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Guest Lecture – Macroeconomics: The European Perspective
May 16th 2017

Course manual:

Proposals to change the process of money creation,
like elimination of the role of commercial banks in money creation.

Bank money creation = credit extension

C = bank credit

I = Investment

S = Savings

Monetary cycle: **C -> I -> S**

Commonly taught: **S -> I**

Jakab, Z. (2015), M. Kumhof, Banks Are Not Intermediaries of Loanable Funds – And Why This Matters, Bank of England Staff Working Papers, No. 529.

Available at: <http://www.bankofengland.co.uk/research/Documents/workingpapers/2015/wp529.pdf>

Spoiler: Bank money supply is rather volatile and over-reacting.

Cash vs Bank money

Cash

Object of ownership (absolute right)

Payment by transfer of assets

Debt is settled

Bank money

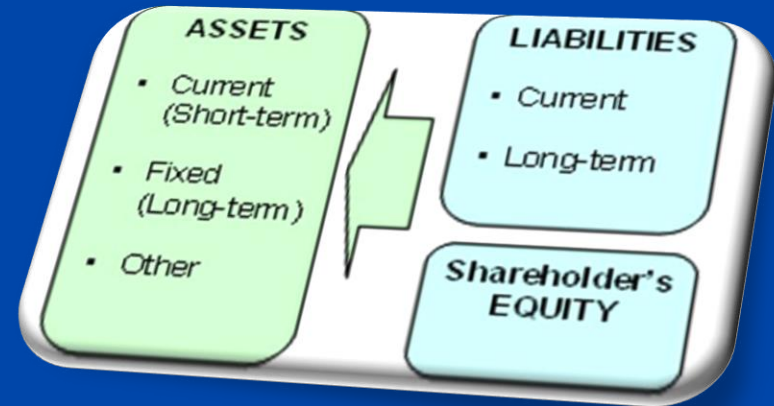
Contractual money claim (relative right)

Payment: the bank takes 'over' an obligation to pay

Debt remains in the credit system

Bank money = contractual money claim

Credibility derived from underlying assets
Hence the importance of the balance sheet



Bank money is prone to runs and risks

- Bank run
The money to satisfy all monetary money claims at once does not exist.
- Dependent on the creditworthiness of the bank (counterparty risk)...
- which depends on the value of its assets (market risks).

Naturally, money claims on different banks cannot trade at par, and cannot be used as money on nominal footing.

-> Grave government interference with the credit system:

The state arranges for certain private debt instruments (money claims on banks) to trade at par, and thus be used as money on nominal footing.

Dual system of financial oversight

- Regular financial oversight: *requiring risk transparency*
- Prudential oversight: *obscuring credit risks*
- Lending money on a properly issued prospectus; or
- Lending money at the blessing of the central bank

Two opposites! - Complexity! - Distortion of market processes!

Banks have access to publicly subsidized credit, that non-banks don't have

Superior money allocation?

No, most bank money is created for the financial sector.

- Non-productive investments
- Asset price inflation
- Feedback loop: *increased asset prices allow for further credit extension.*

Further reading: Dirk Bezemer, Groningen University.

Monetary cycle: C -> I -> S

Bank money supply: rather volatile and over-reacting.

