



Towards a Sovereign Monetary System



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Outline

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- 1. Introduction : Addressed queries**
- 2. Objectives & Rationale**
- 3. The nature of Money in Modern Economies**
- 4. The origins of the Sovereign Monetary System (SMS): A Brief History**
- 5. Implications & Consequences of the Present Monetary System**
- 6. The SMS: Building Blocks, Features, Merits & Critiques**
- 7. Relevance of the SMS to Emerging and Developing Economies**
- 8. The Way Forward**

Introduction

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- ❖ **Do We Need a financial Reform?**
- ❖ **Who owns the authority to create money? And Who should have It?**
- ❖ **Is there a relationship between money creation and some of the deeply rooted disorders like debt and inequality that the world community is suffering from?**
- ❖ **What is the SMS? What does it stand for? And; Is it totally afresh idea?**
- ❖ **Is the SMS reform agenda plausible and feasible?**

Objectives

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- 1. Unveil the nature and impact of money in Modern economies ‘*as practiced, not as taught*’**
- 2. Share and exchange ideas about some pressing issues in the current order of the financial system**
- 3. Explore the reality of the Sovereign Monetary System (SMS) reforming agenda and some of its features, merits & critiques**
- 4. Highlight the relevance of the SMS reform to emerging and developing economies**

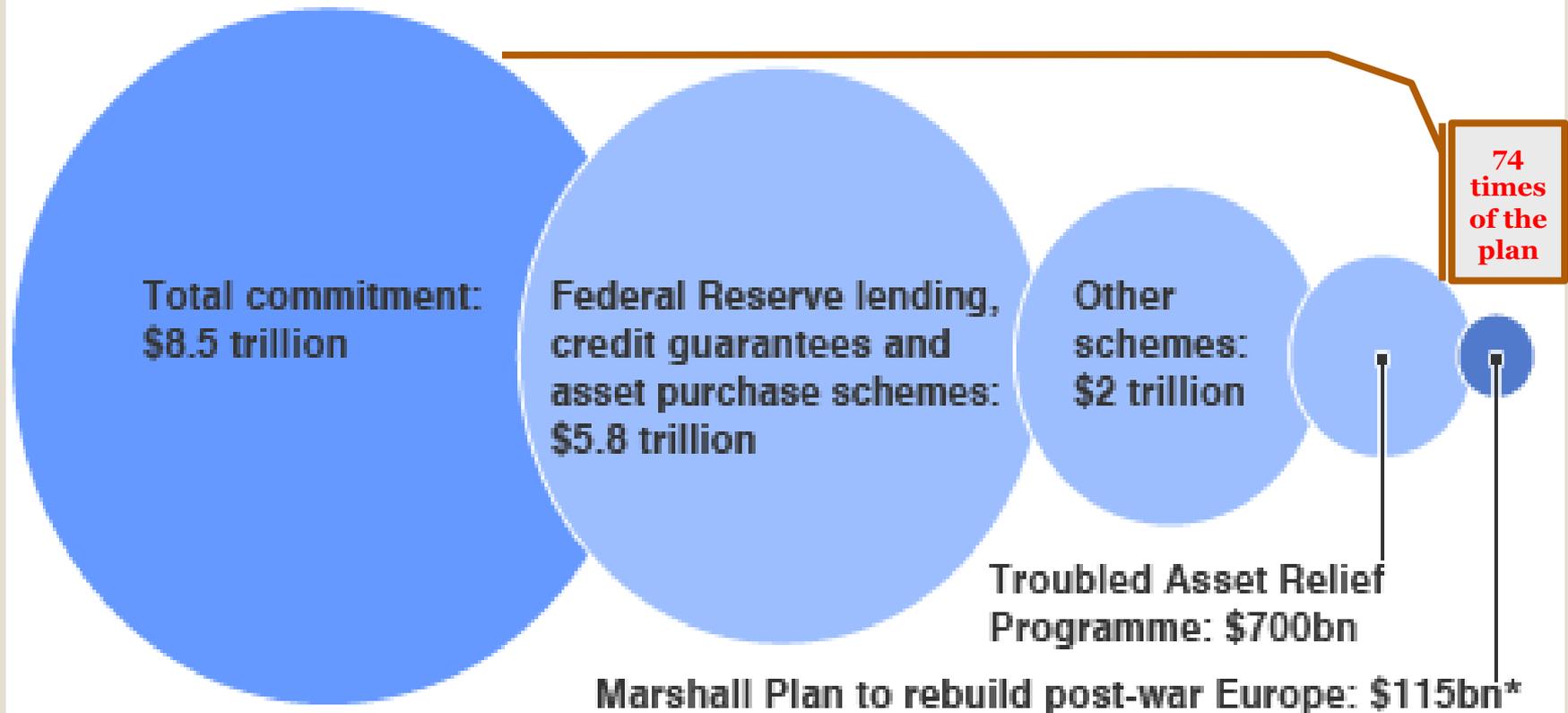
Rationale: Do We Need a financial Reform?

