Taxes are for Redemption, Not Spending

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In one short article, it is impossible to deal with all of the arguments for fiscal austerity. In this piece I’m going to tackle just one justification: that government faces a budget constraint similar to that of households. Hence, even if we wanted to loosen fiscal policy, we might not be able to do so due to financial constraints. Indeed, by tightening now we create fiscal space that might be needed in the future. In the orthodox view, government’s spending is constrained by the sum of its tax revenue, bond sales, and money creation. Bond sales, in turn, are limited to the nongovernment sectors’ willingness to lend to government; as sales increase, the interest rate required to bring forth buyers rises—which eventually creates a vicious cycle of rising rates and bigger deficits. Running the printing presses to finance deficits raises the specter of inflation, with too much money chasing too few goods. Hence, prudence dictates relying on taxes to pay for most government spending. The belief that government needs tax revenue to pay for most (or even all) of its spending is nearly universal.

It wasn’t always so. At the end of WWII it was commonly understood by economists from the right (Milton Friedman) to the left (Abba Lerner) that taxes are not needed for revenue purposes. Indeed, the Chairman of the NY Fed, Beardsley Ruml, even wrote a piece entitled “Taxes for Revenue are Obsolete”. None of these economists were arguing that we should dispense with taxes—which can be used for a variety of purposes. Rather, they recognized that unlike a household or firm, government does not need income to finance its spending.

We can go even further and argue that government needs to spend before it can receive income. Indeed, while everyone looks at tax “revenue” as the government’s equivalent to “income”, this view actually prevents understanding. We should instead understand “revenue” as “redemption”. As I’ll show, from the time of the American colonies through the early postwar period, this is the way that many regarded taxes.

We will begin with an analogy provided by G.F. Knapp – the token.

The Cloakroom Debt Token

In discussing money, G.F. Knapp (one of the developers of the State Money Approach, adopted by Keynes and today by Modern Money Theory) made a useful analogy with the cloakroom token. When you drop off your coat at the cloakroom, the attendant offers you a token, usually with an identification number. The token is evidence of the debt of the cloakroom, which owes you a coat.

Some hours later you return with the token. The attendant returns your coat. By accepting the token and meeting the obligation to return your coat, the attendant has “redeemed” herself or himself. The slate is wiped clean; the debt is destroyed. At this point the token is simply warehoused, put back on an empty coat-hanger, waiting to be reused. When the token is in the cloakroom, it is not a debt. It is a circular piece of

3 Our word, revenue, originally came from Latin (revenire, meaning return) through old French (revenue, meaning returned) to old English (revenue). What was returned? The state’s own debts. We still use the term “tax return” from which (much of) the state’s “revenue” derives.
cardboard, perhaps enclosed in a metal ring. Or maybe it is a square chunk of plastic, or a shiny brass coin. Some cloakrooms instead use paper tickets, split into stock and stub at the time a coat is deposited. On your return to the cloakroom, the stock and stub are matched, the coat is returned to the rightful owner, and the stock and stub are thrown away. It makes no difference what form the token takes – it is just evidence of a debt, a “coat debt” that is redeemed by return of the coat.

Note that you could pass the token to your spouse or even to a stranger, with instruction to fetch your coat from the cloakroom.

If coats were homogenous, the tokens would be valuable to anyone who might want a coat. They could become a sort of currency passing from hand-to-hand at the value of a coat debt, so Knapp’s analogy is not so far-fetched as it might first appear. However, coats are not uniform, and the attendant cannot simply return “a coat”, but must return “your coat” in redemption for the token.

The point here is that the token is representative of debt, with the specific obligation spelled out by custom or contract and enforced if necessary in the courts.

Money as a Token of Debt

Let us begin with the closest analogue to the cloakroom token: the tally stick. Tally sticks were commonly issued for hundreds of years in Western Europe – by Kings but also by others as records of debt. The sticks were split into stock and stub, matched at the time of redemption and then destroyed.

