editorial

How do money and power interact in the twenty-first century? How are we going to address the risk of inflation? And is it realistic to think that the war in Ukraine, which has changed the world even more than Covid-19, is going to trigger a new cold war not only between countries but also between monetary areas? The international financial system is still broadly dominated by the dollar – as we can see from many articles in this issue – but a currency "multipolarism" is starting to take shape, and it includes the cryptocurrency phenomenon. But let us look at the issue one step at a time.

Geopolitics and geoeconomics tread parallel paths. Currency in all its forms is the connecting link and it measures the rise and fall of the great powers. The monetary thermometer tells us that the dollar's "exorbitant privilege" – to quote former French President Valéry Giscard d'Estaing – is still being enjoyed by the United States. Some 80% of international trade currently takes place in dollars, with oil contracts heading the list; most national currencies in Latin America as well as in much of Africa and East Asia are "pegged" to the dollar. After the pound sterling's reign, the dollar has been – and to some *extent still is – an "imperial" currency. But as the contributors to this edition of Aspenia demonstrate, the point is that the dollar's future primacy is not likely to be challenged by a single alternative currency (China's renminbi, say). What we will be seeing, rather, is the birth and consolidation of alternative currencies in the plural, including the euro. The latter, incidentally, is also going to have to become a full-fledged international reserve currency if it is to support Europe as a geopolitical player.*

In short, we are heading toward a monetary system broken down into potentially distinct and rival areas in competition with each other, a process which could be sped up by Russia's financial isolation (with the collapse of the ruble and Western sanctions) and by the relationship between Beijing and Moscow (with new energy contracts not being drafted in dollars). On the opposing front, the relationship between the euro and the dollar will reveal the extent to which the West, after rediscovering NATO, is also going to prove capable of managing the difficult post-Covid recovery process. The extremely delicate energy and industrial transition is an additional issue of the utmost importance. The recovery profile has already been sketched out, in truth, but with one dominant feature: ongoing rising inflation.

That brings us to the second point. "Inflation is always and everywhere a monetary phenomenon," the greatest exponent of modern monetarism, Milton Friedman, famously said. The Keynesian school argues that a modicum of inflation is the oil required to grease the machinery of the economy, or to reabsorb excess indebtedness and liquidity. This might sound like what we need today, but as Friedman stressed, there are risks for growth. Indeed, these risks are being confirmed to some extent by our present difficulties; moreover, an *important footnote needs to be added today: currency is not simply a whirlwind of numbers and figures, as Friedman appears to have thought; it is also "both a barometer of profound movements and the cause of no less formidable conversions of the masses," as French historian Marc Bloch wrote.*

In order to gain a better understanding of what currency truly is, it may be useful to start with a definition. Over a century ago, Swedish economist Knut Wicksell defined the "monetary triad". As he put it, currency is: 1) a unit of account, which means that it is used as a standard yardstick for comparing the value of products and services that are very different from one another; 2) a value reserve, that is it allows people to push forward into the future that part of their income that they do not use immediately for goods and services; 3) a means of payment, given that it can be instantly exchanged for goods and services (the buyer hands it over to the seller and thus frees himself of any other obligation; the seller, in accepting it, implicitly recognizes its value).

So, currency is the yardstick for all goods. It serves as payment in trade and imparts value to the assets that people accumulate – their "real wealth" in the sense of land, real estate, jewelry and so on. John Maynard Keynes added an appendix: in addition to its use for transactions and savings, currency also serves for speculation.

While monetarists dispute Keynes's appendix, the boom in cryptocurrencies used as chips in casinos is putting it right back in the heart of the debate. In any event, whichever triad is adopted, the end result is that any change in monetary balances becomes first a consequence and then a cause of economic, social and political change, of changes in the markets and in governments' choices. Examples abound throughout history, even dramatic ones such as the devastating impact of hyperinflation on the German Weimar Republic in the 1920s or the global chaos caused by the end of the dollar's convertibility into gold in the 1970s.

Currency can be placed under control in order to contain galloping inflation, but that, too, comes with a cost that can prove intolerable. While inflation hits savers and fixed-income workers, deflation reduces a country's industrial activity and sparks mass unemployment. So currency needs to be handled with kid gloves.

This brings us to today's problem, and to today's debate. To bring inflation under control we need to govern currency, reducing the amount of money in circulation and making it cost more (by raising interest rates) in order to freeze the price dynamic. But the risk, of course, is that we may end up abruptly curbing growth. To beat the hyperinflation of the 1970s, Paul Volcker's Federal Reserve raised interest rates dramatically (in 1979) and all the other central banks followed suit. There ensued a three-year period of recession and unemployment rose; but then the mainspring of industry – as though someone had rewound it in the meantime – sprang back into action and triggered the boom of the 1980s, the Reagan cycle. Over the past decade, the opposite has happened: we have even had interest rates below zero (a contradiction in terms) and yet it has not served to bring inflation back to the 2% annual growth rate target. What it has done, on the other hand, is to create serious imbalances in the balance sheets of banks, insurance companies and governments.

