

Digital cash

Since its inception in 2012, IMMR member 'Ons Geld' advocates the introduction of digital cash. What is that, and why is it important? Edgar Wortmann (Ons Geld counselor and IMMR core-group member) explains it.

Historically, money represents a 'nominal' and an 'intrinsic' value. A silver coin for instance, had the nominal value printed on it, and the intrinsic value of the silver in it. These values were rarely the same, which caused persistent monetary instability. It was attractive to withdraw coins with a relatively high silver content from circulation, and to melt them down into coins with a relatively low silver content.

The present monetary system is no longer based on gold and silver. Yet it is still marked by a difference between nominal and intrinsic value. That is because money 'in the bank' consists of *claims* to money. These claims have a nominal amount, and a fair value that depends on the probability that a bank meets its obligations. The fair value of a money *claim* is usually lower than its nominal amount, because there is always a risk that the bank will not meet its obligations.

Lending out blindly

In a free market, risks are factored in leading to appreciation in fair value. Bank balances ('deposits') are an exception to this. They are withdrawn from free pricing and are valued at (the higher) nominal amount. This is necessary for them to function as money. To this end, free price setting of bank balances (deposits) is blocked. The government does this with special rules for banks. These rules allow banks to borrow money from the public, without saying what they will do with it. Other companies are not allowed to do that. They must comply with rules that ensure that investors know what risks they are exposed to, if they lend their money. For banks, the opposite applies. Whoever puts its money in the bank, lends it out blindly. Most account holders do not even know that they are funding a business by putting their money in a bank.

Thus, the government is doing something which it should not do. It distorts competition and makes people run risks without even knowing it, without consciously choosing it, and without getting the profit from it. This goes hand in hand with accumulation of risks in the monetary system, for which the public ultimately pays the bill. Why does the government do this?

Payment over distance

Payment with *claims* to money was advantageous in comparison to payment in cash. For payment in cash you must transport physical objects; typically notes and coins. If you're together, that's no problem. But if you are in different cities or countries, it is inconvenient. Then it is easier to pay by 'transferring' a claim to money. Payment is then not made by transfer of physical objects (cash), but by transfer of information about bank balances (deposits). By using bank balances, payment over distance became as easy as telephoning and telegraphing. The advantages of this were so great that it explains why governments have given the banks a separate status.

Privileges

Banks enjoy multiple privileges. They can attract funds from the public exempt from market discipline, and they can fall back on credit from the central bank. Consequently, banks receive structural state aid in the form of subsidized credit, unintentionally provided by the public.

Banks also have the privilege of borrowing money from the public and lending it out on their own account. In doing so, the bank balance of one account holder becomes a bank balance of another account holder too. That is the magic of the banker, who seems to multiply money miraculously. In fact, however, no money is created by the bankers. It is promised. Anyone can promise as much as he wants. The question is whether he can also fulfill his promises.

Trust

Sometimes banks are unable to meet their promises. But that's rarely a problem for them, as they can fall back on subsidized credit. If they would not get that credit, public confidence in bank money would crumble upon which the whole system could collapse. The artificial valuation of money claims (deposits) at their nominal amount would become untenable. Bank deposit would then get a constantly changing fair value, varying from zero to above nominal, depending on the creditworthiness of the bank. They would no longer be fit for use as money and would become ordinary investments (bonds).

Digital cash

That is exactly what has to become of 'bank deposits'. All privileges of the banks must be abolished. They are no longer needed. Banks have those privileges to facilitate payment over distance. This was useful in times of stagecoaches and analogue telephones. But in the digital age that is outdated. It has long been possible to introduce a digital form of cash, which can be used for payment over distance, without involvement of any bank balance sheet. The quasi monies issued by banks can then be replaced by publicly issued debt free money. The monetary system is then based on interest-free *property in* money instead of interest-bearing *claims to* money.

Technology has progressed so far that individuals can make their own 'crypto coins' from their attics. But when will democracies begin to see that they should not put the money system in the hands of entrepreneurs? Here lies a public task that is optimally performed by introducing digital cash. This can be done next to physical cash, which can simply continue to exist. Bank deposits however, must then disappear. They are withdrawn from the bank as cash. Insofar as they remain in the bank, they are valued at fair value, and ranked as a bond. The monetary system then only consists of physical and digital cash, of which the nominal value is then no longer undermined by a (lower) underlying intrinsic value. An age-old deficiency of the monetary system has then been overcome.