In the case of the King’s tallies, Redemption Day was tax day when the King’s representative (the exchequer) arrived in the village, spread cloth on the ground, and matched stock and stub. Hallelujah, the tax was paid. The tally stick had value because it could be used to “redeem” oneself on tax day. You owed the king his taxes, and he owed you the right to deliver evidence of his debt (recorded on the stick) to pay your taxes. The sticks circulated because this debt was “homogenous”, unlike the debt redeemed by the cloakroom that takes the form of your specific coat. Anyone with a debt to the King needed a tally stick (any tally stick so long as it was issued by that King) to pay taxes.

A.M. Innes explained the significance of tallies:

“For many centuries, how many we do not know, the principal instrument of commerce was neither the coin nor the private token, but the tally, (Lat. talea. Fr. taille. Ger. Kerbholz), a stick of squared hazel-wood, notched in a certain manner to indicate the amount of the purchase or debt. The name of the debtor and the date of the transaction were written on two opposite sides of the stick, which was then split down the middle in such a way that the notches were cut in half, and the name and date appeared on both pieces of the tally. The split was stopped by a cross-cut about an inch from the base of the stick, so that one of the pieces was shorter than the other. One piece, called the ‘stock,’ was issued to the seller or creditor, while the other, called the ‘stub’ or ‘counter-stock,’ was kept by the buyer or debtor.

Both halves were thus a complete record of the credit and debt and the debtor was protected by his stub from the fraudulent imitation of or tampering with his tally.”

Now, what were coins? As Innes emphasizes, coins were never very important – in spite of all the ink spilled in writing about them. They are essentially metal tallies that can last a long time and still garner interest when discovered centuries after being lost and forgotten. Collectors love them. By contrast, tally sticks are burned or simply rot away; ditto papyrus or paper evidences of debts. But coins were typically a nearly insignificant part of the “money supply”, and most tax collections brought in far more hazelwood tally sticks than coins.

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5 Like the tally sticks that for centuries were split into stock and stub, matched on tax day. See below and Wray, L. R. (ed.), 2004, Credit and State Theories of Money: the contributions of A. Mitchell Innes, Cheltenham: Edward Elgar.
6 The cover of Wray, 2004 (see previous footnote) shows a photo I took of tallies that were used on private estates in Agrigento, Sicily in 1905.
7 Many of the words associated with money and debt were borrowed from religion – reflecting the commonality of debt to both the creditor and the gods.
Economists focus on coins primarily because they outlasted the sovereigns that issued them and many of them contained bright shiny metal that blinds reason. If dried bovine droppings had been stamped, instead, they would have served perfectly well as coins but no one would be interested in them after the demise of the empires that issued them.

Coins were evidence of debt that solved the problem of counterfeiting not through splitting a notched stick but rather through the technology of stamping or, later, milling coins. High quality craftwork and then milling the edges made “fraudulent imitation” more difficult. In addition, the use of precious metals (which were more easily monopolized by the sovereign) made counterfeiting more difficult and more expensive.9 The sovereign spent coins into circulation, then accepted them alongside tallies in tax payment. Coins circulated more freely than tally stocks because the coin by itself contained all the evidence of the crown’s debt (in the case of a tally stick one needed both the stock and the stub).

In addition to promising to take back coin token debts, the sovereign issuer could also promise to exchange them for foreign currency or for precious metal on demand. This is an additional promise added to the promise to accept the coin in payment of taxes. Even without this additional promise, the tally and coin tokens would circulate because they could be used to redeem tax debts. Note also that when the King accepted these in tax payments, he was also “redeemed”. The tally sticks would be burned (wiping his own debt clean) while coins could be stored for reuse, or melted for recoining.

Paper Money Redemption: the Case of the American Colonies

Farley Grubb – an expert on American colonial currency – recently examined colonial Virginia’s use of paper currency that demonstrates the principle of taxes for redemption.10 His exposition confirms my account, both in the details and in the terminology.