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- ❑ **Recurrence of crises : > 147 banking crises over the past few decades (IMF 2012)**
- ❑ **Regulatory measures have not been enough and are too costly: (Basel I was 30 pages, B II 251 pages, B III 509 pages, B IV ???)**
- ❑ **Monetary policy tested to its limits; Unconventional measures adopted**
- ❑ **Free-fall of the great moderation**
- ❑ **Huge Social Costs: Bail-outs, foreclosures & stimulus packages**
- ❑ **Is there or are there (a) fundamental issue (s) that has/have not been addressed by policy makers yet?**

Huge Costs - Bail-Outs

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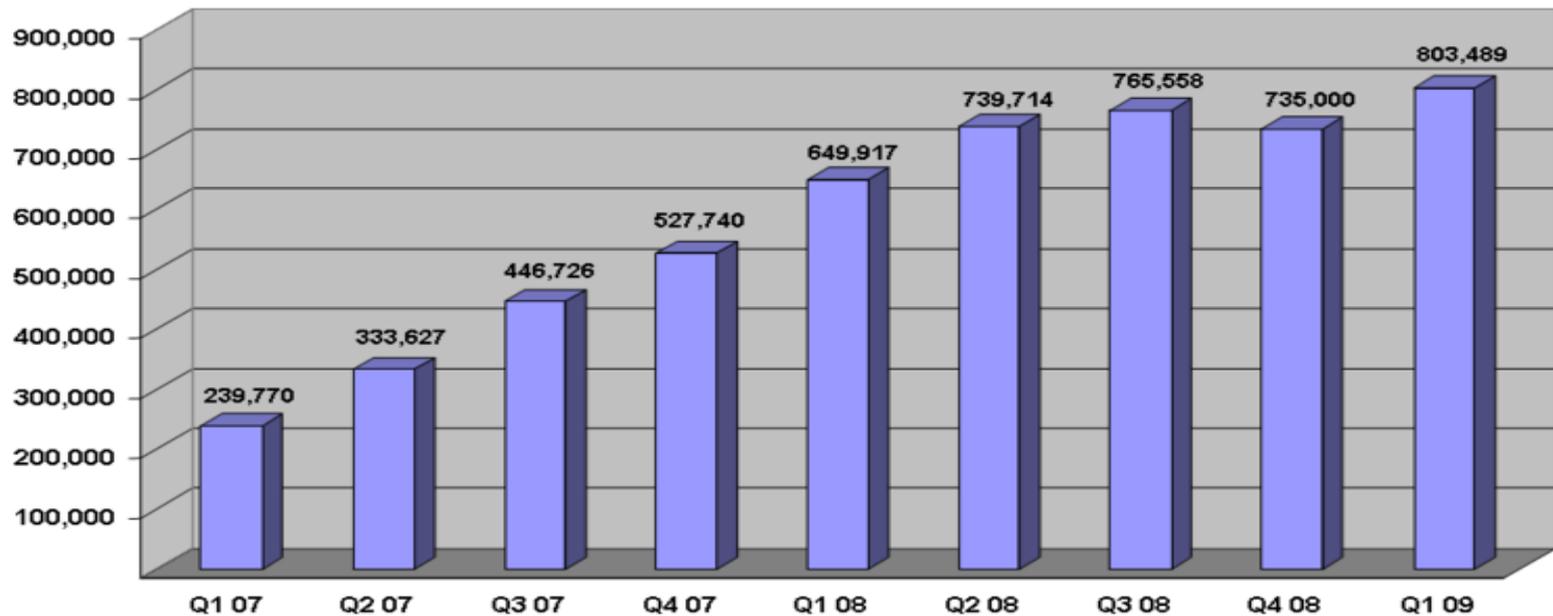
*Adjusted for inflation

