

Reform Proposals in the Monetary System for Attaining Global Economic Stability

Mark Joób

*Professor at the West Hungarian University, Faculty of Economics and
Researcher at the Institute for Business Ethics, University of St. Gallen, Switzerland*

In this article, I will first scrutinize Bernard Lietaer's Trade Reference Currency (TRC) concept by placing it in the context of the existing monetary system and evaluating its operational features. Then I will describe some features that are not included in the TRC concept but, in my opinion, are essential to an international monetary system that effectively promotes global economic stability.

To tell it in advance: In my view, the TRC concept has some severe shortcomings and therefore, it cannot offer a convincing way to significantly contribute to global economic stability. The list of shortcomings begins with a mistaken analysis of the current monetary system and includes problematic operational features of the TRC. In the following sections, however, I will also point to the strengths of the TRC concept.

1. The Lesson to Be Learned From the Current Monetary System

Justifying the need for a global currency, Lietaer identifies a "monetary monoculture" as the main structural cause for the lack of economic stability. Consequently, Lietaer demands a "diversification of the types of currency in circulation and the types of agents that issue them" (Lietaer, 2017, p. 48). But there is certainly no monetary monoculture at the global level. On the contrary, we find a multitude of

approximately 200 official currencies with quite different properties: the US dollar as a global lead currency, the Swiss franc as a safe harbor currency, the euro with a large currency zone, the South African rand as a very volatile currency, the Hungarian forint as a very small currency and so forth⁽¹⁾. In addition to these currencies, there is an international reserve asset named special drawing rights (SDRs) created by the International Monetary Fund (IMF) since 1969. The SDR is based on a basket of four key currencies (US dollar, euro, yen and pound) and represents a right to obtain foreign exchange from other IMF members (IMF, 2010, p. 20). As an international complementary reserve asset and unit of account, the SDR is a near-currency with the potential to become a global currency in the foreseeable future. So, on the global level we already have a huge diversity of currencies which means that the identification of a global monetary monoculture by Lietaer as the cause for the existing global economic instability must be wrong.

Furthermore, if we take a closer look at the monetary system that we find worldwide within individual

(1) See the "Current currency & funds code list" from the Swiss Association for Standardization, published 1 Jan. 2017: <https://www.currency-iso.org/en/home/tables/table-a1.html> [retrieved 2017-04-03].

countries, then we realize that even at the national level there is a certain degree of monetary diversity both with regard to the types of currency in circulation and with regard to the types of agents that issue them. Today, two different kinds of money are in circulation: legal tender (i.e. cash and central bank reserves) and electronic money substitutes (i.e. commercial bank deposits). Legal tender is issued by the central bank whereas electronic money substitutes – that amount for over 90 percent of the money supply in developed countries – are created by different, for the most part privately owned, commercial banks (McLeay, Radia, & Thomas, 2014; Werner, 2014). Under normal circumstances, the money substitutes of commercial banks are handled equally to legal tender and therefore, two types of money appear to constitute a single currency. But from a legal point of view, each commercial bank issues its own private currency when creating deposits. In times of crisis, if the issuer faces liquidity and solvency problems, the exchange rate of such a private currency may be lower than the rate of the legal tender it refers to. This results in losses on deposits for bank customers, as was the case in 2013 in Cyprus, for example. So, even on the national level of individual countries there is no monetary monoculture.

This fact clearly shows that Lietaer's analysis of the current monetary system is mistaken. Rather the opposite of what Lietaer claims is true. We have empirical evidence indicating that the commercial banks' non-coordinated money creation is the main cause for the heavy fluctuations of the business cycle with their destabilizing effects on the economy (Jakab & Kumhof 2014; Yamaguchi, 2014). So, in reality, it is not some kind of monetary monopoly but the lack of coordination between the different money-creating agents that leads to economic instability. And from this corrected analysis follows that the most promising way to attain economic stability is instead of further monetary diversification we need monetary coordination. That is to say, a monetary system with central authorities both at the national and the international level which are in the position to effectively control and coordinate the money supply. I will return to this demand in the closing part of my article.

2. The Three Main Strengths of the TRC Concept

Among the operational features of Lietaer's TRC concept, I see three main strengths: (a) voluntary collaboration, (b) smoothing of the business cycle and (c) debt-free currency issuance.

(a) The TRC is designed as a complementary currency based on voluntary collaboration between economic actors both regarding the membership of the TRC Alliance and regarding the acceptance of the TRC as a means of payment. This feature greatly contributes to the general feasibility of the TRC system since it can be introduced without the necessity of establishing a new international monetary framework which would require international political negotiations that are lengthy and have uncertain outcomes. The structure of the TRC as standardized international barter provides a well-known and reliable legal basis for its operation and confirms its foundation on voluntary collaboration.

(b) Another strength of the TRC concept is the mechanism of smoothing the business cycle. To transform excess inventories of commodities that are rather illiquid assets into TRC money as more liquid and faster circulating assets in times of economic downturn. This would probably have a stimulating effect on the economy and result in a shorter downturn than otherwise would be the case. In boom periods, on the other hand, large TRC amounts would probably be cashed in because the TRC users would like to profit from a high TRC exchange rate towards other currencies resulting from high commodity prices that are typical for boom periods. This profit-seeking behavior of TRC users would lead to a reduction of liquid TRC money and dampen economic activity making the boom cycle less extreme.