Here’s the background. The colonies were prohibited by England from issuing coin, so as to protect the King’s monopoly of coinage. The colonies obtained coin from export, but of course as a major mercantilist power, England wanted to limit colonial exports to the raw materials she needed. The colonies had to import finished goods, shipping the coins back to England. The King wanted to limit expenditures on its empire, so the colonies were largely responsible for funding their expenses, which included fighting wars with the French, the Canadians, and Native Americans. Colonial governments were chronically short of British coins, obtained through taxes such as poll taxes and taxes on exports of slaves and tobacco.

To increase fiscal capacity, the colonial governments began to issue paper money. Virginia’s colonial government passed a series of acts to authorize the issue of treasury notes. Each law would include the total value of notes (denominated in Virginia pounds) to be issued and would set a date for final “redemption” (the term used by Grubb as well as by the lawmakers). Interestingly, the law also would impose a new set of taxes at the time of the note issue:

“Every paper money act included additional new taxes, typically a land tax and a poll tax, that were operative for a number of years. The number of years over which these new additional taxes were operative was chosen so as to generate enough funds to fully redeem the notes authorized by each respective paper money act. The date in each paper money act set for the final redemption of the notes authorized by that act closely matched the end to the taxing period set by that act…. From 1755 through 1769, the taxes imposed by the paper money acts included a poll tax, a land tax, a slave import duty, and a tobacco export duty.”

9 I won’t go further into the history of coinage here – and all the myths about value being determined by embodied precious metal – see Wray Modern Money Theory: A Primer on Macroeconomics for Sovereign Monetary Systems, 2012 (revised 2015) Palgrave Macmillan.
So the Paper Money Acts that allowed the treasury to issue notes also imposed new taxes that would be of sufficient size and over a period long enough so that the notes would be redeemed – the recognized purpose of the taxes was to “redeem” the currency, by accepting that paper money in payment of taxes. In fact, colonial paper money could be “redeemed” in two ways: payment of taxes or presentation at the treasury for payment in (British) coins. In other words, the treasury would spend the newly issued paper money into the economy and those receiving the treasury notes could use it to pay taxes, or spend it, or submit it to the Treasury in exchange for coin.

What did the Treasury do with the notes it received in tax payment? Grubb reports that the “notes were removed and burned” – not spent.

“Most redemption taxes were collected in the fall, and so notes reported in the Journals of the House of Burgesses as burned were likely removed via tax payments in the prior year.”

Grubb’s careful research shows that most taxes were paid using the paper money, and most paper money was “redeemed” in tax payment:

“Were redemption taxes paid in notes or in specie? The treasury accounts provide some evidence to answer this question. The clearest statement in the treasury accounts was made on 15 June 1770: ‘It appears to your Committee, that the Balance in the Treasurer’s Hands of Cash received of the several Collectors for Taxes appropriated to the Redemption of the old Treasury Notes [those issued before 1769], amount to Ten Thousand Three Hundred and Twenty-six Pounds Eleven Shillings, of which they have burnt and destroyed Seven Thousand Eight hundred Pounds, and have left in the Treasury, on that Account, in Specie, a Balance of Two Thousand Five Hundred and Twenty-six Pounds Eleven Shillings to be exchanged for old Treasury Notes.”

From this evidence, Grubb concludes:

“A redemption tax of 10,327£VA was collected, of which 2,527£VA was in specie that was explicitly set aside in a dedicated account to be used to redeem notes brought to the treasury. The rest of the tax payments were burnt, implying that those tax payments were made in notes. Therefore, 76 percent of this tax was paid in notes, and 24 percent was paid in specie.”

So, three-quarters of taxes were paid by “redeeming” the notes.

