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Money as Communication: A New Educational Video by the Atlanta Fed

Roughly a year ago, the Federal Open Market committee (FOMC) switched from date-based forward guidance on the federal funds rate path to guidance based on economic conditionality. The idea, as Chairman Bernanke put it in his post-FOMC press conference, is that "[b]y tying future monetary policy more explicitly to economic conditions, this formulation of our policy guidance should also make monetary policy more transparent and predictable to the public."

Now, on the one hand, you can't be any more clear than to say that the policy interest rate will remain near zero until such-and-such a date. But if you really want to know the "reaction function" that guides monetary policy decisions, date-based guidance isn't going to speak very clearly to this question. Rather, you would probably rather know the economic conditions that would warrant the FOMC's decision to adjust the policy rate.

Let me suggest that clear communication is one of the foundations of good monetary policy because it's one of the foundational characteristics of good money.

A textbook description of money is usually just a recitation of its functions—it acts as a store of value, a medium of exchange, and a unit of account. This definition of money is a rather hollow one (as Minneapolis Fed President Narayana Kocherlakota noted back in his academic days) because it tells us only what money does but doesn't speak to the core issue—what is the problem that money solves?

The "unit of account" function, in particular, gets little development in the textbooks and has generally not carried much weight in the academic literature on the theory of money. (There are a few exceptions, like this NBER working paper by Matthias Doepke and Martin Schneider.) But if people are going to communicate with one another about value, those communications are going to be most effective if done using some standardized metric—and that's where money comes in. As a "unit of account," our money is how we communicate about value. It can be a physical thing, like a particular commodity, or it can be an abstract concept, like the broad purchasing power of a medium of exchange.

But this isn't to imply that all things are equally up to the job of being a good unit of account. Many economists, beginning with Adam Smith, have been critical of commodity-based monetary systems in this regard. In Congressional testimony in 1922 about stabilizing the purchasing power of our money, famed economist Irving Fisher argued that while gold may have been chosen as our money because it was a good medium of exchange, it had proven to be a poor choice as a unit of account on which contracts could be negotiated. Indeed, he argued for a system where the value of money was fixed in terms of a statistical index of its broad purchasing power, a system certainly similar in spirit to the one the Federal Reserve pursues today:

> Is it not absurd to have a dollar also a unit in weight, when it is not intended to measure weight, but is intended to measure purchasing power. It is used in commerce in buying and selling, by debtor and creditor for lending and repaying; and we propose that the repayment shall be just. What does that mean? It does not mean that you shall return a given weight of gold or a given weight of anything; it means that you shall return to the lender something that is a just equivalent. Value is involved in there, and value is statistically increased by an index number average purchasing power.

In other words, it's essential that the unit of account conveys value so that the units expressed in trade, contracts, and financial accounts are both meaningful and durable. We recently produced a simple four-minute video on the subject. Give it a view and let us know what you think. We're big on getting our communications right.

By Mike Bryan, vice president and senior economist in the Atlanta Fed's research department

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