

The Invention and Adventures of Family Money

ending in

A Gaggle of Whirling Dervishes

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This economics tale has been inspired and guided by the writings of Warren Mosler, a wealthy bond trader, super-car builder, Senior Associate Fellow at the University of Cambridge, and advocate of sound economic policy:

<http://en.wikipedia.org/wiki/Mosler>

<http://www.moslereconomics.com>

My good friend, William Hummel, has given sound advice:

<http://wfhummel.cnghost.com>

Neither Mosler nor Hummel bear any responsibility for oddities and errors found in this Smith-family fable.

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The Coupon Economy of Family Smith

Mr. and Mrs. Smith and their lively gang of five kids lived happily on Strawberry Lane in a friendly neighborhood in the Silicon Valley. But the Smith children didn't like to do chores. Mom and Dad Smith were tired of begging, cajoling, scolding, nagging, and punishing.

And the children were loudly bickering over toys, clothes, and everything else they shared or refused to share. They often traded things but quarreled over the trades.

The Creation of Money

Dad Smith had a great idea: he would create family money: coupons. He could print coupons on his computer printer, using the paper sold for printing business cards. He would pay them coupons for doing their chores. One coupon for making a bed, five for mowing the lawn, and so forth. The Smith family government can print its own money.

The Smith-Family government can create its own money and can create as much as it wishes, any time it wishes.

Taxes

The children saw no reason to want coupons until Dad Smith told them they had to pay him ten coupons every week or be punished: no TV for the next week.

Extortion and the use of force worked. The kids started doing their chores to earn coupons and escape punishment.

Chores were done. Coupons were earned. Taxes were paid. Of course the parents didn't need the coupons. If they had jelly stains they just threw them away. They quickly printed as many coupons as they needed to pay for chores.

Taxes make the coupons valuable.

Trading

So now the kids had coupons, payed their taxes, and did chores to earn more coupons. But they discover something: they can trade coupons between them and Dad has no objection as long as the chores get done by someone. A child who has a lot of school homework can pay someone else to do a chore that day. The older kids took the most advantage of this scheme. Sometimes a quarrel broke out when someone traded coupons, then refused to accept a coupon in return, wanting a candy bar instead. So Dad Smith issued a ruling: coupons must be accepted in trades.

Smith coupons assist in trading. They are valid by fiat: the command of Dad Smith.

Savings

One of the boys, John, knows how to carve little propeller toys for the younger ones, but the propellers often get lost or broken. John has a clever idea. He trades propellers for coupons. His acquires a store of wealth: coupons. Coupons do two things: they make it easier for the kids to trade, and – at least for John – they store wealth for future use – they are a way of saving.

Coupons can be used for saving.

The system worked well. But Dad doesn't think he needs more chores done and even thinks there may be too many coupons – making them less valuable – so he cuts back on paying coupons for chores and the kids start to run out of coupons. Their trading becomes more difficult and the lawn isn't getting mowed very often. There were not enough coupons to make the system run well, and Dad Smith was becoming confused.

Dad Runs a Deficit and Builds a Debt

Dad Smith noticed that there are too many coupons and they are losing value – coupon inflation. So instead of printing more, he borrowed coupons from John. John was promised a few extra coupons in reward. This took coupons out of circulation and increased their value.

About this time, the neighbor kids entered the scene. They started getting coupons by doing favors for the Smith kids. With the coupons they too could trade more easily and buy toys from John, who now is making a variety of propellers and wooden trucks and carved dolls for the girls – and for the neighbors in exchange for coupons. John taught another boy, Henry, how to make toys and pays Henry coupons for his work. Trade has spread over the cul-de-sac and there is toy factory.

Coupons were getting lost and there was some stealing of them among the unruly Joneses down the street. So they start loaning their coupons to Dad Smith where they are safe and earn more coupons. Dad Smith makes notes of what they've loaned him and throws those coupons away. He really has no use for them. When any child wants his coupons returned, Dad prints some for him.

This goes on and Dad has a big coupon debt to his Smith family and to neighbor kids. There are still coupons getting lost or stolen, so Dad sets up records in his computer to keep track of everybody's coupons. Coupons are largely replaced by the bytes in Dad's data base and are safer that way.

Dad Smith doesn't need to print coupons, he can borrow them from the kids. That reduces the number of coupons in circulation.

A Paradox: Debt is Good

Dad borrowed 40 coupons from Louis to get the front porch fixed by the big neighbor boy who is good with tools. The debt to Louis is recorded on Dad Smith's computer. Dad spends the coupons and gets the porch repaired. He pays Louis the 40 coupons and Louis spreads them around the neighborhood as he trades for things. The neighborhood has 40 more coupons and Dad Smith has a debt of 40 to Louis. Dad's debt is equal to the neighborhood's new savings of coupons. More parent debt has produced more savings.

Dad's deficit produces an equal amount of savings. The deficit is good for the neighborhood coupon economy.

