What is "Minting the Coin"?

ERM

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1 What's the Problem?

The government has obligations it has to meet. It spends on programs and projects (basically anything you can think of that the government does), it pays interest on outstanding debt, and retires maturing debt (pays off notes that come due). To meet those obligations, the government can do three things:

1. Issue more debt;
2. Issue more money;
3. Raise money through taxes.

We can write this relationship, the "budget constraint", as follows:

$$G_t + B_t^M + r_t B_t \leq \Delta B_{t+1} + \Delta M_{t+1} + T_t,$$

where subscript t denotes the value of a variable in time t. G_t is government spending, $r_t B_t$ is interest that has to be paid, B_t^M is maturing debt in period t, ΔB_{t+1} is newly issued debt, ΔM_{t+1} is newly issued money, and T_t is tax revenue. This isn't a modelling choice; it's an accounting identity. What this relationship says is that outstanding obligations have to be less than or equal in value to new debt, new money, and tax revenue combined.

Okay, so what's the problem? Well, the government, for some reason, has a debt limit. That means once the government hits that limit, it can't issue any more debt, except to roll over its current maturing debt. Note that this is a legal constraint, not an economic one. We can write debt in the next period as follows:

$$B_{t+1} = B_t - B_t^M + \Delta B_{t+1}.$$

In plain English, the debt next year is equal to current debt, minus maturities to be paid off, plus newly issued debt. If $B_t = \bar{B}$ (debt is at the limit), B_{t+1} must be less than or equal to the limit $\bar{B}$. This means that $\Delta B_{t+1} \leq B_t^M$. That is, you can't issue debt except to cover maturities that come due.

2 What Are the Options?

Again, the equations described above are just accounting identities that describe the financing options available to the government; they're not modelling choices. In normal times, away from the debt limit, we can issue debt and money and use tax revenue as needed to pay down our obligations. However, when we're at the limit, we can only pay off interest and spending using new money and tax revenue. We can write that equation as below.

$$G_t + r_t B_t \leq \Delta M_{t+1} + T_t.$$

What normally happens is that congress fights and the debt limit eventually gets raised, allowing the government to issue new debt again. What if that doesn't happen? What if congress reaches an impasse and the government faces a default? Well, one idea is to issue more money (set ΔM_{t+1} so that our obligations are taken care of). Usually, that requires congress's approval, but, if that's infeasible (i.e. they won't make a deal), what do we do? One option that people have suggested is to allow the Treasury to mint a large denomination platinum coin and give that to the Federal Reserve to take care of outstanding obligations. People have suggested that this is legal (Wikipedia article), but that's beyond my knowledge.

In effect, this is allowing the government to print more money without congress' say-so. But why would we need it? We would need it if spending and interest are greater than tax revenue (as in the equation below):

$$G_t + r_t B_t \leq \Delta M_{t+1} + T_t.$$

Generally, under current trends, tax revenue is not enough to pay for these things on its own. So, the options are to try to get more money in taxes, lower spending, and/or issue more money. If you don't want to increase taxes or cut spending to the required levels, it's possible to try to issue money from that loophole.

Whether that is necessary depends on how much fiscal adjustment is required to actually make things work. If it requires unprecedented austerity measures (huge cuts to spending and huge tax hikes), it might do more harm than good to go that route. Again, that depends on how big the cuts are, but I assume they'd be pretty big cuts. So, if you want to keep things as they are, you can theoretically do so by "Minting the Coin".

The alternative, if you don't want any of those, is default, which is easily the worst option. That would potentially destabilize the world economy and harm the US government's ability to issue dollar denominated debt in the future. Countries that default usually have to issue debt in a more stable foreign currency, which means that natural fluctuations in inflation and exchange rates can't dampen economic shocks the way they usually do. This is a wonky point, but suffice it to say the US should really want to be able to keep issuing debt in dollars (i.e. they pay off maturing debt using dollars if they don't want to roll it over).

3 How Does "Minting the Coin" Work?

Regardless of whether you think it's a good idea, this is how it would work:

1. The Treasury mints the coin;
2. The new reserves (newly created money that comes from the issuance) go to the Federal Reserve, which can use them to pay down obligations;
3. To control the new monetary expansion's potential inflationary impact, the Fed can unwind its balance sheet and sell bonds in exchange for newly created money.

Why is the third part important? Dollars are highly liquid and bonds, while liquid, have longer maturities and can't generally be used as a means of exchange by consumers. If you just gave everyone a ton of money (like A LOT of money, like A LOT A LOT), that money could be spent and you could see acceleration of inflation. So, in effect, the minting and the Fed's unwinding combine to create a scenario that's as if the government just issued more debt to cover its obligations.

At this point, you may be asking yourself "Why doesn't the Fed just sell the bonds on its balance sheet?" The answer is that this would be taking a large amount of money out of the economy, so the net cash balances would fall, which might have a contractionary effect on the economy (read: lower inflation and GDP growth). So, you need to have the two together to achieve a scenario that's similar.

Of course, this is all theoretical and we don't know how it would play out in practice. Some still have reservations about it, including Treasury Secretary Yellen, who was an excellent chair and is a very talented economist. However, if the rubber hits the road and we face a choice of crippling austerity or default, I would probably pull the trigger. However, the likelihood of such an event, I believe, is low. Still, there's nothing wrong with exploring an option to keep in your back pocket.