Further reading: M. Kumhof, Bank of England

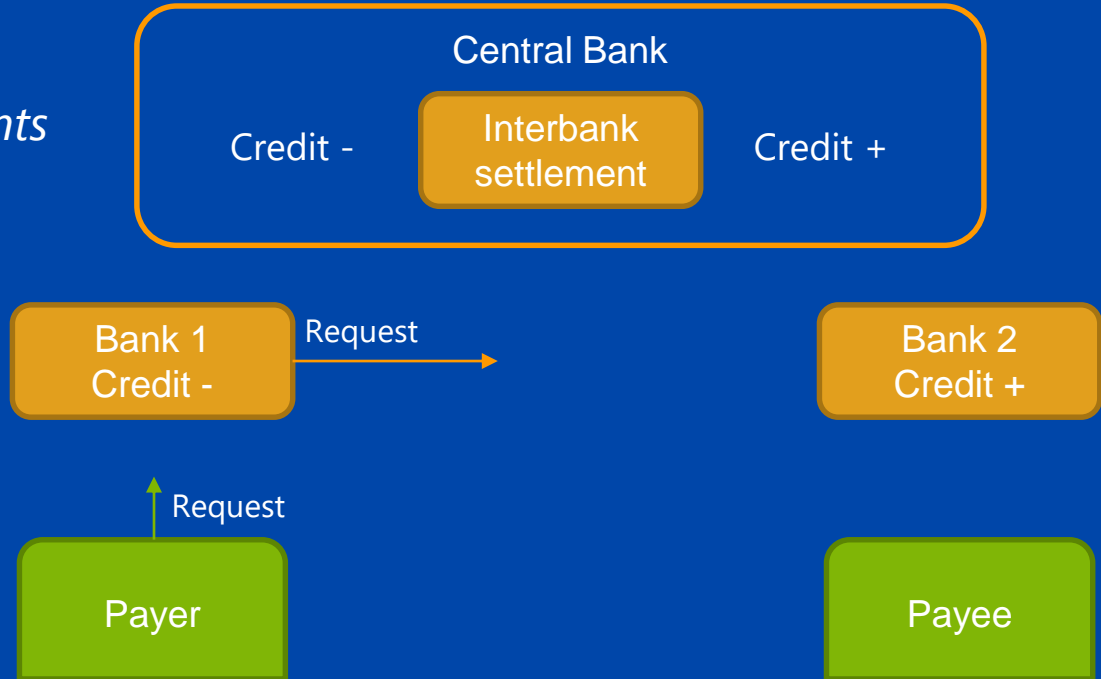
Banks Are Not Intermediaries of Loanable Funds – And Why This Matters

Payment with bank money

enabled payment over distance

*No transfer of assets
Just communication and
settlement on bank credit accounts*

*Involving bank balance sheets
and bank liabilities*



Digital Cash

- ✓ Payment by transfer of an intangible liquid asset
- ✓ Direct transfer from payer to payee
- ✓ Convenient payment over distance
- ✓ No bank balance sheet involved
- ✓ Not exposed to the risks inherent to bank money



Not backed by assets

means less risk exposure!

- Digital cash *is* money (not a *money claim*)
(Bank-runs lose monetary relevance)
- It's no bank liability (no counterparty risk)
- It's not dependent on the value of bank assets.

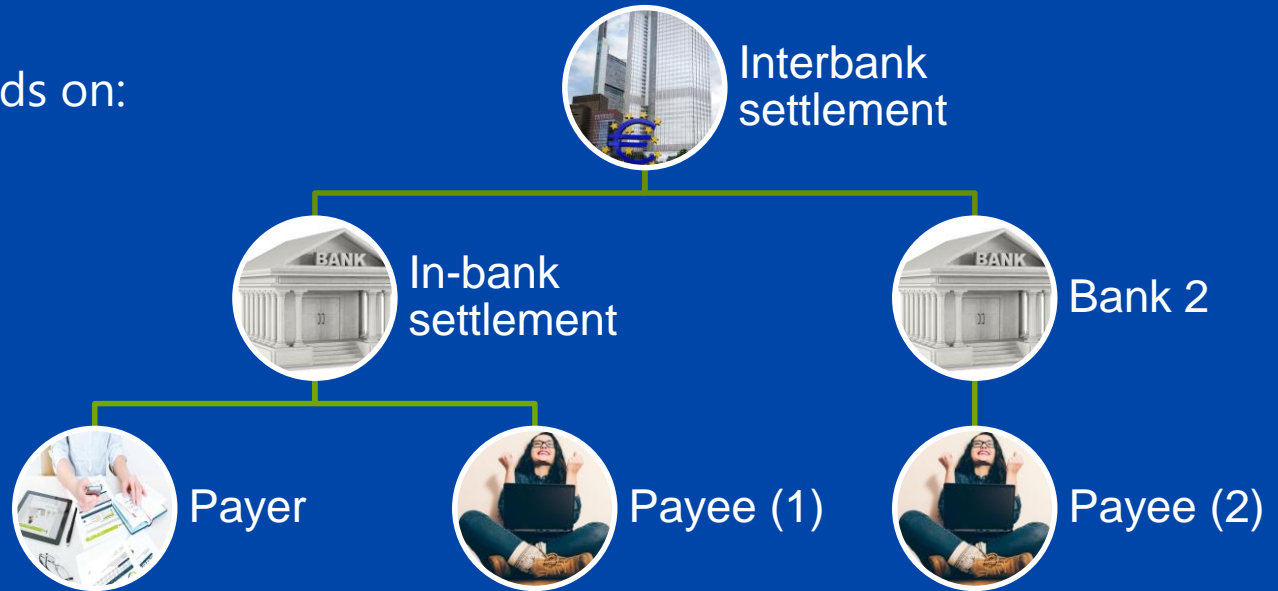
Digital cash is 'backed' by good governance of the digital cash system