(c) Debt-free currency issuance is a feature of the TRC which provides fundamental economic benefits as well as intercultural applicability of the TRC system. In the case of the TRC, debt-free currency issuance means that in contrast to conventional currencies TRC money is not created as debt but as assets of the first user (a TRC Alliance member) while it still represents a debt of the TRC Alliance towards the TRC users who may cash-in their TRC

amounts at any time. Debt-free money creation reduces indebtedness, in general, making economic actors more resistant against bankruptcy and thus greatly promoting economic stability. A further effect of debt-free money creation is that money originally does not carry interest, which alleviates the problem of exponential growth of monetary assets with its negative impact on human and natural resources (Joób, 2015, pp. 7-8). Finally, since the TRC embodies originally interest-free money, the TRC system itself seems to conform to the requirements of Islamic finance with regard to the prohibition of *ribā* (el-Gamal, 2006). This broadens the cultural and geographical sphere of the applicability of the TRC system so as to include the Islamic world.

3. The Three Main Weaknesses of the TRC Concept

In parallel with the three main strengths described above, I see three main weaknesses among the operational features of the TRC concept: (a) the structure of the TRC basket, (b) demurrage fees and (c) the scope of the TRC.

(a) The structure of the TRC basket is subject to unforeseeable and potentially huge changes, which increases the volatility of the TRC. The reason is that the TRC is backed by a physical inventory which the

TRC Alliance members fill up by selling the commodities they have in excess to the Alliance in order to receive TRC money. Since the TRC Alliance members, apparently, are free to decide whether they want to sell any commodities to the Alliance, and if so, which commodities that are eligible for the TRC basket they want sell, the structure of the TRC basket highly depends on the discretion of the Alliance members. In part, the structure of the TRC basket also depends on the decisions of the last users of the TRC because they can choose to convert their TRC amounts to either a conventional currency or a volume of commodities from the TRC basket. There would be a high risk – especially if the TRC would not become popular enough on a global scale – that the desired balance between the components of the TRC basket could not even arise or could break due to changes in the structure of the basket. This could lead to large fluctuations in the TRC exchange rate and undermine the function of the TRC as a stable standard of value turning it into a rather speculative asset. If, for example, crude oil had strong predominance in the TRC basket, then the TRC exchange rate would be nearly as volatile as the oil price which has been subject to extreme fluctuations in the past years, as shown in Figure 1.

Figure (1) Crude Oil Price (2000-2017)⁽²⁾



(2) Source: <http://www.infomine.com/investment/metal-prices/crude-oil/all/> [retrieved: 2017-04-04]

In my view, only a basket with a fixed structure can provide a stable backing for a currency. Consequently, the TRC should be linked to a fixed virtual basket of reference commodities instead of a changing physical inventory.

(b) Demurrage fees make it costly to use the TRC as a means of payment. This would most probably deter many economic actors from accepting TRC money or at least induce them to anticipate the expected demurrage fees (and the cash-in fee), which at the end of the day would result in the TRC exchange rate being lower than the effective value of the TRC backing inventory. The fact that holding TRC money imposes costs stands in contradiction to Lietaer's aim of providing an "inflation-resistant" standard of value because demurrage fees are equivalent to a negative interest rate that in practice would exert pressure on the TRC to lose value towards conventional currencies with positive interest rates. Furthermore, it is very unlikely that demurrage fees would produce the main benefit Lietaer attributes to them, namely, the realignment of financial interests with social long-term concerns. As long as conventional currencies remain the primary means of payment, economic actors will conduct their discounted cash flow valuations using conventional currencies and not the TRC. Demurrage fees could be a circulation incentive, as Lietaer claims, once the TRC system would work at a large scale but, in my opinion, they would much more act as a deterrent from using the TRC at all and prevent the TRC from becoming a globally significant currency. In the TRC system demurrage fees are necessary to cover the storage costs of the physical inventory of commodities, therefore, these fees cannot be abolished without replacing the physical inventory by a virtual basket of commodities.

(c) The scope of the TRC is strongly limited by the fact that only commodity producers and other economic actors which are physically in possession of commodities can generate the creation of new TRC money if their commodities are qualified for the TRC basket and they want to sell a certain volume of these commodities to the TRC Alliance in exchange for TRC money. This is an even stronger restriction on money creation than the restriction that would be imposed by applying a gold bullion standard since in the monetary system

of the gold bullion standard there is a central bank which is in charge of providing the economy with an adequate amount of money and of buying the necessary volume of gold that is needed for the backing of the currency. Besides having the benefit of contributing to the feasibility of the TRC, the voluntary nature of collaboration within the TRC system also represents an obstacle to a foreseeable and reliable money creation process because the TRC system lacks a central authority that would be in the position to control the TRC money supply according to fixed rules and to guarantee that a certain amount of TRC money is in circulation. In lack of such an authority, TRC money creation fully depends on the non-coordinated behavior of the TRC Alliance members and TRC money destruction fully depends on the non-coordinated behavior of the TRC users, which in practice would permanently threaten the TRC system to run out of money and to be shut down.