The specie (coins) received in tax payments could be used to “redeem” the notes that were not “redeemed” in tax payments. What about the notes that were not “redeemed” by either method? They continued to circulate. Grubb asks, “Were Virginia’s notes used as a circulating medium of exchange? The denominational structure is consistent with such usage. Virginia’s notes were issued in relatively small denominations, small enough to make paying yearly tax assessments easy with said notes, and small enough to make it an easy domestic circulating medium of exchange in terms of being able to make change with said notes.” He concludes:

“The above analysis establishes that redemption taxes generated specie sums that were to be held in the treasury until the final redemption date legislated for each paper money act, at which time holders of those notes could cash them in at face value for the specie held in the treasury for that purpose. However, at the final redemption date holders of the respective notes did not rush to the treasury to exchange them for specie. The notes continued in circulation and note holders could cash them in at the treasury at their leisure. Robert Nicholas Carter, Virginia treasurer after 1766, noted this behavior, “Most of the
Merchants as well as others, ..., preferred them [Virginia's treasury notes] either to Gold or Silver, as being more convenient for transacting the internal Business of the Country" (William and Mary College Quarterly Historical Magazine 1912, p. 235).

Adam Smith had argued that if the colonies were careful to ensure they did not create too much paper money relative to taxes, it would not depreciate in value (indeed it might even circulate at a premium, he argued). Redemption of the notes in tax payment would remove them from circulation – keeping them scarce. Grubb argues that this was well-recognized by the colonial government:

"The Virginia legislature took note redemption and its effect on controlling the value of its paper money seriously. Such is illustrated in the March 1760 paper money act which stated, 'And whereas it is of the greatest importance to preserve the credit of the paper currency of this colony, and nothing can contribute more to that end than a due care to satisfy the publick that the paper bills of credit, or treasury-notes, are properly sunk, according to the true intent and meaning of the several acts of assembly passed for emitting the same; and the establishing a regular method for this purpose may prevent difficulties and confusion in settling the publick accounts,… Be it therefore enacted, by the authority aforesaid, That Peyton Randolph, esquire, Robert Carter Nicholas, Benjamin Waller, Lewis Burwell and George Wythe, gentleman, or any three of them, be, and they are hereby appointed a committee, to examine at least twice in every year (and oftener, if thereto desired by the treasurer for the time being) all such bills of credit, or treasury-notes, redeemable on the first day of March, one thousand seven hundred and sixty five, as have been or shall be paid into the treasury, in discharge of the duties and taxes imposed by any former act of assembly; and upon receipt of the said bills or notes, the said committee shall give to the treasurer for the time being a certificate of the amount thereof, which shall avail the said treasurer in the settlements of his accounts as effectually, at all intents and purposes, as if he produced the said bills or notes themselves: And the said committee are hereby required and directed, so soon as they have given such certificate, to cause all such bills or notes to be burnt and destroyed" (Hening 1969, v. 7, p. 353).

This emphasizes that removing the notes from circulation was to protect the value of the government's paper currency – not to provide "revenue" that government could spend. The problem with spending notes in excess of redemption would not be government insolvency but rather inflation.

Let us recap what we can learn from the early Colonial American experience. The government imposed taxes payable in its own paper notes (its liabilities) or "specie" coin (liabilities of the crown of England). It issued its paper notes in payments by the treasury. When it received its tax revenue in the form of its own paper notes, it burned them. When it received coin in tax payments, it held them until an announced redemption day, to exchange for paper notes.

The paper notes were thus "redeemed" in two ways: payment of taxes, or exchanged for coin. A large majority of the notes were redeemed in tax payment; a small minority were redeemed for coin. The government recognized that it spent the paper currency into existence. It recognized that the purpose of the taxes imposed (by the same Acts that authorized issuing paper notes) was to redeem as many notes as possible. The taxes were not to "raise revenue", indeed, when the paper notes were received in tax payments, they were burnt, not spent. The government also realized it needed to receive a portion of tax revenue in the form of coin. This was to ensure that it could meet its promise to redeem notes for coin.