Above all, we must now ask ourselves whether this is the end of the era of "helicopter money" – that which led to what Keynes called the liquidity trap. The US Federal Reserve certainly seems to think so and, indeed, various rate hikes are expected. The European Central Bank, for its part, is a tad more hesitant in the belief that, faced with the uncertainty of post-Covid recovery and the green transition, at least some of Europe's economies still need monetary lubrification. Policy in Europe is based on the belief that the real antidote to debt is always and invariably growth. We shall have to wait and see how long that approach holds sway.

Until late 2021, the prevailing interpretation was that inflationary pressure would be temporary and that the long-term trend would remain the same as in the previous decade. Technological innovation and globalization have lent such a boost to competition both in goods and in labor that production costs, including salaries, have come down. In short, the Chinese worker and the Polish plumber, to use two hackneyed figures, have de facto put paid to the risk of inflation. But while that may have been the case in the past, things have now changed: "The genie is out of the bottle," wrote Martin Wolf in the "Financial Times", adding: "The danger is that this ignites a spiral, in which inflation expectations shift upwards, causing a flight from money and so further destabilizing expectations." We are not looking at the two-figure increase of the 1970s, but when the price dynamic exceeds all forecasts and shows no sign of slowing down, "credibility will have to be preserved, whatever it takes." And the war in Ukraine, with its impact on money markets and on the international production chain, has fanned the flames yet further. A squeeze now looks unavoidable, although it needs to be implemented gradually and with the greatest care.

Finally, we need to remember that inflation works in favor of those in debt (including governments), while penalizing fixed-income workers and savers who are unable to adjust their assets accordingly. Defending oneself against inflation is difficult and even harmful: every form of indexing, every race between incomes and prices ends up fueling inflation. But if central banks start pulling on the handbrake too hard and too soon – tightening the purse-strings and reducing the money supply while raising interest rates and failing to purchase government or private-sector bonds – they risk triggering a recession. The turnabout in policy, if poorly governed, becomes harmful. It is a *matter of how, how much and when to act. In 2011, the ECB raised interest rates when the economic cycle was already on a downward trend, thus facilitating the sovereign debt crisis. After 9/11, on the other hand, Alan Greenspan opened the faucet to prevent Wall Street from collapsing and a long recession from kicking in, but he continued to pump out money, thus facilitating the subprime crisis and the collapse of the global economy in its entirety in 2008. The central banker's profession is an art, as British economist Ralph George Hawtrey said in 1932, when he saw that it was proving impossible to prevent the Great Depression.*

What has happened over the past few years has imparted a fresh boost to the age-old debate between the banking school and the monetary school. For the banking school, at the end of the day, it is the market that dictates supply; for the monetary school, supply is dictated by government which, however, needs to keep an eye on the behavior of the "invisible hand." The financial crisis proved the banking school right, but today's inflation is proving that currency counts enormously as well. Former Bank of England Governor Mervyn King stressed this when he said: "Central bankers also have to reconsider some of their recent doctrines."

The new cyber phenomenon, in turn, is altering the money supply and making it more difficult to bring things under control. El Salvador is the first country to officialize cryptocurrency. How many others are going to follow in its footsteps? Bankers are running for shelter. The digital currency phenomenon is spreading fast, but central banks are lagging behind, and considerable shocks are in store. Mervyn King admits that "central banks cannot say what they are going to do, because they do not know what the economy will do." And in his view "average inflation targeting is surely stillborn."

Furthermore, as Martin Wolf explains, "A big lesson of history is that if economists think they understand how the macroeconomy works, they will be *wrong. In the 1930s, the conventional wisdom was that the economy was self-stabilizing. In the 1960s, it was that inflation expectations and money did not matter. In the 1980s, it was that only money mattered. In the 2000s, it was that credit expansion would not destabilize the financial system. In 2020, it was that money was irrelevant. Again and again, we fall in love with naive stories. We want to believe the economy is a simple mechanism, but it is not."*

Marc Bloch – in his "Outlines of a Monetary History of Europe", a work he never finished because he was murdered by the Nazis – ironically relates the complaint of Gilles Li Muisis, the abbot of Tournai, seven centuries ago: "Money and currency are very strange things; They keep on going up and down and no one knows why; If you want to win, you lose, however hard you try." So, has nothing changed since then? History is full of epoch-making transformations alongside major continuity. Every time money has served to satisfy a sovereign's desire for power or has marked its distance from the "trade game," it has spun out of control. The distinction between the financial economy and the real economy has narrowed today; over the past two decades, the former has prevailed, but the need to maintain a balance in the magic monetary triad remains more relevant than ever.

