ARE MMMFs MONEY?

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Two decades have passed since the Federal Reserve instituted the "monetarist" experiment. This attempt to implement Fed policy based on quantity theory prescriptions was flawed almost from the beginning, with one monetary aggregate after another being tried and eventually discarded. The Lucas critique was in effect, and, with changing technological innovation, exactly what was "money" became more and more difficult to define. The Fed thereafter resumed targeting the Fed Funds Rate and de-emphasized monetary aggregates. Monetarism as a theory was widely discredited, at least in a practical sense for public policy.

Changing monetary instruments and institutions may affect other theories as well. The central core of the Austrian business cycle theory (ABCT) suggests that monetary expansion is responsible for the boom-and-bust business cycle (Mises 1981, pp. 403-04). But what measure do we use to determine whether we have a monetary expansion? Differing Austrian examinations of business cycles have used slightly different definitions of money, for each investigation, but central to each is the role of fiduciary media, which traditionally are expanded when the central bank increases reserves. Previous investigations have limited the fiduciary media in question to checkable deposits (and notes when legal for banks to issue). But as institutions change and financial

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1Milton Friedman claimed that the policy followed was anything but monetarist, as monthly money supply figures were highly variable—exactly opposite of a monetarist approach. The Fed, for its part, acknowledged the lack of precision in hitting targets, but claimed it was doing its best, given changing money demand functions.

2Rothbard was widely criticized (wrongly, in my view) for including the cash surrender value of life insurance policies in his definition of money in America's Great Depression. Recently, Hughes (1997) simply used M2 in his analysis.
innovation increases, is this the only form of fiduciary media that Austrians should consider in their views on business cycles? This article will specifically examine the question of whether money market mutual funds (MMMFs) are fiduciary media in a Misesian sense. If MMMFs are considered money, for instance, who creates them? Are there any direct limitations on their creation via Federal Reserve action? If not, how are these monies affected by Fed policy? And if MMMFs are money, are there nonbank sources of inflationary credit that can initiate a business cycle? This article will argue that, in the economically relevant way, MMMFs are money, and while nonbanks cannot initiate a credit expansion, their ability to expand their balance sheets should be a relevant factor for Austrian analysis.

For Austrians as well as most economists, there is little debate as to the "moneyness" of fiat currency or checkable deposits; yet the question of MMMFs offers the possibility of a fruitful debate. Consequently, while this article will not assess whether each particular asset is money, the principles developed will apply when assessing any monetary instrument. The other main reason for focusing on MMMFs, and the nonbank intermediaries that issue them is simply the tremendous increase in the number of MMMFs, in the 1990s. This is contrary to the approach that White (1989, p. 207) took: he examined traveler's checks in-depth, even despite their lack of practical importance to the money supply (to illustrate the principles involved). Conversely, we will look at MMMFs precisely because of their growing importance to the broader money supplies. Figure 1 below shows the growth of MMMFs as a percentage of the broader money supply M2, contrasted with a reduction of checkable deposits as a percentage of M2.

![Figure 1: Percentage of M2](source: Federal Reserve)