, but you still hear this commentary from people - Weimar Republic, hyper-inflation, dollar's going to go to zero, gold prices are going to go through the roof, Bitcoin's the future of humanity. How do you start to dismantle this?

Howard Nicholas: Well, my starting point is actually the dollar. So the one thing I'm in agreement with a lot of people is the dollar is basically overvalued. Why? Because the U.S has run consistent trade deficits since the mid 1950s, and unless the laws of gravity, economic gravity, have changed one thing that we know is that countries, even if they print world money, cannot indefinitely run balance of payments deficits. So there must be an adjustment somewhere down the line. That is where the possibility of inflation in the U.S. is likely because if the dollar depreciates significantly, as many are expecting, then we could see considerable inflation in the US. However, and this is my however, Ross, I think it's not in the interests of the major players in the world to allow an uncontrollable fall in the dollar. It's not in the interests of the Europeans. It's not in the interests of the Chinese. It's not in the interests of the Japanese because these are all export oriented economies. And my guess is what you're likely to see is a new global monetary system in which there is a phased depreciation of the dollar. The dollar has to depreciate, but it'll have to be phased and ordered otherwise, you're likely to see a massive collapse of the global financial system. Nobody wants that and one can't really afford it at this juncture.

Ross: Howard Nicholas, welcome back. Second half. In that first half, we talked quite technically about money. You've had a eureka moment, really. You claim your euphoric no less because you have at last worked out what money truly is. It's the one thing that economists, philosophers, business people can never agree on but you've nailed it. Just give us a very pithy summation of what you think money is to remind us.

Howard Nicholas: Just to recap what I said, the one thing that seemed to me to be missing is the primary function of money. So you open any book on the theory of money or you open any book on money and financial markets and there you have the standard things: It's a medium of circulation. It's the means of settling debt. It's a store of value. And then somewhere a vague statement - it's a unit of account. And we don't really get what that unit of account really means. And that's the thing that attracted my attention over a long period of time. And what I wanted to understand is, what are we talking about there? And what we're talking about, but appears to have been deliberately ignored, is the fact that we use money to value things and we say that it's a measure of price. It's a measure of the exchangeable worth of goods and services. And because of that, we use it to denominate debt and we use it as a store of value. And the store of value over time has become also money capital in the sense that when we hold money, we don't just keep it under our pillows, we put it in a bank. And up until recently, we used to get some interest on it, but now we actually don't get any interest on it. But to me, the whole debate centred on the functions that money performed. And once you have this, and here's my bottom line. The thing that everyone misses is this: Why is it that no matter what we have done, there has been deflation? Why is it prices have continued to fall? And, you know, look at the budget deficits. We are talking in the U.S. of nearly 20 percent of GDP. Before, if you had 20 percent of GDP, you'd be howling and screaming inflation, hyper-inflation. This is insanity of the highest order. But remember, the US has been running these budget deficits now for going on 12 to 13 years. And it's been getting greater and greater. So what is the one force - and it's a force of gravity that we ignore all the time - productivity. And that is because we're in the middle of one of those great technological revolutions that appeared last in the 1920s. And we had exactly the same phenomenon and that is prices falling to very, very low levels and a fundamental change in the way we work and consume and basically go about our daily business.

Ross: When we talk about the D word, deflation, we can't talk about deflation and productivity without talking about private debt. If we look at the 1920s, margin, debt and private debt were very high. And ultimately it led to the embarrassment of an economist called Irving Fisher saying that he felt that stock prices were at a permanently high plateau and could only go in one direction. Weeks later, he was bankrupt and lost his shirt. But all credit to him - credit's probably not the right word - but all praise to him because he said after that, he went out to prove what had gone wrong, and that deflation was explained very well. Is it the case that we have debt deflation now, specifically private debt deflation?

Howard Nicholas: I don't actually know what that means in actual fact. But what I see at this moment in time is - and this is exactly what happened in the 1920s. It always happens so I'm one of these believers. So immediately you'll get howls from all your audience that are listening. I believe in the long cycle.

Ross: Oh, we've just got hundreds of emails I can tell you that.

Howard Nicholas: And what happens at the bottom of a long cycle is you have this huge accumulation of debt. Why? Because the system is not working, you know? And to compensate debt is basically the way in which we get around that. Now, before the system regenerates and goes on its upswing phase, a lot of that has to be destroyed. That is where I take issue with Irving Fisher because he I think together with people like Minsky, both of them have the same position. They believe that that's not necessary and it's actually very destructive for the system. I'm actually on the other side that I think it's very important for the system.

Ross: Now, just clarify what you think is important, i.e. the destruction of non-performing loans, debt, debt that can't be paid - in short, the deadwood within the system. You're arguing to get rid of that so a new cycle can begin?