SOURCE: Bloomberg, US Treasury, Federal Reserve, US National Archive

Huge Costs - Foreclosures

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Properties with Foreclosure Activity

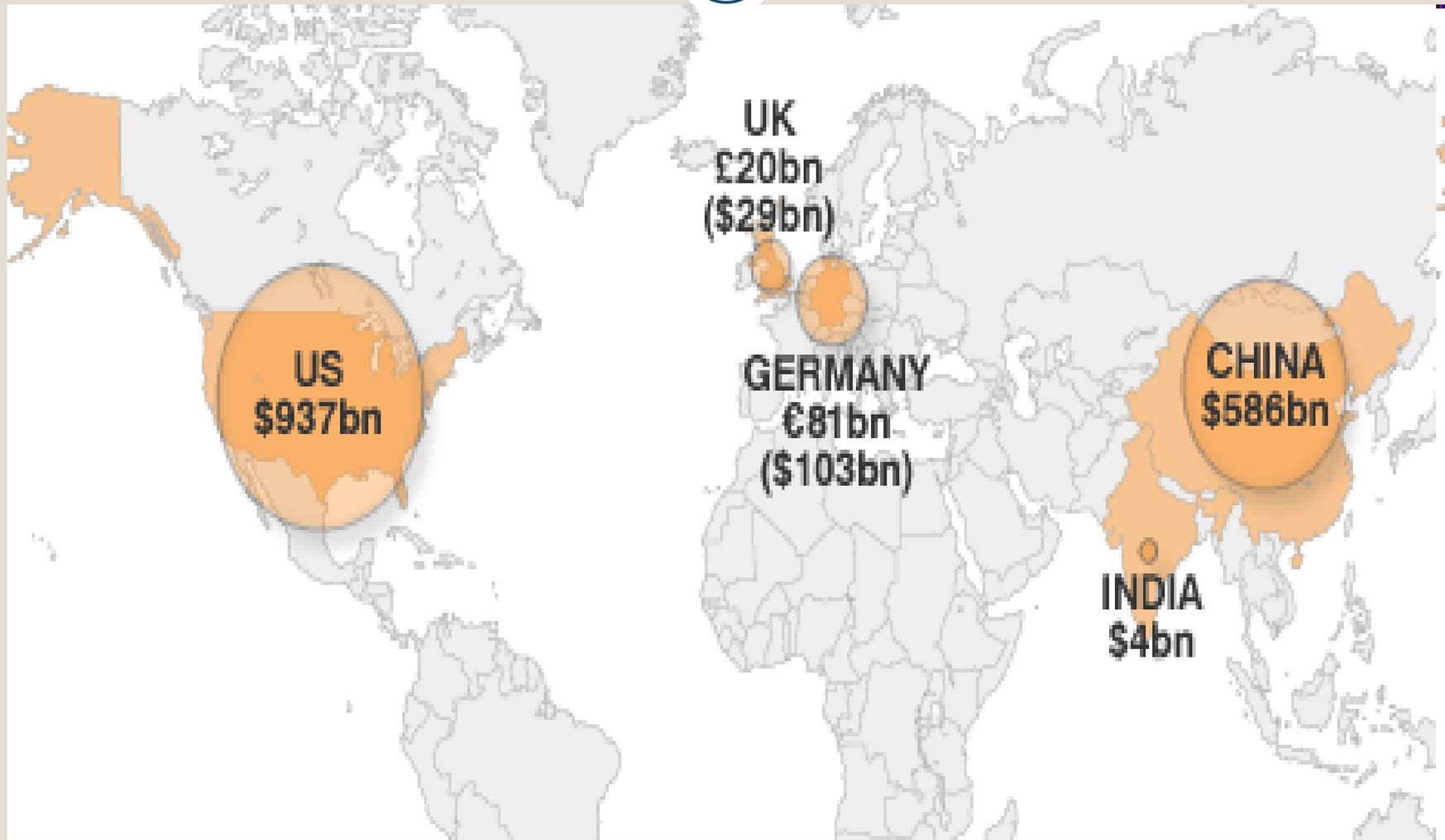


