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100% Money and *Vollgeld*, a Solution for a Stationary Economy? a Critical Analysis

sustainable money research group
www.geld-und-nachhaltigkeit.de

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proponents in degrowth community

„whitin the present monetary system, it is not possible to have an end of growth (…) How can we fix this? (…) a monetary reform, like 100% Money or Vollgeld (…)“

H.C. Binswanger 2011, 7. Session of Enquete Commission Growth, Prosperity and Quality of Life in the Bundestag

see also: Seidl, Zahrnt (2010, 2013)

similar: Huber (2012), Peukert (2011)

present credit money system

1. banks create money (deposits) through lending or buying assets
2. central bank supplies reserves on demand (no constraint)
3. money and credit are two sides of the same coin
4. banks transform maturities
5. central bank policy: inflation targeting with controlling interest rates

critique of the reformer

- **procyclical money creation by banks**
  impact: destructive boom-bust cycles

→ **entirely Control of quantity of money**

- **identity of credit and money**
  impact 1: instability of financial system and *to big to fail*
  impact 2: high degree of indebtedness of the economy
  impact 3: growth imperative

→ **seperation of monetary and credit function and debt-free issued money**

- **„money creation out of nothing“, caused by fraktional reserve requirements**
  impact: unfair profits of the banking sector and systemic advantage over other sectors

conclusion:

100% money regime leads to dramatic reduction of the public debt, elimination of bank runs, much better control of bank-lending-driven business cycles

smoother business cycles through monetary control?

monetary policy:

- monetary growth oriented to the potential GDP
- similar to the Bundesbank policy:

short term interest steering, in the midterm monetary targeting

monetary targeting - a monetarist aberration

critique on the quantity theory of money:

- assumes linear correlation between money growth and consumer price inflation
- ingnores store-of-value function

empirical evidence:

- correlation between inflation and money growth is in low inflation countries obsolete (de Grauwe und Polan, 2005)

- Bundesbank can much better described as inflation targeter, than as monetary targeter (Clarida und Gertler, 1997)

- monetarist experiment of the FED at the end of the 70th has failed

how can asset price inflation be avoided?

nor monetary targeting nor inflation targeting (interest steering) can avoid asset price inflation

- consumer and asset prices evolve not directly proportional
- low interest rate elasticity of borrowing for speculative porposes

solution:

- macroprudential supervision and regulation
- macroeconomic monitoring and coordination

bank runs and financial instability (1)

<u>whence appeares instability?</u>

- maturity transformation satisfies liquidity preference and allows a lower interest rate level

→ but this creates inherent instability

<u>what could the reforms solve?</u>

- sight-deposits would be save independent of the solvency of the bank

→ but: every net portfolio shifting from time-deposits to sight-deposits would cause necessity for selling assets

bank runs and financial instability (2)

present solutions:

- **Lender of Last Resort** as a public good

→ Only for illiquidity, not for insvolent institutes!

- maturity transformation is limited through **liquidity regulations**
- **regulatory capital requirements** constrain the solvency problem
- public and private **bank deposit guarantee scheme**
- **participation of creditors** in case of insolvency and **debt equity swaps** (european banking union)

monetary keynesian theory of interest (Berlin School)

initial question: is the interest a policy rate only? (postkeynesian - exogenously) (Lavoie, Wray..)

interest rate ist endogenously determined by liquidity preference and portfolio-decision of the wealth owners (Riese, Betz)

- portfolio theory of tobin is developed further:

portfolio alternative tangible asset without productive purpose is introduced

- interest is incentive for wealth owners to hold long term nominal assets in the currency, to enable a income generating process

- **central bank have to execute an level of interst rate wich appropriate to the equilibrium of the asset market**, to avoid inflationary portfolio shifting to foreign currencies or to tangible asset

interest rate level by reduced government debt (1)

debt repayment in 100% Money Regime **leads not to money destruction** (*stock of money !)*

→ money stock requires interest rate appropriate to the equilibrium of the asset market

→ interest payments have to financed through lower liabilities, that means lower percentual interest rate on deposits

→ seignorage profits from reduced public debt is equivalent to taxation of deposits

→ central bank has to execute an higher interst rate level, for avoiding inflationary portfolio shiftings

Interest rate level by reduced government debt (2)

risk premium:
disctinction between liquidity risk and risk of insolvency:

- liquidity risk is solved through central bank as lender of last resort for the government

- risk of insolvency is still existent:

risk for the wealth owners is not to receive the equilibrium interest rate and uncertainty about real value in the future (inflation)

preliminary result of reducing public debt

public debt can massively be reduced

but no pareto-improvement!

- **seignorage profit is a simple tax on deposits**
- **no change of solvency risk premium**

do banks earn unfair profits?

hypothesis: caused by fractional reserve requirements, banks would earn unfair profits (similar as seigniorage) (z.b. Huber 2013, Peukert 2013, Glötzl 2013)

but:

- In modern currencies the reserve requirements are cost-neutral because central bank pays interest on reserves
- without interest payment on reserves, it would be am simple tax and therefore increase the level of interest rate
- profit margin depends on the competitive situation of the sector
- only central bank can generate seigniorage, when private actors are willing to hold interest-free central bank money (reserves)

does the monetary system contain a neccesity for growth?(1)

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popular hypothesis:
interest burden cannot be repayed, if no additional money will be issued
WRONG!

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does the monetary system contain a neccesity for growth?(2)

- fully consumption of income allows redemption of debt

→stationary state is theoretically compatible with an positive interest rate

only non-consumption of labor- and capital-income inhibits redemption and interest payment (siehe Wenzlaff, Kimmich und Richters 2014)

→hence **monetary savings (thrift) create dynamic**

A) thrift cause a neccesity to growth to mitigate the costs of rising unemployement (paradox of thrift)

or

B) thrift cause investments and induce a growth dynamic

summary

- inflation targeting is superior to monetary targeting
- Smoothing business cycles and improving financial stability can be much better achieved through macroprudential and macroeconomic regulation and coordination
- reduction of public debt offers no advantage (equal to a tax on deposits)
- 100% Money increases the interest-growth-differential

-> no solution for a stationary economy

thanks for your attention, any questions?

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