About this and more, Aspenia talked to Giulio Tremonti, Chairman of Aspen Institute Italia and former Minister of Economy and Finance.

ASPENIA. *Money and power: the fate of humanity rests on this dynamic duo. And yet the relationship between the two is not always clear. Indeed, it changes according to the time and the place. How should we look at these two phenomena?*

TREMONTI. In his *Manifesto*, Karl Marx expressed a deep nostalgia for the "colorful constraints" that were typical of the old world, and which have been replaced by a single new constraint: "ruthless payment in cash." Cash has fallen somewhat out of fashion today, but I still doubt that Marx would like the instruments that have replaced it.

Talking about money and power means looking at combinations that seem to contradict one another, that somehow have opposite meanings, like auto-antonyms. Where to begin? Well, from the beginning of course.

Pecunia, Latin for money, derives from *pecu*, Latin for sheep: long ago, coins represented heads of livestock. Herds represented mobile wealth as they wandered around a given territory, but they became much more mobile when they came to be represented by a piece of metal. Later, the heads of sovereigns replaced those of animals, and the sovereigns symbolized not only wealth, but also power. Currency eventually became paper – the banknote, Goethe's Faustian bill of exchange – and then, much later, plastic. Finally, today, money has transubstantiated into an aseptic computer sign. And this is how we arrive at the present time.

In order to maintain an organic, political idea of currency, as we have always had, we must appreciate that currency has never been only a "monad" (a software design pattern with a structure that combines functions and wraps their return values in a type system, with additional computation); in other words, currency is not a technical entity abstracted from life and politics. It is rather, always, a structural element of political architecture.

Digital technologies and cryptocurrencies: how compatible are they with our entire economic framework? After all, that framework, together with the markets, is based on the issue of currency as a state monopoly and attribute of sovereignty.

We are in a magical moment, which begins with bitcoins and goes on with "libra" – an ideal currency for the platform, a currency that is not a store of value, but is nevertheless an effective means of payment. Today we are going even further; we are entering the "metaverse".

Goethe's prophecy about Mephistophelean bills of exchange is coming true: we can now go beyond material reality through abstraction, replacing it with invented realities and virtual worlds. Today, in the digital world, we inhabit a space where a categorical *digito ergo sum* prevails, above all.

So what should we expect in the evolving relationship between economics (or rather finance) and politics? Does it make sense for governments and central banks to get involved in the digital currency game? Is this the last stage of "fintech", with the victory of finance over the real economy? Or is it rather the reaffirmation of the role of the state?

Today it is the material, political reality that forces us to set our feet firmly back on the ground. Four points must be recognized:

A. Technical know-how has allowed the development of a magical "fiat money": the money supply has developed at a rate of 3 to 1 – unlike in the real world. Indeed, the unit of account has gone from billions to trillions.

B. After – and because of – the financial crisis of 2008, when we went from "helicopter money" to "whatever it takes", our money supply has continued to grow even more, without basis and without limits.

C. The pandemic has taken us from an excess of austerity to its exact opposite. We now think there is "good debt" (a formula that updates the old Golden Rule). We now have the idea that public debt is an outdated concept.

D. In the Bible, there is the myth of the Tower of Babel: man challenges the divinity by erecting a tower that rises to the sky, but the divinity reacts by depriving him of a single common language.

The pandemic has wreaked a similar havoc: it has "hacked" the software of globalization, which has broken the pattern of the single thought by making history re-emerge. We had foreseen the end of history, but it is back with a vengeance – just look at the war in Ukraine.

We find ourselves back in a *mundus furiosus*, where certainty is replaced by uncertainty. Uncertainty of everything and about everything. With the ensuing economic effects.

What key policy choices should we be making today, then, in such a volatile environment?

In 2009, at the height of the financial crisis, two visions collided: that of the Global Legal Standard and that of the Financial Stability Board. The GLS, proposed by the Italian government and then voted on at the OECD assembly, was the draft of a multilateral treaty inspired by the idea that the time had come to move "from free trade to fair trade". This proposal envisioned a system of general rules for the economy, including, for example, about environmental protection and public health (sound familiar?). On the other hand, the FSB excluded the need for new rules for the economy as a whole, and foresaw the introduction of just a few new rules for finance, specifically. The Financial Stability Board prevailed. However, since then, we have yet to see much financial stability.