Payment with bank money

No cash involved
Executed on bank balance sheets

Payment system depends on:

- Bank liquidity
- Bank solvency
- Short term lending



Digital Cash

Payment from payer to payee

- ✓ No bank balance sheet involved
- ✓ No bank liquidity involved
- ✓ No interbank settlement involved

No asset backing

- ✓ Plain fiat money
- ✓ Backed by good governance (protocol)

At least as convenient as bank money



Two actions in tandem

1. Provide state issued (digital) cash money society needs

2. Abolish all state aid to financial institutions

- ✓ State only backs money it has issued itself
- ✓ Private money (claims) not accepted for tax payments
- ✓ Interbank settlement divested from the public sphere
- ✓ Deposit guarantee schemes discontinued
- ✓ Prudential oversight reformed

Implementing proper demarcations (...) (...) of public (money) and private affairs (money lending) in the financial system,

characterized by:

1. Abolition of state support for private monies and its issuers.
 - (i) abolition of deposit guarantee schemes,
 - (ii) discontinuation / privatization of interbank settlement,
 - (iii) privatization of short term lending to financial institutions,
 - (iv) dissolution of prudential oversight in a single (non-dual) system for financial oversight
 - (v) application of regular insolvency procedures to financial institutions.
2. The EU and its Eurozone Member States, abstain from backing any monies, apart from physical and virtual Euros, that are legally issued by the EU itself, or by its Eurozone Member States.
3. Taxes are no longer payable in private monies (like bank deposits); only physical and digital Euros that are legally issued by the EU or its Eurozone Member States, are accepted for payment of taxes.
4. Public budget deficits are exclusively funded by v-EUR borrowing, on the secondary market.

“Systemic debt”

Bank money is inextricably linked to debt:

- It is a contractual money claim
- Most bank money is ‘lend’ into circulation

Systemic debt relates to the amount of bank money in the economy. Systemic debt is accompanied by a systemic debt burden, which consists of the net interest the banking system charges on the bank money in circulation.

Further reading: Wortmann, E., A proposal for radical monetary reform, Ons Geld, 2016
https://onsgeld.nu/onsgeld/2016/wortmann_radical_monetary_reform.pdf

Debt and debt burdens are a collective concern

"Indebtedness unduly limits our ability to prosper"

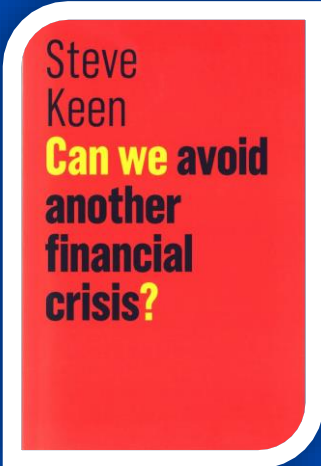
Bank money and economic stagnation

Current aggregate debt levels result in persistent stagnation.

Egmond, N.D. van, B.J.M. de Vries (2016), Monetary Reform: dynamics of a sustainable financial-economic system, Utrecht University / Sustainable Finance Lab.

Available at: <http://sustainablefinancelab.nl/files/2016/03/SFL-WP-NI-Egmond-de-Vries-May-12-2016.pdf>

Steve Keen: Can we avoid another financial crises?