Howard Nicholas: Exactly, exactly. I mean, and then of course, you have a debate. How can it be done? So some people say the only way we can do it in this day and age is hyper-inflation. Others believe that it can be done, and some people think that the Japanese have been experimenting with this by the government buying all the private debt out there and cancelling it.

Ross: Monetisation of debt?

Howard Nicholas: Exactly. But then cancelling it because of course, if the government owns all of the debt, then it's up to them. It's a discretionary thing. They can cancel it.

Ross: What about a debt jubilee?

Howard Nicholas: Well, do you mean a moratorium on debt? Yeah, so of course, this is one part of it where the government then announces forgiveness in certain stratifications. OK, so this is the most important - forgiveness. Then we go down and to sweeten it, we will say we forgive all student loans. OK, so you know, we're doing something also for the masses as well as for business. One way or the other, this mountain of debt is going to impede any future major recovery. And I think this is the point that we're at is how do we resolve this problem? I don't believe that we can just turn a switch and have hyper-inflation. And I think if we did, we're really all of us in trouble. And I think the government would take action almost immediately to kill that.

Ross: What's your view on your discipline and what has been taught over the last, say, 45 years since Reaganomics or Thatcherism in the U.K.? What's your take on what that has done to society and also done to the life chances of people coming through this economic system?

Howard Nicholas: It would be easy to say that it has been destructive, but I don't think this really captures what's going on in my discipline. I think, at least from my perspective, orthodox economics has always been ideological. I don't think there's virtually any science in it. And it's actually very easy to prove that. Firstly, as I said, there's no theory of money. Secondly, you ask any economist, OK, conceptualise capital. Explain profit. Then you can see the overheating of the brain takes place because it's very difficult, if not impossible. And that is because this discipline was born as the result of an ideological attempt to undermine classical economics. We know that when something is born, as a result of an ideological attempt to do something it cannot really pretend to be science, even though we have all these mathematical models and sophisticated econometric analysis, which actually, quite frankly, are not worth the paper they're written on. Because you'll remember only a matter of 20 years ago we used to tell everybody, you print money, you get inflation. Government should never print money. You remember this Ross? From all the textbooks, it's the one mantra that we were all taught. Every developing country was taught that the old problem is you print so much money.

Ross: And now look.

Howard Nicholas: Exactly, exactly. So where are all these academics who told us that we would get hyper-inflation? Did they actually even invest according to their own theories? I don't think so. I think there is going to come a moment in the not too distant future as a result of all the debacles where people will start to say, Well, wait a minute. Isn't there something wrong with our foundations where remember, this was a pillar? This was an absolute pillar and you can't get rid of it that printing money causes inflation. Why is there inflation? - Printing money. Because if you get rid of that, if neoclassicals are really saying that now we are abandoning this, they have to actually abandon the foundations of everything that they're teaching.

Ross: Wow!, quite a thing. You won't thank me for saying this, because you're a humble man, but you've won the teaching award at your university for the last couple of decades. You're obviously doing something right, and students want to come to your lectures, want to listen to you. It's more than can be said for a lot of other professors of economics. But the other thing about you, which I found interesting through the research, is that you are an investor. You do invest your own money. You do put your money where your mouth is. And as an economist, you will invest in those things that you have thought through and often get a return from that.

Howard Nicholas: I've tried to Ross, I'll tell you why, because there's no better learning experience than when you lose money.

Ross: Ask Irving Fisher.

Howard Nicholas: Absolutely. And I've lost a lot of money in my time. But the thing that really hurt me the most was after I got my Ph.D. and the title of my Ph.D. was Money and Business Cycles. And this was in the 1980s. My father retired from his job and you know, he was a clerk in the post office in Britain. And so not much of a pension, but he was offered the chance of getting a lump pension. And he took it. And then he asked his son, who is a genius, you know, because I just got a Ph.D. in economics in money, and he asked his son, What should I do with it? And the son being so brilliant, said to the father, we'll go to the bank and ask them what to do with it. Shall I tell you the date? 1987, August. And you know what the bank advised him to do? Buy unit trusts? It's not the bank that I blame for this, Ross. It's myself because my father came home and told me, son the bank has advised me to buy a unit trust, which they told me is as safe as a deposit. And so the son who couldn't be bothered because I think I was watching Manchester United playing a football game at the time said to the father, just do what they say, Dad it must be good. So my father lost 47 percent of his life savings when the great crash happened. And at that moment in time, I said to myself, I'm not going to teach anything that I don't invest in.

Ross: Howard Nicholas, you've summed it up perfectly for us. Not only have you solved the conundrum of money, but we've been round the houses about the economics discipline, the world policymakers. It's been a real pleasure. Thank you very much for your time.

Howard Nicholas: Pleasure's mine, Ross. Thank you for having me.