“No banks no crisis”

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Abstract

The USA narrowly escaped state bankruptcy in January 2013. Cyprus is on the verge of bankruptcy and many other European states require the extension of public sector loans or debt rescheduling to sustain the confidence they enjoy in the money and capital markets. Politics is reacting in a Pavlov-reflex manner by further tightening the knot on the regulation of credit institutes and is already debating Basel IV – a long-known separation of loan and deposit businesses by banks. It is becoming clearer in the process that an ever-stricter and thus more bureaucratic and transaction-cost-generating process of regulating banks is quickly reaching its limits. The system of money and capital markets is, therefore, questioned by scientists while alternatives are being sought. Alternatives can be free banking, regional currencies, bartering systems or Irving Fischer's 100 percent money. This article shows us these alternatives and the opportunities in the future.

Keywords: money, banks, capital markets, credit institutes.
JEL Classification: G21.

Introduction

"Entitlement to the sheep does not boost the number of the sheep" (Joseph Alois Schumpeter).

The USA narrowly escaped state bankruptcy in January 2013. Cyprus is on the verge of bankruptcy and many other European states require the extension of public sector loans or debt rescheduling to sustain the confidence they enjoy in the money and capital markets. At the moment though, faith in the ratings that are supposed to express this confidence in the form of valid assessment of the solvency status of debtors, is dwindling. The USA is even instituting legal actions against Standard & Poor's because it was apparently unable to foresee the crisis in some states in good time.

Politics is reacting in a Pavlov-reflex manner by further tightening the knot on the regulation of credit institutes and is already debating Basel IV – a long-known separation of loan and deposit businesses by banks. It is becoming clearer in the process that an ever-stricter and thus more bureaucratic and transaction-cost-generating process of regulating banks is quickly reaching its limits[1]. The system of money and capital markets is therefore questioned by scientists while alternatives are being sought. Long-known and new alternatives that may be capable of replacing the current monetary system are presently being debated in politics and science at multiple instances[2].

1. Fiat money in discussion

In the process, the point of origin of this re-discovered debate in a world without (traditional) money is the criticism of the policy of monopolist cash generation by central banks without gold or commodity coverage, multiplicative loan-approval by banks on the basis of their own capital instead of the limitation of credit issuance on the savings deposit of the customer and finally, the criticism of growing disintermediation in investment banking, which renders the control of money by central instances impossible through derivative instruments. The term "Fiat money system" has thus begun to appear more often in written sources and has already been consolidated in Macroeconomics textbooks in Anglo-Saxon countries. "Fiat" is Latin for "being or emergence" and depicts that money in the current loan-money businesses may simply emerge from nowhere and not require the need for saving or value coverage of the money created by the central bank and issued by the banks[3].

The debate about alternatives to a fiat money system is mostly rooted in the so-called Austrian school[4]. This liberal school that was essentially formed by Ludwig von Mises and Freidich August von Hayek is founded on the premise of the fundamental failure of central planning systems and this means in effect that even a central bank is also never in a position to detect, monitor or even control changes in the demand and supply of money[5].

2. Back to history

Looking into history in the current debate, references are repeatedly made to the year 1844, in which the so-called Peel's Banking Act[6] was passed in England and named after the Prime Minister of the time Robert Peel (1788-1850). Following numerous banking and financial crises that are definitely comparable to today's situation, there was no more appetite to

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[1] Arestis (2006), Binswanger (2012 13 ff).

[2] There are two different discussions in the banking world. Once to chance the whole financial system and other to add the current system with complementary money currencies. We want to discuss the second approach. An overview about the systemcritics are in www.zfsö.de and www.ijccr.net.

[3] The discussion of fiat money was foundet from Silvio Gesell in 1916 and further developed from Selgin George, vgl. Selgin (1988).

[4] Faber, Berlin (1979), Gloria-Palermo (1999).

[5] Vgl. Hayek (2012), Mises (1924, 2005, engl. 2013); www.hayek.de; www.mises.org

[6] Bank Charter Act, 1844, Bank of England Archive. Retrieved 2010-10-27.

accept that banks had granted loans in excess of their own deposits in money and gold and the savings of their customers and that a huge amount of the so-called "fiat money" emerged. This multiplier effect that was limited to 12.5-fold of the liability equity capital in Basel II and was subjected to a further limitation of the assignment of equity capital in banks in Basel III, was – at the time – virtually set to 1. Only as much money was loaned as was (in reverse) covered by depositors or the bank itself.