Steve
Keen
**Can we avoid
another
financial
crisis?**

Ways out of stagnation

Inflation (*bank money paradigm*)

- Reducing nominal debt burdens
- Lowering default risks in society
- Fighting debt with more debt

Debt write-off

- "Jubilee"
- Mandatory cancellation of debts
- Debtors win, creditors lose

Sovereign money creation (*deleverage without a crunch*)

- Replacing bank money with sovereign money
- Repayment of bank loans
- Monetary neutral operation



Benes, J. (2012), M. Kumhof, The Chicago plan revisited. IMF Research Department Working Paper, WP12/202, IMF. Available at: <http://www.imf.org/external/pubs/ft/wp/2012/wp12202.pdf>

Kumhof, M. (2013), The Chicago Plan Revisited. Presentation. http://www.bankofengland.co.uk/research/Documents/ccbs/Workshop2013/Presentation_Kumhof.pdf

citizens' dividend



Eurozone debt problems

Solving the monetary debt problem
by issuance of virtual Euros by the EU (v-EUR).

Regarding the Eurozone, issuance of v-EUR
is the legal power of the Union (3 TFEU).

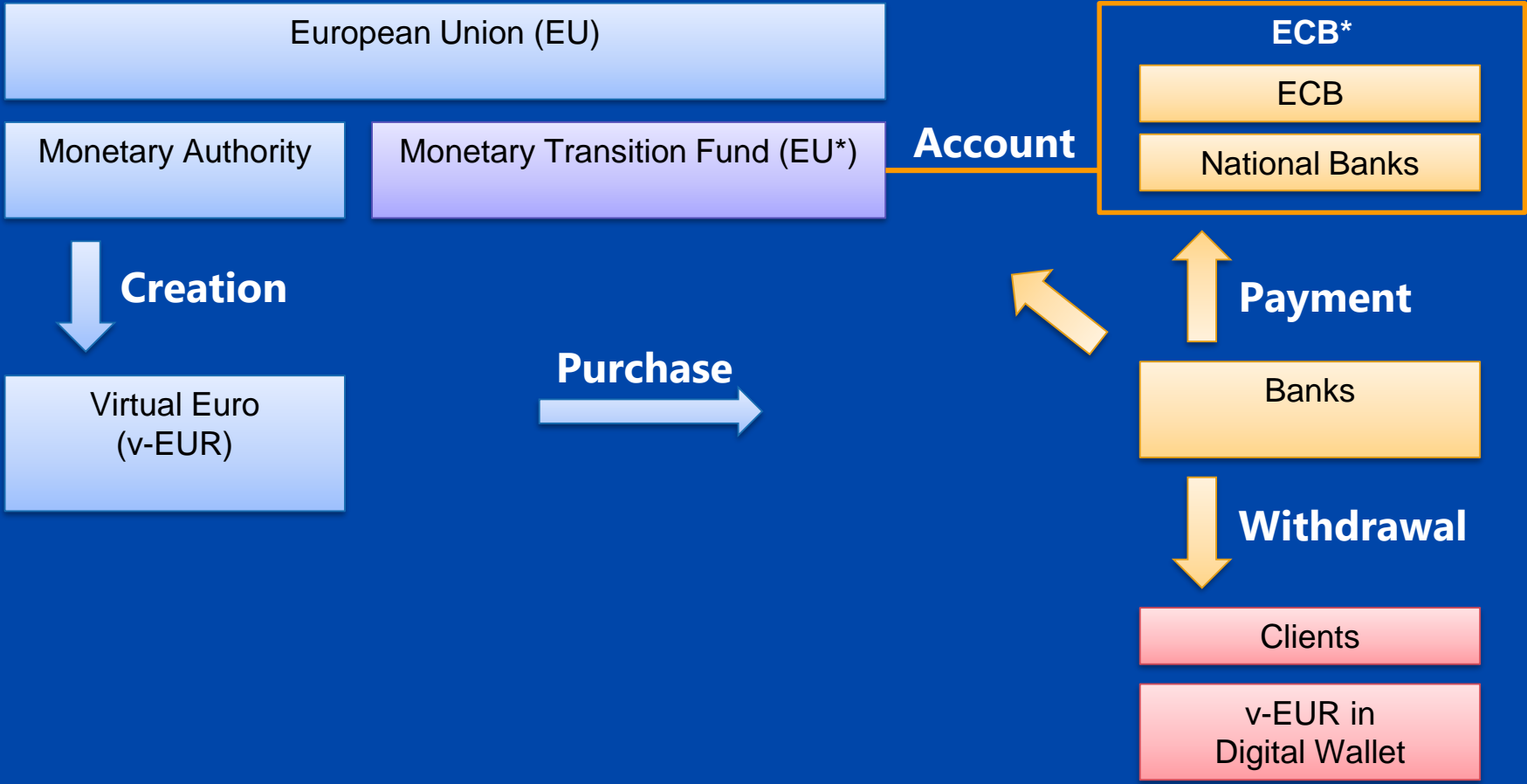
Deleverage without a crunch

v-EUR issuance for conversion of existing bank deposits

Prior to conversion

EU*		ECB*		Banks	
		Credit to Banks on collateral	Reserves	Reserves Loans	EC BC Deposits

Prior to the conversion, the Union attributes issuance of v-EUR to a separate EU-governmental power, the Monetary Authority. The Monetary Authority is not entitled to the revenue (seigniorage) derived from the conversion. This seigniorage is granted to the *Monetary Transition Fund* (EU*). Deleverage is achieved by a balanced distribution of the seigniorage derived from the conversion, among debtors and creditors, Eurozone Member States and Eurozone citizens.



Deleverage without a crunch

v-EUR issuance for conversion of existing bank deposits

Conversion (1) – Absorption of reserves

EU*		ECB*		Banks	
Deposits at ECB*	EC	Credit to Banks on collateral	Reserves EU*deposits	Reserves Loans	EC BC Deposits –

Purchase of v-EUR by banks to accommodate digital cash withdrawals.

Payment by crediting the EU* account at the ECB.

Deleverage without a crunch

v-EUR issuance for conversion of existing bank deposits

Conversion (2) - EU* credit extension

EU*		ECB		Banks	