Redemption of the tax obligations by returning paper notes to the treasury not only redeemed the colonial government, but it also redeemed the taxpayers who owed taxes. The redemption is mutual and simultaneous – both the "creditor" taxpayer and the "debtor" note-issuing treasury were redeemed. At the same time, the "debtor" taxpayer redeemed himself of his duty to pay taxes to the "creditor" treasury. The four entries on balances sheets were all simultaneously wiped clean.
Creation of the notes preceded their redemption in tax payment. Creation always comes before Redemption. Indeed, it would have been literally impossible for the colonists to pay the new taxes given the chronic shortage of coin. They needed the treasury to spend the notes first before the taxes could be paid. Nor would the governments have needed to impose the new taxes if they were not going to spend the notes! But if they were going to engage in an act of Creation, then they had to follow that with an act of Redemption.

The American Colonial experience with note issue verifies what MMT has been saying for the past quarter century. Careful study of other examples will confirm MMT's approach.

Let us turn to private paper token money. We will see that its issue follows a similar logic – a point emphasized by Innes. This is important because modern governments use their central banks and private banks to make and receive payments.

**Bank Paper Money and Deposit Debts**

Paper money has been around for a long time, but became common in the west only in the past few centuries. Most of it was issued by private banks, in the form of bank notes. You did not owe your bank taxes. So what debt was evidenced by the bank note?

The bank issues notes when it made loans. It holds your “note” (the IOU you signed; we still use the term to refer to the documents associated with loans) as evidence of your debt to the bank. It issues its own “note” as evidence of the debt of the bank. You can spend the note, passing it to a third party. That third party could present it to the issuing bank to pay down debts owed to that bank. But with a clearing system, you can repay your debt to Bank A by presenting for “Redemption” notes issued by Bank B. The bank notes are essentially circulating private “tallies”. The system clearer returns notes to the issuers as banks clear debts with one another. Like the cloakroom tickets, the notes might be destroyed by their issuers when they are returned. Or they can be stockpiled in bank warehouses for use later (just as the cloakroom’s token might be warehoused on empty coat hangers).

Eventually government central banks would do much of the clearing, originally issuing their own notes. The first central banks were explicitly created to issue notes to finance government spending, with the notes collected in tax payment. Not liking competition, governments taxed private bank notes out of existence. Banks moved to deposit-based banking (rather than note-based banking). And, eventually, we got to the present day when the payments system mostly uses keystroked entries of debts and credits. These technological advances (if we can use that term) changed the physical form but not the nature of debt and redemption. “Bank Money” is an electronic entry on the liability side of the bank’s balance sheet, and an electronic entry on the asset side of the depositor’s balance sheet. (Called double entry book-keeping, the “keystroking” of deposits when a bank makes a loan means there will be four entries – the “note” of the borrower is the bank’s asset, and the bank’s “deposit” is its liability; the deposit is the borrower’s asset, and the note held by the bank is the borrower’s liability.) Depositors can write checks on these deposits to pay down their own debts, including debts to banks.

“Central Bank Money” is generally comprised of two forms: paper notes and electronic reserves. The paper notes are the central bank’s liability and the asset of the holder. Federal Reserve Notes (FRNotes) are mostly used outside the USA, often for illegal activities. (To increase the circulation of FRNotes, we could raise the denomination of the largest denomination notes – the almighty dollar is being replaced by larger denomination Euro notes as the preferred medium of exchange by global drug dealers, although Bitcoins are making a dent.) FRReserves are keystroke entries, representing the Fed’s liability and the asset of depositors. Unless you are a bank, a foreign central bank, or some other special entity, you cannot hold these.

In theory, the government should accept its central bank notes in tax payment. In practice, US taxpayers make tax payments using their banks – either with checks or direct withdrawal. The Fed then debits the private bank’s reserve deposits. So whether taxes are paid with FRNotes or FRReserves, in either case, the Fed’s liabilities to the US private sector are reduced. (There is also internal accounting involving the Fed’s and the Treasury’s balance sheets – the Fed credits the Treasury’s deposit account at the Fed.
This is rather like the husband owing the wife some dishwashing – the internal accounting has no impact on external balance sheets.)