Much like those engaged in the debate today, protagonists at the time, based their arguments on the much older facts of the Spanish schoolman and subsequent Roman legal philosophy which refused to accept the multiplication of savings deposits in loans and thereby, the Floor Balance theory. The law however, had a crucial weaving flaw. Loans at the time, were still granted largely through the issuance of bank notes on which the law was based. The banks, therefore, shifted their activities from the regulated issuance of bank notes to the certification of sight deposits which at that time, were not yet customary. The politics of the time was able to integrate sight deposits into the concept and definition of money supply only in 1870 as the so-called Gold standard was introduced, which after all, permitted the right of exchange at all times, for all notes and sight deposits. The gold-based currency system that was adopted by some states in Bretton Woods in 1944 was to advance this philosophy. The abolition of the gold-coverage of the dollar in 1931 and the Bretton Woods system in 1971 is now history.

The fact however that financial crises have become frequent ever since, may be a coincidence or a result of uncovered monetary systems. How then could it have happened that there is an estimated 50 times more money available and in circulation today since the seventies than would be required for the exchange function of commodities and services in accordance with the yet predominant Fisher Transaction Equation? According to this equation, every central bank should generate only as much money M at a fixed circulatory velocity V as is required for transaction purposes T at current price level P ($M \times P = P \times T$). One possible reason is that precisely these central banks do not want to admit that the circulatory velocity of money has meantime, become hardly calculable and many payment transactions today are made through alternative Internet pay systems (see Bitcoin, PayPal, Bonus miles, Customer Cards) and are therefore no longer controllable.

The fact that the volume of transactions for production and above all, for services in a global and interconnected world is hardly still calculable may equally be one reason for the failure of the value creation-related control of money supply. It therefore becomes compelling to ask the system question if money can still be centrally controlled in any way, or if a liberal market approach should not rather be followed, in which case, the issue can be made free-for-all to allow market participants decide for themselves on which means and systems are more trustworthy for making payments. In written sources, "Free Banking" is used in this context as the magic phrase and would be the opposite of "Central Banking". Precisely in this Free Banking system, "Money production" would be left to the market and it could be assumed that market participants trusted only such systems as for instance, promise a 100% coverage through real values (gold, material assets). Confidence would also be shown in non-governmental institutions whether or not their mere sizes (e.g. Google, eBay, payback) are known and are obligated by virtue of their reputation not to operate in real money but in real swap options (for example bartering). It can be further assumed that market participants rather trusted regional currencies (compare Chiemgauer, Donauthaler)[1], for which issuance would be comprehensible or visible on-the-spot. The Free Economy School of Silvio Gesell (1892-1930) which suggests index-secured depreciative money goes even further than the Austrian school[2], which basically, only calls for free market economy and seeks to leave cash-generation to market forces.

Given the well-known statement made by him that everything else except money, rusts and is subject to wears and tears, it is concluded that the hoarding of money is prevented through "Demurrage" in the sense of charges placed on shipping vessels for anchoring in harbours. Wear fee would be virtually equivalent to negative interests and would continuously devalue money in a systematic manner in such a way that money owners would have an interest in circulation and thereby, consumption and investment. Such depreciative money has always had its place in existing monetary systems only when the countries were hit by such financial crises as threatened basic existence. Such depreciative money (for example Corn Giros) existed already in ancient times and in Egypt of the 1st century before Christ and there are several examples known from regions of the middle age, in which economic cycles were financed with money which systematically lost value year-in, year-out.

3. The Austrian experience

The well-known "Miracle of Wörgl" during the Second World War went down in history as a testi-

[1] Detaillled descriptions and overview of "Local Money" in: Bernard (2002). Based on: http://www.complementarycurrency.org/ccDatabase/les_public.html.

[2] A differenciation from the Austiran to the Chicago school shows vergy good: Skousen (Washington, 2005).

mony to the fact that the depreciative money, which was accepted by all members of the community led to a boom in this community in a region that otherwise, was enduring a dire period of economic recession[1]. Had the Austrian government not stopped the experiment in 1933 at the prompting of the Austrian National Bank and banned the Wörgl-Shillings, we would today, have been richer by one more experience in alternative currency system in the form of depreciative money in modern age.

The findings would probably have been that growth in an economy is not only possible through interest-based borrowing and the hope of future debt repayment but also through limited money flow and real covered notes and sight deposits and may even lead to (real) welfare.

In any case, with alternative monetary and currency systems at the heart of the debate, it can be ascertained that the classical functions of money namely value protection and the exchange and payment function are losing significance. Local Exchange Trading Systems (LETS) and Time Banks, Regional Monetary Systems and Bartering, technical forms of payment such as Bitcoins[2] are already real. Other far-reaching models of the free banking system will however require political majorities. To understand the alternatives to the current monetary system, we will specify below, the main features of the most popular five alternatives.

