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Global Currency Reform: A Proposal

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Bernard Lietaer (2017) makes a new contribution to the literature on international monetary reform with a proposal for a global currency valued against a commodity basket and subject to demurrage. The proposal is novel in particular because the currency would be private and self-financing, and would operate in parallel with conventional currencies; its impact would depend on how far demand would be diverted from conventional currencies. Lietaer adds to a long tradition of searching for a truly global currency to replace systems which created the problems to which this proposal is designed as a solution: monetary instability and financial instability. By including demurrage on the new currency, the proposal follows in the tradition of identifying the payment of interest on loaned money as a source of instability and usurious, as well as violating Sharīʿah law. In addition, the need for a stable international standard of value has been a recurring theme in discussions of international monetary reform.

Based on my understanding from a reading of Lietaer (2017), his proposal for a new global currency will be discussed here in relation to earlier ideas for monetary reform, focusing on Keynes's monetary theory, his views on interest rates and his proposals for international monetary reform. There is a remarkable parallel between current discussions of monetary reform and those of the 1930s. An important source was Silvio Gesell ([1916]1929), who had developed a critique of interest as diverting income to the financial sector while holding back consumption demand, thus creating unemployment as a long-term, rather than just a cyclical, phenomenon. The level of interest was determined by forces in financial markets rather than the need for loanable funds to finance investment. Gesell's proposal for a state-issued money, with demurrage to discourage hoarding, drew considerable attention and inspired a number of local experiments. Keynes (1936, pp. 353-358) drew particular attention to Gesell, showing appreciation for his analysis of interest; Keynes too was concerned that a monetary rate of interest would be kept at too high a level for full employment.

It is instructive in considering the Lietaer proposal to reflect on the reasons behind Keynes's ultimate rejection of the demurrage solution as a practical proposition. The first was that demand for money arises not just from the need for a unit of account and means of payment, but also for a store of value. While Lietaer proposes his new currency as only serving as unit of account and means of payment, Keynes's argument was that society needs money also to be a store of value. Given the universality of uncertainty, a monetary production economy can only function with a basis for contracts and for payments which holds its value, particularly at times of high uncertainty as to the value of other assets. At such times, the demand for money (or more generally liquidity) is high – hoarding serves a reasonable purpose even though it creates the social problem of

unemployment. A negative interest rate is designed to discourage such hoarding, keeping money in circulation, but the power of uncertainty can be strong enough to produce unstable demand for money even with a negative interest rate.

In any case, as Keynes pointed out, the financial sector is sufficiently innovative to create alternative assets which perform the functions of money (including being held as a store of value) without a negative interest rate. The current proposal is already for a parallel currency so competition with conventional currencies would be an issue from the start. Indeed an experiment in Gesellian money in 1935, in a Canadian province rather than just a local community, foundered because the population preferred to hold conventional money (Dow, 2016). But even if the new money were attractive as an asset to hold, constraints on its flow at times of high demand for money to hold would encourage recourse to alternative forms of money generated by (interest-bearing) credit. In Gesell's system, the supply of new money would be determined by the fiscal expenditure through which it would enter the economy. In the Lietaer system, supply would be determined by trade flows and the preference to acquire, use and not cash-in the Trade Reference Currency (TRC).

In an international context, gold and silver did succeed in providing a standard of value independent of any national economy, at least until the early years of the twentieth century. But by the 1930s, the system had ceased to provide an equilibrating mechanism as central banks attempted to hoard gold in order to limit any need to deflate to address a deficit. But given differential power in capital markets, some central banks were more able to hoard than others. So other central banks found themselves having to set interest rates at levels required to maintain the gold-value of their currencies, but which were too high for domestic purposes. Discussions of international monetary reform centered around finding an alternative stable international money which was not subject to the vagaries of gold-mining conditions relative to the desire to hoard on the one hand and the greater power of some countries to attract capital inflows on the other.

The result was the dollar-gold standard of the 1944, the Bretton Woods system which operated until 1971 when the US suspended dollar convertibility into gold, leading to generalized floating exchange rates. The Bretton Woods system, operated by the International Monetary Fund (IMF), was based on the US plan rather than Keynes's (1942) plan for an International Currency Union. Keynes had proposed a stand-alone international currency, the bancor, in which all international transactions, routed through central banks, would be denominated. There would be provision for bancor to be lent to countries experiencing balance of payments deficits. In this context, Keynes proposed a form of demurrage: not only would interest be charged on debit balances, but it would also be charged on credit balances. The target was countries able and willing to promote payments surpluses to protect their domestic economies. But, while the system of international payments in the 1940s was closed, operating only through central banks, the situation has changed dramatically. Now the Keynes plan would be subject to Keynes's own critique of Gesell: central banks can no longer exercise control over capital flows and there are alternative forms of international liquidity which do not attract interest charges. The demand to hoard international liquidity is at the same time enhanced by the instability of the international monetary non-system.

