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Development of Financial Markets and Institutions

XIV. Monetary Reform Proposals

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XIV. MONETARY REFORM PROPOSALS

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1. PROPOSALS FOR MANAGED MONEY

THE CHICAGO PLAN

Origins

- Formulated in the 1930s by the early Chicago school
- Main idea: impose 100% reserves on demand deposits, end bank money creation
- "Nationalize money, but do not nationalize banking"

Main Ideas

- Banks left free, but money now managed by the state
- Abandon the gold standard: some form of index standard should be adopted to stabilize the value of the monetary unit
- Inspired by Fisher's (1913) compensated dollar plan
- Price level stabilization an important policy goal, pioneered by Fisher

SOVEREIGN MONEY

Origins

- The theory behind the Swiss 2018 Vollgeld initiative referendum
- Inspired by chartalism and the currency school
- Main theorist Huber (2021)

Main Ideas

- Main reform idea: money should not be created in a market process
- Fundamental problem: money is today created in a market process by banks
- This system leads to periodic crises for the whole economy
- It favours banking and finance over real economic activity – financialization
- The dominance of bank money makes conventional monetary policy ineffectual

SOVEREIGN MONEY

Proposed Solution

- End bank money (and other private money) creation
- Central bank money to be substituted
- Overnight or over a short transition period

Ideal Outcome

- Central bank money will be the only kind of money in existence
- Cash, digital currency or accounts managed by the banks – but always fully backed

SOVEREIGN MONEY

Consequences

- Without bank money creation, there will also no longer be bank crises
- The state will earn the full seigniorage instead of private banks
- This can help fund government spending

Monetary Policy

- Policy will again become powerful without the intermediation of banks
- It again becomes an important tool for guiding the economy

BANK OF ENGLAND PROPOSAL (BUSH ET AL. 2011)

Proposal focused on the international monetary system

- Several problems identified
- Large imbalances between countries
- "Uphill" flow of capital from poor to rich countries (the Lucas paradox)
- Nominal rigidities

General Problems

- They identified lower growth rates
- And higher inflation rates since the end of the Bretton Woods System
- Their conclusion: a better managed monetary system can eliminate these problems

ECONOMIC PERFORMANCE AND MONEY

- Bush et al (2011) show differences in economic performance
- Under different monetary regimes

Table A Selected metrics for measuring the performance of the IMFS over time[a]

PANEL A:

		World GDP (per capita)[b]		World inflation[c]	
		Growth Annual average Per cent	Volatility Coefficient of variation	Average Per cent	Volatility Standard deviation Percentage points
Pre-Gold Standard	(1820-1869)	0.5	—	—	—
Gold Standard	**(1870-1913)[d]**	**1.3**	**1.2**	**0.6**	**3.0**
Interwar Period	**(1925-1939)[d]**	**1.2**	**3.3**	**0.0**	**4.6**
Bretton Woods	**(1948-1972)[e]**	**2.8**	**0.3**	**3.3**	**2.1**
memo:	*1948-1958 [e]*	*2.7*	*0.4*	*3.1*	*2.9*
	1959-1972	*3.0*	*0.3*	*3.5*	*1.3*
Current	**(1973-2008)**	**1.8**	**0.7**	**4.8**	**3.5**
memo:	*1973-1989*	*1.4*	*0.8*	*7.5*	*3.4*
	1990-2008	*2.2*	*0.6*	*2.3*	*0.9*

PANEL B:

		Downturns		Current account balances
		Years of negative world GDP growth Share of period Per cent	Years of negative country GDP growth[f] Share of period, median country Per cent	Surpluses and deficits Per cent of world GDP[g]
Pre-Gold Standard	(1820-1869)	—	—	—
Gold Standard	**(1870-1913)[d]**	**7**	**19**	**2.4**
Interwar Period	**(1925-1939)[d]**	**21**	**27**	**1.2**
Bretton Woods	**(1948-1972)[e]**	**0**	**4**	**0.8**
memo:	*1948-1958 [e]*	*0*	*0*	*0.8*
	1959-1972	*0*	*0*	*0.8*
Current	**(1973-2008)**	**0**	**13**	**2.2**
memo:	*1973-1989*	*0*	*18*	*1.6*
	1990-2008	*0*	*11*	*2.8*