“Treasury Money” is now mostly coins; in the past treasuries issued notes (and some still do) and while the US Treasury could issue notes, it now only issues coins. What is a coin? It is stamped evidence of the Treasury’s debt. While the US Treasury accounts for coins as “equity”, equity is of course on the liability side of the balance sheet. In theory, one should be able to pay taxes by returning the sovereign’s coins. In practice, hardly anyone does that. In any event, most US taxes are paid as described above – with debits to the taxpayer’s bank account and debits to her bank’s reserves at the Fed. You can certainly deposit coins (and FRNotes) at your bank and write a check to the IRS – redeeming yourself in the eyes of Uncle Sam without ruining the day of IRS agents.

The modern system inserts central banks and private banks between the treasury and the recipients of treasury spending as well as those who need to pay taxes. For the most part, treasuries no longer spend their own currency (coins, notes, tallies) into existence, and taxpayers do not pay taxes with treasury’s currency. This has obscured the logic behind operational procedures to such an extent that most economists and policy makers believe that governments must first tax before they can spend. There are at least three problems with such a belief. First, there are hundreds and even thousands of years of experience with direct spending by sovereign governments. Hence, there is no logical or practical barrier to returning to such a system; current procedures are a matter of policy choice and could be changed if desired. Second, the operating procedures actually adopted do not, as a matter of fact, create constraints on government’s spending. This has been demonstrated many times by close inspection of those procedures. Indeed, if one understands clearing mechanisms and recognizes that there are literally billions of payments made every day by taxpayers and government without treasury checks bouncing, one can see why central banks, private banks, and treasuries cooperate to make sure the payments system operates smoothly. Indeed, modern procedures were developed to facilitate payments rather than to constrain government spending.

And, finally, the argument that government spends first and then taxes follows from the same Keynesian logic that investment creates saving. I will not go through the “injections and leakages” approach here, which should be obvious after principles of macroeconomics. The “government budget constraint” suffers from the same logical flaws as the “loanable funds” view that “saving finances investment”.

Implications of the Shift of Thinking

Affordability is not the problem. A sovereign government can always afford to spend more. Like the American colonies – which authorized more spending financed by paper notes – today’s government can spend more using keystroked entries into balance sheets. This spending increases government’s debts, recorded as credits to recipient accounts. Government can redeem these debts through tax payments. It can also promise to redeem the debts by exchanging them for gold or foreign currency, although a sovereign country like the USA does not do so. This preserves more policy space as the USA (as well as other sovereign currency issuers) does not need to accumulate gold or foreign currency in anticipation of such redemption.

If government keystrokes more credits to accounts of recipients than it debits through tax payments, we call that a budget deficit. Note that this is largely nondiscretionary as spending and taxing totals are separately determined – with countercyclical movement of spending and procyclical movement of taxing. In other words, government deficits are to some degree generated by the nongovernment sectors’ behavior. When the nongovernment sector reduces its own spending – perhaps in an attempt to increase its saving – the government’s deficit is likely to rise. Indeed, at least to some degree the government’s deficit rises until the nongovernment sectors’ desire to save has been satisfied.12

11 I used to think that the IRS would not accept coins in payment of taxes, but apparently Tea Partiers are doing just that. According to a news report, one of them delivers, each year, a bag full of coins in payment of taxes, with the stated intention of wrecking the day of some IRS agent, who presumably has to spend a few hours stacking and counting (tallying?) the coins. So it is apparently still possible to push a wheelbarrow to the IRS steps to pay your taxes in coins.

12 I am not going to address the issue of sales of treasury bonds. A reader can reasonably wonder why government sells bonds if it pays for its spending through issue of notes, tallies and coins, or if it uses keystroke credits to bank accounts. Governments that issue their own currency do not borrow their own currency to spend. Indeed, currency that is redeemed for taxes or in receipt of bond sales is burned, not spent. In other words, bond sales do not provide revenue to government that can be spent, any more
While affordability is not in question, inflation is a danger. To be sure, inflation can occur even at low levels of aggregate demand (witness the stagflation of the 1970s in the USA), but if government spending should drive the economy beyond full employment, then inflation will result. Government spending can also be inflationary before full employment if it is directed to sectors with a low elasticity of output (where additional demand causes prices to rise without increasing output much). One could envision additional ways in which misdirected spending and poor policy could cause inflation. The point is, however, that the danger is not affordability but rather inflation.