Although the Bretton Woods system in many ways created a stable environment for international payments for many decades, it was fundamentally flawed. The so-called Triffin problem was that demand for dollar reserves created massive capital inflows into the US which required a US current account deficit to balance them. Yet such a deficit from time to time raised serious doubts about the value of the dollar, encouraging outflows. The result was a marked imbalance in international payments between the US and the rest of the world. Imbalances are not a problem in themselves. It is customary for newly developing economies (such as the US in its pioneering era) to finance necessary imports of manufactured goods by attracting capital inflows for direct investment. In the 1970s, the recycling of petrodollars as financing for oil-importing economies was a case of sustainable imbalance. But when the financing becomes particularly uncertain, such imbalances do become a problem. In recent decades, significant imbalances have arisen which may not be sustainable, e.g., capital inflows from China into the US at a time when the balance of power over international capital flows and national currencies is shifting.

These problems stem from the international currency being the liability of one country. This creates the 'n-1' problem that of n international economies, the nth reserve-currency country is the only one not obliged to adjust to payments imbalances. In 1969, the IMF sought to provide additional global liquidity in a form which did not depend upon any one national economy: Special Drawing Rights (SDRs). They were restricted to use in official international transactions, but it was always possible for the private sector or other international organizations to denominate transactions (such as bond issues) in SDR. As with the Lietaer proposal, SDR were designed to operate in parallel to other currencies (especially the dollar). They are valued as a weighted basket of leading currencies in an effort to have a more stable value than any one currency, just as the TRC is valued in terms of a basket of commodities. But it has to be admitted that the SDR has not been as widely accepted as a unit of account as many had hoped, something which is relevant to consideration of the Lietaer proposal.

When the Bretton Woods system broke down in 1971, replaced by the current non-system, the resulting currency instability was compounded by a general process of deregulation of finance which led ultimately to the banking crisis of 2008. The dollar has continued to act as the dominant international money; its attraction as a store of value has attracted continuing capital inflows, sustaining its value. There have been periods of dollar crisis (given the Triffin problem) which have encouraged proposals for a new, truly international, currency. But IMF reform requires such a long bureaucratic process that the dollar has always revived before any progress has been made.

Some of the proposals for alternative global currencies have, like the present one, been valued in terms of commodity baskets (see e.g., Cowen & Kroszner, 1994). The present proposal is less ambitious and therefore more feasible than most other proposals since it is intended to be self-funded, organized by the private sector TRC Alliance, and the TRC is intended to operate in parallel with national currencies. It also incorporates an inventory stabilization mechanism which in turn should stabilize commodity prices, with beneficial effects on the cycle in real economic activity; Keynes (1938) too had proposed a buffer stock scheme to stabilize commodity markets. The TRC could well be an attractive basis for trade-related transactions. Against the cost of demurrage would need to be set the cost of hedging against unpredictable movements in conventional currencies, and the TRC could act as a substitute for (interest-bearing) trade credit.

But the proposal has bigger aims, which require us to consider, not just trade but also capital flows. Keynes (1936, ch. 17, pp. 222-244) suggested that the expected yield of any asset consists of its expected return, plus liquidity premium, minus carrying cost. Conventional money dominates alternative assets when expected returns are low or highly uncertain because its liquidity premium is so high. A carrying cost tips the balance to other assets. But so does confident expectation of returns on alternative assets, as long as they are reasonably liquid. This explains the attraction of the dollar: a liquid international money expected to hold its value, or even better to appreciate in value. (A problem for a currency basket valuation, as with the SDR, is that some currencies necessarily perform better than the average.)

Other things being equal, it is capital flows which determine the value of national currencies, and yet it is not clear what their place is in the proposed system. A significant proportion of international flows occur within the financial sector itself, without reference to the real sector. Indeed, it is capital flows which have created international financial instability, so it is important to explain how the TRC would achieve sufficient liquidity relative to the demurrage to be appealing for financial transactions. Therefore, since the current proposal is put forward as moderating the business cycle, taming financial instability and encouraging long-termism, it would be good to see much more detail on how these admirable goals would be achieved, in particular with much more discussion of the implications of the proposal for the financial sector and international capital flows.

It is one of the appeals of the Lietaer proposal that it is for a stand-alone, self-financing system which gets round the tortuous process of inter-governmental negotiations. But the wider problems of financial and monetary instability arguably require other solutions involving public sector intervention. However stable the TRC, it is not clear how it would compete with alternatives which are highly liquid and without charges. Even a valuation based on a commodity basket may depreciate during a recession. Further, it

is not clear how the supply of liquidity within the TRC system can satisfy the needs of international financial markets. For Keynes, the answer lay in an international monetary system based on a centrally-administered international currency, which allowed governments to pursue domestic objectives, and for these objectives to be met by monetary policy focused on a low and stable interest rate and institutions designed to promote stable real investment. For him it was the duty of the central bank to ensure that domestic money, created by means of bank credit, would be sound as a result of a combination of bank regulation and bank liquidity support. Ultimately, in the long run, he foresaw interest rates falling so low as to lead to the 'euthanasia of the rentier' (Keynes, 1930).

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