Source Data: RealtyTrac Press Releases of "U.S. Foreclosure Market Report"
Chart Created by Contributor

Huge Costs - Stimulus Packages

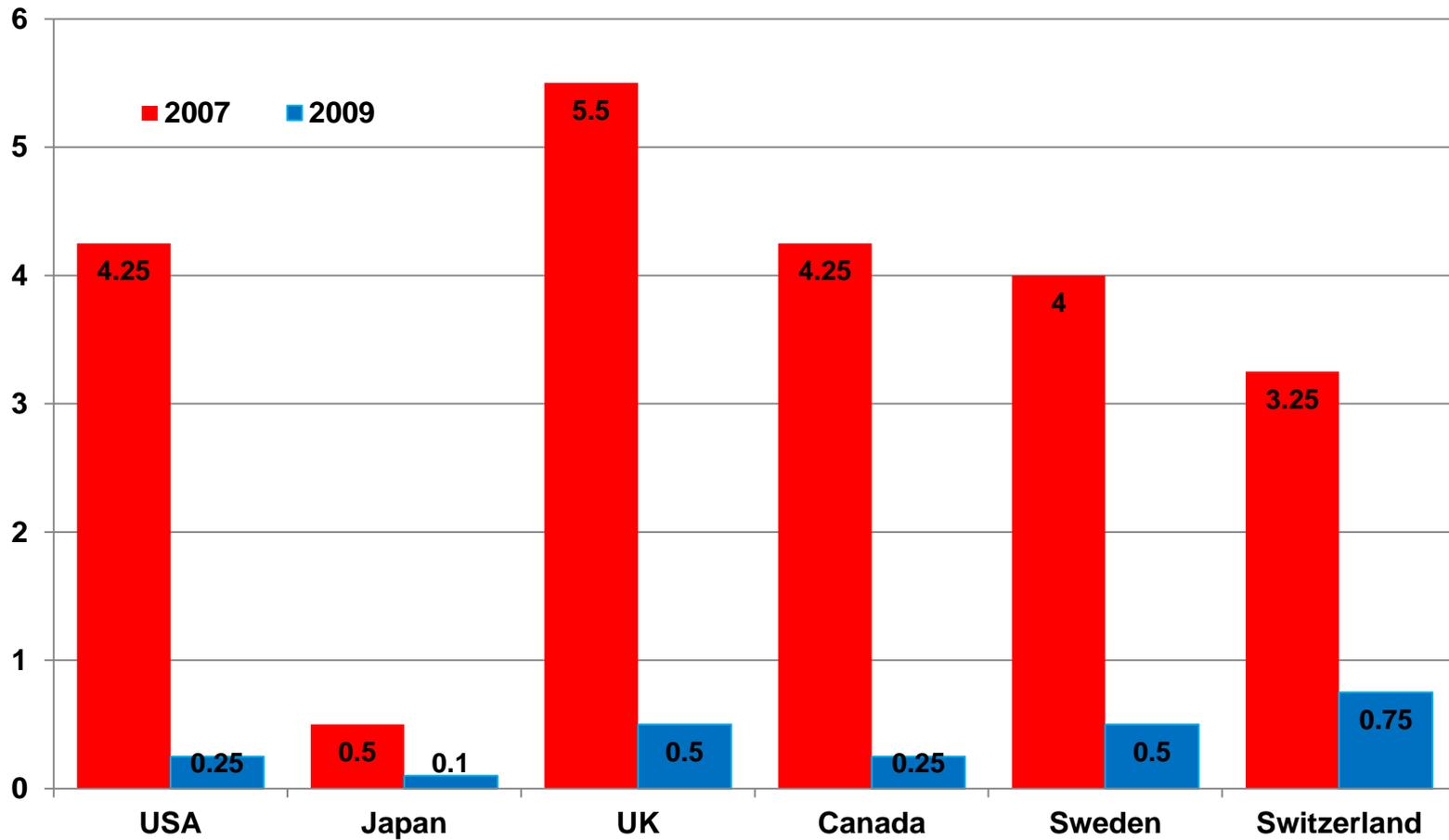
(GFC – 2007-2008)