Deposits at ECB	EC +	Credit to Banks on collateral	EU*deposits	Loans	EC BC + Deposits EU*-credit
Credit to Banks on collateral					

Purchase of v-EUR by banks to accommodate digital cash withdrawals.

Provision of v-EUR on credit by the EU.

Deleverage without a crunch

Seigniorage distributed and used to repay bank loans

Dividend distribution to Member States and citizens

Prior to dividend distribution

EU*		Member States		Banks	
Deposits at ECB*	EC	Taxes	Public debt: - to Banks - to ECB* - other	Public debt Loans to L Loans to N	EC BC EU*-credit
Credit to Banks on collateral					

L = legal persons | N = natural persons (Eurozone citizens)

Deleverage without a crunch

Seigniorage distributed and used to repay bank loans

Use of debt repayment vouchers by Member States

EU*		Member States		Banks	
Deposits at ECB* –	EC –	Taxes –	Public debt: - to Banks - to ECB* – - other	Public debt Loans to L Loans to N –	EC BC EU*-credit –

Deleverage without a crunch

Seigniorage distributed and used to repay bank loans

Use of debt repayment vouchers by citizens

EU*		Citizens		Banks	
Deposits at ECB*	EC –		EC + Bank debt –	Loans to L Loans to N –	EC BC EU*-credit –
Credit to Banks on collateral –					

Deleverage without a crunch

Creditors profit as well

Dividend for creditors

EU*		Citizens		Member States	
Deposits at ECB*	EC/shares of Member States & citizens	Shares in EU*	EC +	Taxes – Shares in EU*	Public debt: - to ECB* – - other –

A monetary neutral operation

- ✓ The money quantity has not changed
- ✓ The nature of money has changed
- ✓ Money is no longer a *contractual money claim*

It is physical and digital cash money

Further reading:

Wortmann, E., A proposal for radical monetary reform, Ons Geld, 2016
https://onsgeld.nu/onsgeld/2016/wortmann_radical_monetary_reform.pdf

Wortmann, E., Deleverage without a crunch, expected 2017.

The current 'credit pyramid'

central bank -> monetary financial institutions -> society

Sovereign money sequence

Primarily:

Monetary Authority (issuing) -> state (spending) -> society -> financial intermediaries

Supplementary:

Monetary Authority (issuing and lending) -> financial intermediaries -> society

How to determine the money supply?