Currency depreciation is also a possibility for floating exchange rate systems: spending more could cause the value of the currency to fall. This might happen, for example, if it induces more imports, or if it simply scares foreign exchange markets (causing a movement out of the currency). If a country pegs, such pressures could also cause a currency crisis as holders of the currency fear that the reserve of gold or foreign currency is too small. Hence, there is some danger (although usually overstated in the case of floating exchange rate sovereign currencies) that more government spending could cause depreciation. Again, however, affordability is not the issue (except when the currency is pegged – in which case the problem is the affordability of the reserves that are needed to maintain the peg).

Hence, “more austerity” can be the right answer, but only in specific circumstances. If government is spending so much that prices are rising faster than desired, or if the currency is depreciating more than desired, then the answer could be to reduce spending or raise taxes. The difference here is not subtle. In these cases, it is not affordability but rather inflation or currency depreciation that is the problem. Policy makers ought to be able to see the difference: austerity is needed not because government is running out of its own currency but rather because prices are rising or currency is depreciating more rapidly than desired.

Conclusions

When the sovereign issues currency, she/he becomes a debtor. The sovereign's currency is debt. The holder of the currency is the creditor. The most fundamental promise made by any debtor is the promise to redeem, by acknowledging his/her debt and accepting it. Those who themselves have debts to the sovereign can submit the sovereign’s debt in payment. Refusal by the sovereign to accept his/her own debt is a default. This will have implications for future acceptance of that sovereign’s debt.

Acceptance by the sovereign of his/her own debt is redemption. Airlines also redeem their frequent flyer miles by accepting them in payment for actual flights. Redemption “wipes the slate clean”. It eliminates the debt. Keystrokes take away the frequent flyer miles from the accounts of passengers. In the old days sovereigns burned their debts on redemption.

Homeowners commonly used to have mortgage note burning parties when they redeemed themselves by paying off their homes. Probably no one lives long enough any more to do that.

I have argued that the sovereign imposes debts – tithes, fees, fines, and taxes – on the population. Those with tax debts can redeem themselves and wipe clean their tax debt by delivering back to the sovereign her/his tallies, coins, or paper notes. Today it is actually done with keystrokes – debits to private bank deposits and the bank reserves at the central bank. Note that tax payment redeems both taxpayer and sovereign. Isn’t that nice? The sovereign’s currency is burned, and the taxpayer can burn her tax bill. Hallelujah!

Currency must be debt and it must be redeemed to have a determinant nominal value in terms of the domestic money of account. The sovereign might make other promises when she/he issues debt. There could be a promise to pay interest over time. There could be a promise to redeem her/his debts for the debts of other sovereigns. While uncommon even in history, the sovereign could also promise to redeem for precious metal bullion. These are additional promises but are not necessary to create a demand for the sovereign’s currency.

Taxes remove currency from circulation; this has long been recognized as a way to prevent currency issues from causing inflation. However, it is not necessary to remove all the issued currency through taxes. Some will continue to circulate to facilitate private transactions. Some can be accumulated as net saving. And some can be “redeemed” for bonds should the treasury decide to sell them. To an uncertain but significant degree, the difference between spending and taxing over any particular period is “endogenously” determined by economic activity. By definition. The government’s deficit (its spending less its tax receipts) must equal the nongovernment sectors’ surplus (receipts from government spending less tax payments). In nominal terms, the equation is guaranteed and we can even assert that it is a position that is desired by the nongovernment sector (for otherwise, it would have spent more – reducing the government’s deficit – or less, raising the deficit). The question is whether that equality occurs without inducing inflation or currency depreciation. There is no question that the sovereign can “afford” it.

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