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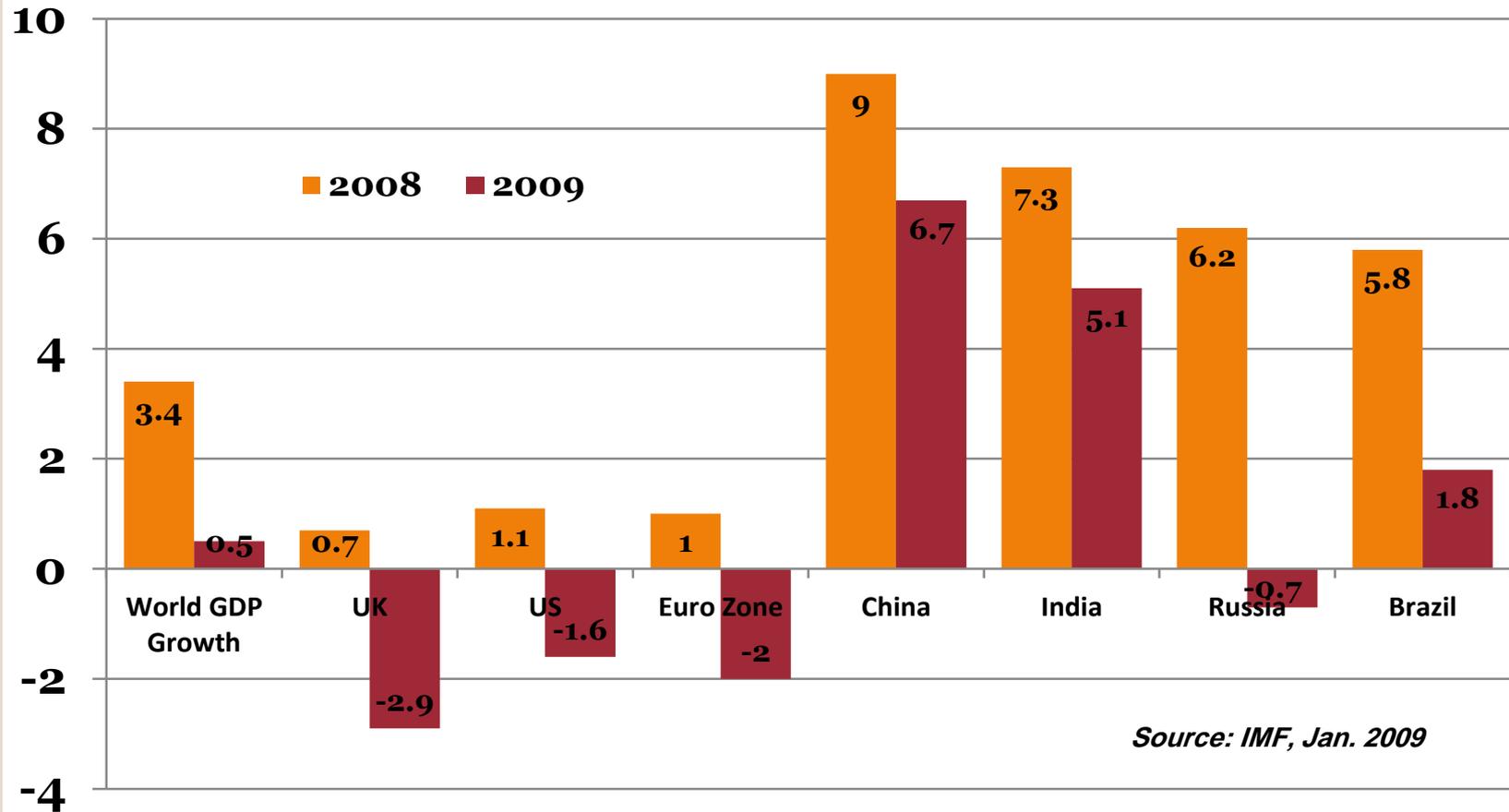
Historical Cuts of Base Rates