Enabling society to flourish to its full potential

1. Conversion

conversion 'per demand' of monetary money claims (e.g. bank deposits)

2. Sufficient v-EUR liquidity buffers in society

to sustain decent living standards, private investments and risk coverage

3. Supplementary v-EUR issuance for real-economy investment

setting a ceiling on interest rates for real-economy investment, if necessary

New monetary management

- ✓ Bound by zero inflation policy
- ✓ Direct control of money quantity
- ✓ Real-time insight in stock, flow and allocation
- ✓ Monetary taxes / instant clearing
- ✓ Adequate liquidity-buffers throughout society
- ✓ Actively and effectively sustaining the economic flow



Policy towards interest rates

- No centrally determined 'risk free' interest rate
- Undistorted transmission of market-price signals via interest rates
- Supplementary v-EUR lending on interest, if necessary

- Central bank sets a floor for interest rates (*discontinued*)
- Monetary authority sets a ceiling, if necessary

Monetary Authority

Provides liquidity to society.
Is not involved in the business of banking.
Supervises from an independent stately position.
Monitors liquidity throughout society.
Directly supplements liquidity for real-economy investment, if needed.
Does not provide short term credit.
Is not exposed to counterparty risk.
Has no self-interest in money creation.
Administers the money system 'off-balance sheet'
Insulates the currency from market and credit risk.
Has direct control of the money supply.
Is bound by a zero-inflation policy.
Does not set a 'risk free' interest rate.
Sets a ceiling for interest rates, if desired.
Is insulated from both commercial and political interests.
Does not fund public nor private deficits.
Is part of a single system for financial oversight.
Contributes to transparency and a level playing field.
Applies regular insolvency procedures to banks.
Operates under democratic control.
Applies the power to create the general currency in the public interest.

Central bank

Provides liquidity to banks.
Is deeply involved in the business of banking.
Supervises from an actively implicated position.
Monitors liquidity of banks.
Supplements liquidity to financial institutions, potentially triggering asset price inflation.
Provides short term credit.
Is exposed to counterparty risk.
Has self-interest in money creation.
Administers a money system on its balance sheet.
Exposes the currency to market and credit risk.
Has weak and indirect influence on the money supply.
Needs inflation to implement its policies.
Sets the 'risk free' interest rate.
Sets a floor for interest rates.
Is insulated from political interests.
Does not fund public deficits.
Is part of a dual system for financial (and prudential) oversight.
Obscures and levels bank credit risks.
Applies special insolvency procedures to banks.
Operates beyond democratic control.
Applies the power to create the general currency in the interest of the banking system

Hyperinflation?

Weimar republic

Hyperinflation exploded when the state gave up all monetary control.
Hyperinflation ended quickly when the state regained control.

Zarlenga, S. (2002), *The Lost Science of Money. The Mythology of Money – the Story of Power.* American Monetary Institute (AMI).

Hyperinflation

Demand and supply intermediated by price

Bread: at a certain point demand is satisfied

Money: demand is never satisfied

Feedback-loop: as prices rise, demand for money increases.

Applying basic market principles to money -> hyperinflation



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Questions?

Wortmann, E., A proposal for radical monetary reform, Ons Geld, 2016
https://onsgeld.nu/onsgeld/2016/wortmann_radical_monetary_reform.pdf

Making the invisible hand visible and accountable

Wortmann, E., A proposal for radical monetary reform, Ons Geld, 2016
https://onsgeld.nu/onsgeld/2016/wortmann_radical_monetary_reform.pdf

Five presidents

“As the vast majority of money is bank deposits, money can only be truly single if confidence in the safety of bank deposits is the same irrespective of the Member State in which a bank operates. This requires single bank supervision, single bank resolution and single deposit insurance.”

Junker, J-C. (2015), D. Tusk, J. Dijsselbloem, M. Draghi, M. Schulz, Completing Europe's Economic and Monetary Union, European Commission.

The five presidents do not want us to consider the true value of a money claim on a bank. They use government power to obscure and level credit risks, thereby distorting competition, implying moral hazard and burdening society with private risk taking. They don't solve the problem with our money system, they create it.