Stable and serving

The people can then collect their money from the banks and store it in their digital safes. It is then no longer exposed to credit risk. The government can then conduct monetary policy focused on zero inflation, so that cash (physical and digital) retains its value, and that interest on savings can be abolished. Those who save, save their money for later, without losing its purchasing power. Whoever seeks a return on his money invests it, or lends it out, thereby making a profit perhaps *and* carrying the risk.

By creating money itself, the government enables society to pay off debts. In that way the European debt problems can be solved, without austerity and extortion. Social achievements are then strengthened, instead of being abolished. Moreover, it allows the government and the population to invest in quality and sustainability: clean air, clean water, sustainable food production, good healthcare, good education and a pleasant environment for everyone.

A public digital cash system can make society flourish. It provides insight where money accumulates and sees where there are shortages. Money is the bloodstream of the economy. It must circulate. With digital cash, a faltering economy can be effectively kept going. Monetary taxes take away undue accumulation of cash, and monetary benefits complement cash deficiencies. In that way the economy can run smoothly without unnecessary fluctuations and continue to provide the necessities for everyone.

Why did that not happen yet?

Why don't we have a digital cash system yet? Politicians have been told by economists and bankers for decades that they should not interfere with the money system. Politicians have come to believe that commercial entrepreneurs are the best caretakers for the money system, and that the government would make a mess of it. If you extend this line of thought, the government can better leave the army, the police and parliament to commerce too.

The view that the government can better keep aloof from the money system is not based on facts. The facts show that the commercially exploited bank money system is inherently unstable and accumulates increasing risks. Government power is what keeps the bank money system upright. That is reflected in the preference of commercial liquidity providers for government debt as a backing for their quasi monies. Government debt is covered by the power to levy taxes. In the bank money system this power is used to a large extent to keep the money up. Thus, in the current monetary system, even the power of taxation is (indirectly) exploited commercially.

The debt money system

This bank money system has reached its limits, though. It is based on debt and is therefore accompanied by debt burdens. It is a gigantic administration of unpaid debts. The actual money to pay those debts does not exist. That stresses society and the banking sector itself. To create more bank money, debts must increase, which increases default risks. This leads to structural stagnation and loss of welfare. The remedy against this is inflation, because inflation decreases actual debt burdens and default risks. In the bank money system, 'moderate inflation' is therefore the goal of monetary policy, which is remarkable, as this detracts from the stability of the currency.

To get inflation, central banks have bought an unprecedented number of bonds in recent years. They did this on interest-bearing credit, adding the purchase price of those bonds to the accounts of their member banks. The interest they pay on these accounts is currently low, zero or even negative. For now the central banks are doing rather well. But if inflation picks up, that will change. The value of the purchased bonds will then fall, and the costs of the central banks will rise. They may end up with residual debt and net interest payments to commercial banks. The creditworthiness of central banks then becomes questionable, and as the taxpayer has to jump in, the legitimacy of this institution comes into question as well.

In fact, that legitimacy should already be an issue. Central banks disrupt the markets and hamper competition. With huge purchases they distort financial markets. They also ensure that the public lends their savings blindly to the banks, and they keep those banks afloat with state aid. The cause for the next crises is created by the central banks.

Government policy

For the time being, policy makers come up with completely wrong responses to this. Instead of structurally reforming the monetary system, they are reforming society. Social achievements are demolished to uphold a greedy credit system. With austerity and extortion, funds are reserved to buy off the next crises. However, these funds can never be sufficient to cover the risks accumulated in the bank money system.

These policies are doomed to fail and to feed political tensions. Fortunately, the way to address the problem with our money system effectively is only one step away. For that politicians must learn to see that provision of all money that embodies the general unit of value, is a public task which cannot be relinquished without compromising the primacy of democracy, and the prosperity of the people.

With digital techniques this task can be fulfilled in a stable, socially responsible and cost-effective way. In the past, the government had good reason to leave the money system to banks. But that is out of date. We can now organize the monetary system better than ever before, disentangle it from commercial interests, and make it serve whatever we want to achieve as a democracy.

Edgar Wortmann - May 7, 2018

Published by [IMMR](#). Originally published in Dutch by [Ons Geld](#).