Dad Smith is Confused

But something is not quite right. Dad gets antsy about coupons and bytes. Dad Smith is a nice fellow but not too bright. He starts hoarding coupons and the lawn isn't getting mowed often enough. The house needs painting and repair. Dad Smith has a bad back and can't do the work himself. The teen age boys could paint the house but Dad wants his coupons.

Dad Smith is getting a bit wacko. The house and yard are getting run down. A grass fire runs through the weedy lawn and burns the front porch.

The kids are living in a run-down place. All because of coupons and Dad Smith's screwy obsession of hanging onto coupons.

Trouble is rising. The kids don't have many chores, what with Dad's mental illness. They are short of coupons for trading. John's toy business slows down. He no longer needs Henry to help him make toys. Henry becomes unemployed.

Dad Smith thinks he sees the problem: there is too much debt. So he cuts back on expenses and cuts back on house repairs. The kids don't have chores to earn coupons. The supply of coupons shrinks. John shuts down his toy factory. The kids become angry and disobedient. The house is an eye-sore in the neighborhood.

Deficit and debt reduction in a time of recession can cause a Great Depression.

An increase in deficit spending will help an economy suffering from low demand.

The deficit and debt might wisely be reduced in prosperous times without harm.

In Whirl The Dervishes

Janie, the oldest daughter of the Smiths, has graduated from Harvard and returned home. A neighborhood boy, Dan, graduated from MIT a year earlier and works for a bank. The two have discussions about banking, investment, finance, and economics and have a clever idea for neighborhood fun. They know all about derivatives.

They will gather coupons in sealed envelopes and sell them. The value of the envelopes will be uncertain but some may be very valuable. So the neighborhood kids – there are now many new ones with little coupon experience – pay coupons for the envelopes of coupons, hoping to hit it rich. Some do: Janie and Dan become wealthy in a hurry.

Janie and Dan needed a name for these envelopes that are whizzing around the cul-de-sac and called them “dervishes.” The kids loved it: they’ve seen dervishes whirling on the TV. And they did whirl. For a while.

John, the toy manufacturer, has opened a bank. He knows little about banking but sees a way to get a lot of coupons: by taking deposits, paying interest and making loans at higher interest. Also, he will do investment banking, not just deposits and loans. His bank gets into the dervish game in a big way. Janie and Dan are having great fun. And John’s bank has lots of dervishes on the balance sheet: valued at the price paid for them -- as is proper.

Banks can speculate in coupons and dervishes.

The kids go crazy, gambling with dervishes. It’s all great fun bit gets a bit out of hand. Mother Smith, always protective, begins to worry and warn Dad Smith that all is not right.

The neighborhood kids became worried. They were not certain what these dervishes are worth: their coupon exchanges were confusing. They see that the John, Janie, and Dan have lots of coupons and the dervishes don't look so attractive: the market price of dervishes falls.

John's bank borrowed coupons from the neighborhood and even found some to borrow from another cul-de-sac where the coupons had wandered in trading deals. One day two of those neighbors wanted their coupons returned. John didn't have enough on hand to give them.

All hell broke lose on Strawberry Lane and all its neighboring lanes. The coupon system collapsed, chores were no longer done, the neighborhood became a slum, the kids got into fist fights, Mrs. Smith filed for divorce. Dad Smith killed himself. John's toy factory was closed for good. Janie and Dan fled to the Bahamas with lots of real money they had collected in the dervish business.

===== the end =====

Readings for Learning

“The 7 Deadly Innocent Frauds of Economic Policy” : 2009

Warren Mosler, Senior Associate Fellow, Cambridge Center for Economic and Public Policy, Department of Land Economy, University of Cambridge, and Valance Col, St. Croix, USVI.

<http://www.moslereconomics.com/>

Mosler is also a wealthy bond trader and builder of 1,800 hp super-cars: <http://www.moslerauto.com/>) He is proposing to run for President in 2012.

“Fifteen fatal fallacies of financial fundamentalism: A disquisition on demand-side economics” : 1996

<http://www.columbia.edu/dlc/wp/econ/vickrey.html>

William Vickrey, Economics Department, Columbia University, Nobel Memorial Prize in Economics 1996, National Academy of Sciences, past president of the American Economic Association.

http://nobelprize.org/nobel_prizes/economics/laureates/1996/vickrey-bio.html

“Teaching the Fallacy of Composition: The Federal Budget Deficit” : 2006

<http://www.cfeps.org/pubs/pn-pdf/PolicyNote2006-1.pdf>

L. Randall Wray, Professor of Economics, the University of Missouri-Kansas City, and Senior Scholar, Levy Economics Institute.

“The Great Deficit Scars: The Federal Budget, Trade, and Social Security” : 1997

Robert Eisner was the William R. Kenan Professor of Economics at Northwestern University and a past president of the American Economic Association.

<http://www.tcf.org/list.asp?type=PB&pubid=123>