4. How to Reform the International Monetary System

The evaluation of Lietaer's TRC concept that I have conducted above clearly shows that the TRC has severe shortcomings regarding its foundation in the context of the present monetary system and with regard to its operational features. Therefore it does not provide a convincing solution to the problem of global economic instability. In the following, I will shortly describe four features that are not included in the TRC concept but, in my opinion, are essential to an international monetary system that can effectively contribute to attaining global economic stability.

- As I have deduced in the first part of this article: To end the heavy fluctuations of the business cycle with their destabilizing effects on the economy, we need monetary coordination, that is, a monetary system with central authorities both on the national and the international level which are in the position to effectively control and coordinate the money supply. Centralizing money creation and placing it in charge of central banks which pursue the long-term goal of steady and sustainable economic development instead of short-term profit-seeking that is typical of commercial banks. This is a main feature of the sovereign money system

which has been elaborated for reforming existing currencies but can provide inspiration for how to reform the international monetary system too (Huber, 2017). Besides promoting socially desirable long-term goals, establishing a global central bank would also enhance transparency of global finance and have the following benefit identified by the IMF: “The global central bank could serve as a lender of last resort, providing needed systemic liquidity in the event of adverse shocks and more automatically than at present.” (IMF, 2010, p. 28)

- In the last years, countries have rapidly increased their foreign exchange reserves, mostly as a tool for influencing exchange rates and as an insurance against international financial imbalances and shocks (IMF, 2010). These reserves are held in assets denominated in the international key currencies, mainly in US dollar. Because of the high demand for US dollar reserves, the US benefits from an almost unlimited possibility of increasing its foreign debts and thus from being financed by the rest of the world to a considerable degree. But countries with US dollar reserves have to carry the burden of their reserves’ value depending on US fiscal and monetary policies. Furthermore, holding reserves for the purpose of financial stability means that these reserves are trapped, which leads to a huge lack in effective demand in the world economy (Klaffenböck, 2008). To overcome these flaws, it is imperative to introduce a genuinely global currency that is independent from individual economies and issued by a global central bank. Simultaneously, measures have to be taken in order to establish this global currency as the sole currency for international trade and reserve holding. It is of pre-eminent importance that the costs and benefits of the global currency are distributed according to the principles of social justice among the world’s countries (Robertson, 2012, pp. 145-146).

- In his proposal for establishing an international monetary system after World War II, John Maynard Keynes provides a good description of how the supply of a global currency should be managed: “We need a quantum of international currency,

which is neither determined in an unpredictable and irrelevant manner as, for example, by the technical progress of the gold industry, nor subject to large variations depending on the gold reserve policies of individual countries; but is governed by the actual current requirements of world commerce, and is also capable of deliberate expansion and contraction to offset deflationary and inflationary tendencies in effective demand.” (Keynes, 1980, p. 168) This is exactly what we need today. A global currency can exert a stabilizing effect on the global economy only under the condition that the money supply is in-line with the growth potential of the economy. To reach this goal, it is necessary to introduce binding rules for money creation. Adapting the money supply to economic growth is also a central feature of the sovereign money system (Huber, 2017).

- International current account balances play a crucial role with regard to the stability of the world economy. Global imbalances in current accounts greatly contribute to the accumulation of foreign exchange reserves and regularly lead to financial shocks and crises. A working paper of the Bank for International Settlements (BIS) underlines that current account imbalances threaten financial stability in debtor as well as in creditor countries and formulates the demand of a symmetrical adjustment of deficits and surpluses (Turner, 2013). This demand too was already made by Keynes since the aim of the International Clearing Union he wanted to establish was to eliminate current account imbalances by using a global currency as a kind of buffer (Keynes, 1980). Unfortunately, in the last decades no progress has been achieved in limiting or correcting external imbalances and, accordingly, the BIS working paper I just mentioned concludes that this “remains an important but unresolved issue of international monetary reform.” (Turner, 2013, p. 10)

We will not be able to attain global economic stability by establishing an international monetary system that includes the described essential features unless the large majority of the world’s countries are willing to cooperate on the grounds of mutual respect and common principles of social justice.

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Mark Joób is Honorary Professor at the Faculty of Economics, University of Sopron (Hungary) and conducts research at the Institute of Business Ethics, University of St. Gallen (Switzerland). He holds a Ph.D. in Political Philosophy from the University of Zurich. From 2003 to 2006 he was awarded a fellowship in the international research network “Applied Global Justice” of the European Union at the Institute for Legal Philosophy and Sociology of Law, University of Graz (Austria). His research focuses on business ethics and monetary theory. He is a member of the board of editors of the Hungarian *Journal of Economy & Society*. He is a member of the managing committee of the Swiss *Association for Monetary Modernization* and co-author of the Swiss Sovereign Money Initiative that aims at reforming the monetary system in Switzerland by a national plebiscite.

E-mail: mark@joob.org