PANEL C:

		Incidence of crises		
		Banking crises[h] Number per year	Currency crises[i] Number per year	External default[j] Number per year
Pre-Gold Standard	(1820-1869)	0.6	—	0.7
Gold Standard	**(1870-1913)[k]**	**1.3**	**0.6**	**0.9**
Interwar Period	**(1925-1939)**	**2.1**	**1.7**	**1.5**
Bretton Woods	**(1948-1972)**	**0.1**	**1.7**	**0.7**
memo:	*1948-1958*	*0.0*	*1.4*	*0.3*
	1959-1972	*0.1*	*1.9*	*1.1*
Current	**(1973-2009)**	**2.6**	**3.7**	**1.3**
memo:	*1973-1989*	*2.2*	*5.4*	*1.8*
	1990-2009	*3.0*	*2.4*	*0.8*

BANK OF ENGLAND PROPOSAL

Reforms

- An international system of taxes should be instituted
- Pigouvian taxes to eliminate cross-border "externalities"

Goals

- The goal is to alleviate international imbalances, equilibration of international flows
- But the burden of adjustment will be on nations with a current account surplus
- Countries running current account surpluses will be forced to adjust through taxation
- Countries would be allowed to impose taxes on inflows from countries with whom they have a bilateral current account deficit
- This idea is a clear descendant of the British position at Bretton Woods

NOMINAL GDP TARGETING

Origins

- NGDP targeting became popular after the financial crisis in 2008
- Especially in America
- Born in the blogosphere

Main Ideas

- Monetary authorities should adopt a nominal income target rather than inflation target
- This would work like the gold standard (Sumner)
- Such a target would allow for variations in prices, even a declining price level dependent on real economic growth (Selgin's productivity norm)

NOMINAL GDP TARGETING

Effects

- Keeping nominal GDP on trend would eliminate many shocks and instabilities
- Nominal income stable despite changes in demand for money
- The central bank would increase/decrease the inflow of money in response

Details

- Suppose a target of 5 percent nominal GDP growth per year
- Real GDP grows 3 percent, so the central bank increases the money supply 2 percent
- A rise in demand for money lowers rGDP, but nGDP stable, CB increases inflow
- Tighter money also possible if real GDP rises

NOMINAL GDP TARGETING

"Market Monetarism"

- Monetary policy could be automated or left to the market
- The CB could set up a market in nominal GDP futures
- Essentially bets on whether or not the central bank is on target
- The present price of such futures would guide policy
- The central bank would loosen or tighten policy "automatically"

GOLD STANDARD

"Managed" Gold Standard

- The central bank targets the price of gold and expands and contracts the money supply to achieve the target
- "Gold price targeting" mostly what meant by supply side economists advocating a gold standard in the 80s and 90s
- E.g., Lehrman and Kemp in the U.S.
- What Friedman (1961) called a "pseudo gold standard"

"BRETTON WOODS III"

End of "Bretton Woods II" Proclaimed around 2009-2010

- Andreas Rees, Unicredit Deutschland 2009
- Jörg Bibow (2010) suggest a Bretton Woods III based on U.S. public debt issuance

New Popularity (?)

- Zoltan Pozsar's (Credit Suisse) essay Bretton Woods III end of 2022
- The financialized, dollar-centred system set to decline
- A system of currencies based on commodities will emerge
- Eastern countries (China, Russia) will become independent of the dollar system
- But the ideas are very vague
- Some kind of currency based on a basket of commodities?