4. Five alternatives for money

4.1. LETS and time banks. LETS are economic cycles on non-monetary basis. Michael Lintons, who introduced (working) time as exchange value to Canada at the beginning of the 1980's is considered the founding father of this alternative exchange and payment system[3]. Whoever operates within the scope of such a Local Exchange Trading System (LETS) posts for instance, its offer of services or commodity in an index or a platform and specifies the time-value of the offer either by itself or through the operator of the platform, which on the other hand, can be exchanged with the demand for any other good that is also offered in the same platform. Since – as opposed to money – one hour will still remain one hour even after six months, accounts can be set-off easily. As opposed to money flow, in which the depositor of money in a bank hardly knows the borrower, the communalising function of a Local Exchange Trading System should be highlighted. It becomes quickly obvious that this alternative system of payment functions only within a limited regional radius and also for smaller services or a limited exchange of goods. The global trading of investment goods would rather hit limits in this case. However, the emergence of the so-called Care Banks, in which particularly, today's services can be swapped with time units (with subsequent care services in time) has made these models surely increasingly interesting in the sense of the value protection function of time.

4.2. Regional currencies. As opposed to transactions with time currency, regional currencies are substitute currencies that are equally used as notes or sight deposits but only within a defined region often as means of payment used by market participants that are organized in associations or cooperatives. There are thus over 60 members recorded in the German parent association "Regiongeld e.V." (*Registered Association of Regional Money*). Regional currencies are usually introduced or managed by non-profit organizations, often cooperatives. The German regional monetary systems (e.g. Chiemgauer, Donauthaler) are exchanged at a ratio of 1:1 to the Euro, are convertible and fitted with the right to be converted into the Euro at all times such that it is virtually always covered. Since the Gsell's theory of depreciative money is often applied in this case and the notes are regularly devalued by invalidation stamps, a high circulatory velocity of the money is expected to be attained[4]. The objective of such currencies is often, to strengthen the regional economy and stimulate the industry for small and medium-scale enterprises of the region. The regional money with the strongest turnover in Germany, the Chiemgauer, thus charges a safe-deposit fee of 0.02 percent per day or 8 percent per annum. As with numerous regional currencies, the fees in this case, are used for non-commercial purposes. At the moment, municipal-political involvement, degree of technical organization (Notes versus Cards) and acceptance in the regional economy vary strongly in the known regional currencies in Germany[5].

4.3. Bartering systems. Bartering are exchange systems that are not executed in terms of time but in a fictitious currency. There are 500 Commercial Barter Currencies in the USA alone[6]. The system that is currently most popularly known in this country is the Swiss *Wirtschaftsring* (WIR)[7] that was founded in 1934, to which about 60,000 small and medium-scale companies are currently affiliated. In the meantime, the self-help organization runs a bank that is licensed to operate as a bank and could boast of a turnover in excess of 2.5 billion Swiss Francs in

[1] Unterguggenberger (1934, S. 60 ff).
[2] Aron (2011, S. 23 ff).; original website to BITCOIN: www.bitcoin.org.
[3] Vgl. Homepage of Michael Lintons: http://www.gmlets.u-net.com/ and http://www.gaianeconomics.org/linton.htm.
[4] Blanc, Jerome (1998, S. 469 ff).
[5] Kennedy, Lietaer (2004); Hubert (2004).
[6] An overview about bartering systems in: Oberländer (2008).
[7] WIR-Bank, Annual Report 2012; www.wir.ch.

2011. WIR uses the Swiss Franc as coverage currency and exchanges WIR at a ratio of 1:1 against the Swiss Franc in a way that makes it virtually a parallel currency. Members make mutual payments through a central clearing system without any physical currency, which means that there is no WIR banknote. With WIR, credit interests are neither paid nor is demurrage calculated. Precisely in times of restrictive lending by banks in accordance with Basel II, WIR became enormously significant to small and medium-scale enterprises, which repose mutual trust in each other and finance each other on mutual basis thus sidelining the banks. The scope however remains limited to the circle of the cooperative even though the high number of membership and the confidence that has meantime, being reposed in the complementary money flow, speak for themselves. While the three alternatives presented so far are absolutely effective in their regions and membership structures and can already be ruled out terminologically for a national or supranational system, system-changing models will still be presented in this discourse.

4.4. Irving Fisher's 100 percent money. In the face of the global economic crisis of the time, a group of economists from Chicago proposed in the 1930's that money should be issued only with a hundred percent reserve obligation[1]. By this means, the value coverage of the money can be realized with gold, savings deposits or bundle of goods. This would then mean stripping the commercial banks of the option of cash generation and having them concentrate purely on the role of intermediary in lending money, i.e. intermediation between lending and deposit transactions. Theoretically, the risk of inflation or deflation would have been averted and the currency system made much more stable. Even current surveys such as the study by Binswanger of 2012, address the implementability of the system for the global economy of the present day. It is comprehensible that a paradigm shift will be required in the overall economy and monetary economy.[2] Banks would be stripped of immense income opportunities and economic growth on the basis of debt would no longer be possible. Recently, the deposition of covered money was also linked with CO_2 emission rights, whose value, in the meantime, has become less in doubt[3].

