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Designing money systems for a shrinking or no-growth economy

steering paper

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Almost all the money used in a modern economy only exists because someone, somewhere, has borrowed it and is paying interest on it. Notes and coins are the only non-debt-based non-interest-bearing part of our money stock but cash comprises only about 3% of he money used in the US and about the same proportion in other countries. Moreover, cash is being used in diminishing proportion of transactions and it is being suggested that it be phased out altogether.

The money that goes into circulation when a loan is taken out ceases to exist when the loan is repaid. Loan repayments will therefore reduce the money stock unless enough new loans are taken out not just to replace the retired loans but also whatever fraction of the interest paid on them that was retained by the lender as profit. This means that the level of debt will steadily increase if the lending institutions are profitable. The ratio of debt to income will therefore grow unless there is either inflation or economic growth or a bit of both. De-growth makes deflation more likely than inflation.

In a contracting economy, less money will be needed in circulation to lubricate the reducing level of transactions being carried on. However, for as long as a debt-based money continues to be used, some new loans will need to be taken out to maintain a money stock adequate for the reduced level of trading activity. But will people be prepared to borrow – and lenders to lend – in an economy that is going through a contraction process or which has stabilised at a lower level? Who will have the confidence to undertake to pay back more money than they are borrowing if they have to obtain it from a shrinking or stable pool? In mid February, the *Daily Telegraph* reported that the previous month, bank lending in the US had contracted at the fastest rate in recorded history.

If we think that the reluctance of people to borrow is likely to cause a debt-based money system to break down when an economy shrinks, we need to devise one or more possible alternatives to allow a monetary system to operate, and thus facilitate trading, as the de-growth process proceeds. I suggest that our workshop should be to design a non-debt money that operates primarily as a medium of exchange. Its possible use as a store of value or a unit of account should not be part of the design brief. Other types of money may be required to fill those functions.

If money is not to be lent into circulation, only two other ways of introducing it seem possible. One is that it can be spent into circulation, the other that it be given into use. The first method was proposed by James Robertson and Joseph Huber in their book “Creating New Money” published by the new economics foundation in London in 2000 and available for free download from http://www.e-booksdirectory.com/details.php?ebook=3003 . A recent proposal for giving money into circulation called the Liquidity Network is described here: http://www.feasta.org/documents/liquidity_network/2009_liquidity_network.html

The difference between giving into circulation and spending into circulation turns out to be more apparent than real. Stripped to its essentials, Robertson's and Huber's proposal is that the ability to create money should be taken away from the banks and that they should be limited to acting as intermediaries between savers and lenders. As their lending wound down, the new money required to enable trading to go on would be created by the state, which would spend it into use.

As the state has the power to tax, it could take the money it had created out of the economy any time it wished. This means that it could always ensure that the money stock was appropriate for the amount of trading going on. There would, of course, be worries that a government would spend too much money into use, particularly just before an election, but this could be prevented by setting up an Independent Monetary Commission which would decide how much money the state should inject, or extract, from the system. In effect, then, the Independent Monetary Commission would give the new money to the state to spend.

In Feasta's Liquidity Network (LQN) proposal, however, the new money – called “quid” - would be given by the community trust running the system to all the users, not just to the state. Users would be allocated their share of each new injection of quid in proportion to the impetus they had given to the development of the system since the last injection. For example, if a business had increased its quid turnover, it would be rewarded for that. Feasta argues that distributing new quid in this way is necessary to help defray the system's development costs because an LQN would run in parallel with the euro or other official currency and require the keeping of an extra set of accounts whereas the Robertson/Huber approach just introduces existing money in a new way and requires no additional work by the users.

The trust running an LQN is able to extract quid from circulation if required because all transactions are electronic and recorded on one server. Anyone who had received a payment for helping to develop the system could have part of their payment taken away if their trading level fell below that for which they had been rewarded. Thus, as with Robertson/Huber (R/H), it is possible to adjust the money supply to whatever is appropriate for the current trading level.

In both proposals, then, the new money would be given by a regulatory trust for spending into use. In one, however, it would all be given to the state. In the other, all users, including the state, would get a share. In both proposals, the injected money could be extracted if required. There are, however, some essential differences between the two approaches. These are:

1. R/H works at national or super-national level and can be adopted most easily in countries which still have their own currencies. It could not be used in the eurozone unless the European Central Bank created the new euros and allocated them to governments to spend. By contrast, an LQN is designed to operate at a sub-national level and would be under local rather than national or EU-level control. We need to discuss in the workshop which level of operation and control is likely to be better suited to the circumstances created as de-growth occurs. Would we be worried by the centralisation of power that having our governments spend all new money into use would bring about?
2. With R/H, a country would move gradually from having a 97% debt-based currency to one with lower and lower levels of debt. With an LQN, the currency would always be 100% non-debt but its share of total trading could be expected to increase as the years passed and debt-based currencies fell out of use because of the reluctance to borrow. The exchange rate between the quid and the debt-based currency would change during this transition, with the debt-based one tending to appreciate as it

became rarer. This is likely to mean that the debt-based currency gets used for saving. If this led to hoarding, it would interfere with its use for trading and create additional space for LQN money.

3. The fact that the value of the quid depreciated against whichever debt-based currency it was supplementing would create a benign business climate in which relative prices could change easily. There should be more flexibility with LQN money than with a money whose debt-base was being gradually diluted.

Possible questions for the workshop to consider

1. Do we accept that a debt-based money system will run into severe difficulties if the economy it serves shrinks or fails to grow? If so, would a negative interest rate be the best solution? (See Willem Buiter at http://blogs.ft.com/maverecon/2009/05/negative-interest-rates-when-are-they-coming-to-a-central-bank-near-you/)
2. Some commentators – Tom Greco, for example – believe that all money has to be debt-based or at least, like the Chiemgauer, supported by another money which is based on debt. In other words, they think money has to be a claim against someone or something to keep its value. Do we agree?
3. Do we know of other proposals or examples of non-debt *exchange* currencies besides the two mentioned here? (Currencies backed by something real, such as a kWh of electricity, will be considered in the workshop on financial institutions)
4. Should we press for the ECB to begin issuing non-debt-based euros and distributing them to eurozone governments to spend into use to make up for the decline in debt-based euros? If so, on what basis should the distribution be made? Population? Current level of unemployment? Budget deficit? Need to bail out banks? Share of the eurozone's GDP?
5. What advantages, if any, would a network of regional LQNs, each with its own exchange rate, have over a national or eurozone R/H solution? Would we advocate the establishment of LQNs? Would it be possible/desirable to dilute the debt base of the euro using the R/H approach while simultaneously establishing regional LQNs?