2. PROPOSALS FOR MARKET MONEY

FREE BANKING

- First proposed by Selgin (1988)

Problems of Current Banking

- Real-world banking beset by crises and instability
- Central bank-engineered inflation a key cause of these
- Financial regulations that limit the efficient function of banks also important

Solution: Remove the Cause

- To cure the banking system of these problems, we can simply remove the cause
- A free banking system is an efficient way of providing money
- There is no need for a central bank for its stability

FREE BANKING

Remove the Central Bank

- Freeze the amount of fiat paper money in existence
- Replacing it with commodity money is possible, but not required
- Paper money will become outside money to the banking system
- Abolish the central bank

Allow Free Banking

- Allow complete freedom of entry into banking
- Repeal deposit insurance and similar policies
- Repeal all legal reserve requirements
- Repeal all other bank regulations beyond enforcement of contracts, property rights

CURRENCY COMPETITION

- The idea of currency competition first suggest by Hayek (1990, 2009) in 1976

A very simple Reform

- Repeal legal tender laws
- Gresham's law no longer in effect: better money will gradually drive out bad money

Likely Result

- Competition between national issuers of currency (pounds, dollars, D-Marks, etc.)
- Commodity money also possible
- Private issuers of fiat money – perhaps issuing index-linked currencies
- The market will decide which is the better money and use that

CURRENCY COMPETITION

Important Proponents

- Ssuggested as alternative to European monetary integration, e.g., by Pascal Salin
- An important part of monetary agitation in the U.S. in the 70s and 80s:
  - Hans Sennholz, FEE
  - Ron Paul and the congressional report on gold (Paul and Lehrman 1982)

Problems?

- Perhaps only a halfway solution? (Hülsmann 1996)
- Network effects favour incumbent currencies
- There is always a danger of resumed inflation
- In a free market, paper money will lose out to commodity money (Hülsmann 2003)

GOLD STANDARD REFORMS – A BRIEF HISTORY

Numerous Proposals since WW2

- Mises (1953): conversion of dollars into gold at a reasonable ratio, set by the market
  - Probably $36-8 per ounce
  - A marginal full reserve requirement for fiduciary media
- Rothbard (1963): gold standard with 100 percent reserves
  - Dollar redefined by fiat to ensure full gold cover for all paper dollars
- Salerno (1982): 100 percent reserves and gold standard the optimal reform
- Shelton (1994): "Reformed" Bretton Woods, where individuals too can redeem paper money into gold

WHY GOLD?

Key Reasons

- The political ideal: keep government out of money
- Avoid Cantillon effects that favour some over others, distort the economy
  - Avoid Cantillon effects internationally
  - Less developed countries have the most to gain from the gold standard (Shelton 1994)
- Money production will be 100% endogenous to the economy under a gold standard
  - Money production will be no different from the production of any other good

Why Gold?

- Gold the preferable commodity due to its suitable qualities
- Major nations still have huge gold stocks that makes implementing reform easy
- Gold has historically ensured price stability in the long run (Jastram 2009; Rueff 1972)

GOLD STANDARD AND FREE BANKING

Two Views on Banking and the Gold Standard

- 100 percent reserves should be enforced (Huerta de Soto 2020)
- Free banking on a gold standard would be efficient and desirable (White 2012; 2015)

Ultimately this comes down to how free banking is viewed – see lecture VIII

BITCOIN

"Digital Gold"

- The ideal: bitcoin replaces national fiat money in transactions
- Peak adoption: used for purchasing video games on Steam until December 2017
- Adoption of bitcoin conceived as a "bottom-up" reform
  - ➢ Real currency competition without the need for any legal changes or political action

Advantages of Bitcoin

- The supply of bitcoin is fixed, there is thus no inflation risk
- Exchanges are peer-to-peer: there is no need for clearing, central banks

BITCOIN

An Alternative Vision (Ammous 2018)

- Bitcoin is mainly a store of value – hence, "digital gold"
- It is too expensive to use for daily transactions
- Bitcoin adoption therefore means it will become the clearing asset for third parties
  - Banks, central banks and new native bitcoin institutions

Public Use?

- General public will transact on the "second layer", rarely settle in bitcoin
- Lightning Network the main secondary layer
- It is thus possible that paper money remains for daily use – backed by bitcoin
- El Salvador declared bitcoin legal tender in September 2021
- First step on way to global adoption?

3. LITERATURE

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