4.5. Free banking. The demand for the permissibility of the so-called complementary currencies goes even further than Irvin Fishers Plan up until the creation of an additional private global currency (Parallel money). A free and private cash-generation and the related competition would – in the view of the Free Banking movement – lead to a good number of money types, while none of such monies will have to be identified as a legal tender. The institutions issuing the money would be having strong inducements to pay attention to stability and thereby, the purchasing power of their money since they may end up being displaced from the market. The term coined by von Hayek – the Denationalization of money – can be mentioned in this respect. In effect, goods would of course, be priced in different currencies and theoretically the most stable money would survive through competition under the monetary systems. The numerous game types of Free Banking can be seen in the different approaches of gold and commodity coverage by specific institutions up until the complete freedom to allow anyone to generate uncovered cash. The fact then that exchange rates would emerge in a market between the different complementary currencies for commodities and services or that some commodities would be swapped by their providers only against specific currencies may be considered a disadvantage. It can however be assumed that a strong complementary currency would finally survive and could replace the numerous complementary currencies as a global currency. It will then remain to be seen if the blessing of currency liberalism will be left only to the covered cash-generation of the private sector rather than the uncovered cash generation of the state. These considerations are therefore not far apart from the ideas of Keynes and his so-called Bancor Plan[4] with an international clearing union that is capable of assuming the functions of central banks. The result of an expert commission of the United Nations, which in 2009 together with the participating President of the Chinese Central Bank Xiaochuan[5] welcomed such a private sector global currency, shows how the ideas of Keynes have currently been reignited. Even the shopping cart-based "Terra" that was conceived by Lietaer in 2003 can be seen as an attempt in this direction[6]. Combined with the so-called "Sustainability fee" in the sense of negative interests, we end up once again, with the ideas of the depreciative money of the Austrian school as already described above. Equally current are the proposals made in 2012 by Thomas Mayer of the Research Department of Deutsche Bank, that the Greek state should introduce "Geuro" as a parallel currency, which would virtually mean a return to the "Regional currency Drachma"[7]. The concept advanced by Douthwaite in 2011 which proposed an Irish "Harp" that is available only on electronic basis also goes in the same direction[8].

[1] Fisher (2007). An overview of the influence of the "Chicago boys" in several financial systems in latin America describes: Edwards (1991); Allen (1993, S. 703 ff).
[2] Binswanger (2012, S. 13 ff).
[3] Douthwaite (2011), Eyre (2010, S. 432 ff).

[4] The original plan after the World War 2 for a new worldwide currendy in: Keynes (1980).
[5] Xiaochuan (2009, S. 2).
[6] Vgl. Lietaer, Belgin (2011). All ideas for a worldwide currenty from Lietaer in: http://www.lietaer.com/.
[7] Mayer (2012).
[8] Douthwaite (2011).

Conclusions

If the models considered are to be conclusively evaluated on the basis of monetary functions, it can be assumed in the consideration of the function of money as a medium of exchange, that of all the models, the liquidity preference, i.e. the withholding and saving of money rather than putting it into circulation, will be rather low. Who would want to hoard this medium of payment when there is such a multiplicity of payment forms and negative interests in the model of depreciative money? On the other hand, a high circulatory velocity will then also require less monetary volume. Even in the function of money as a measure of value (unit of account), it can be assumed that the regular set-off of the accounts only in gold or shopping carts, of regional and complementary currencies will ultimately lead to a measure of value. Finally, stock markets in the sense of foreign exchange rates would continuously reflect the values as long as the currencies are traded in a supra-regional manner. The resource-based CO_2 emission rights can serve as examples in this case.

The models will ultimately also not be useful as protection of value whereby the fundamental question may be asked if money is at all an efficient means of protecting value even if it emerges through the monopolist process of cash-creation by a central bank. At this point, the finance theory relates to the disciplines of value teachings and the question if values such as communality that is allegedly boosted in a regional currency, can at all, be measured and if value protection does not ultimately end up in value creation. The readings of the business reports of the WIR Bank should absolutely be able to spur rethinking in this respect. The theory of the "Ecology of Money", a sustained monetary system, is in this case, definitely yet at the infant stages of research and cannot be nearly described with the mere irrationality of the economic subjects from the theory of Behavioural Finance. In the end, no monetary system will also function here without confidence (credit). Whether or not "regional or complementar" confidence in alternative monetary systems and money flows then requires the rating of international agencies will have to be debated.

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