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World Economies Hit Badly 2008-2009

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Source: IMF, Jan. 2009

Unconventional Measures

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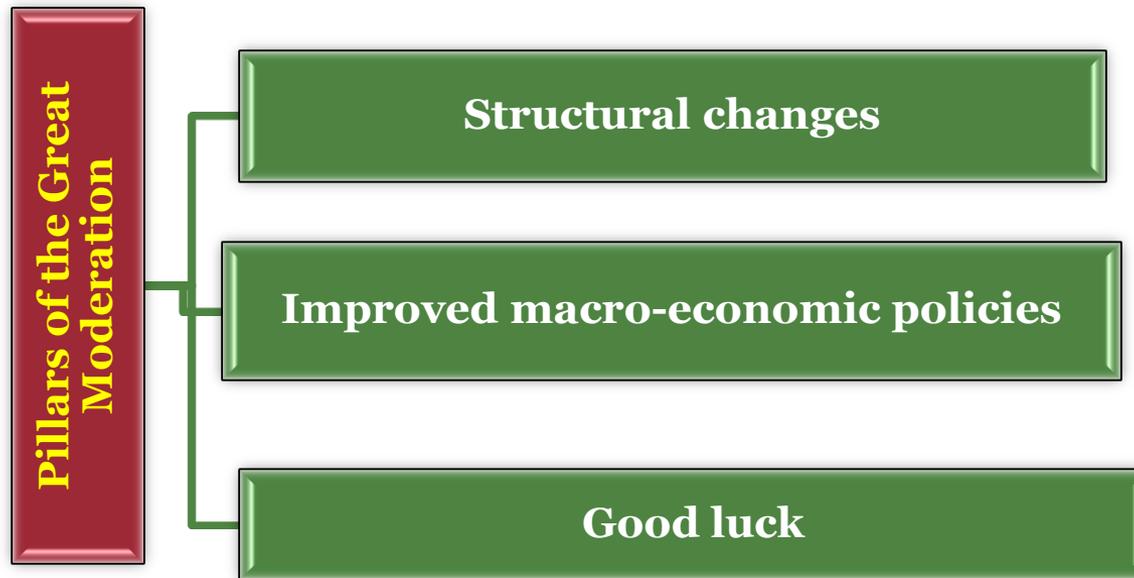
- ❑ **Zero Interest Rate Policy (ZIRP)**
- ❑ **Quantitative & Credit Easing Policies**
- ❑ **Public Entities for Waste or Toxic Assets
(e.g. Public-Private Investment Program (PPIP)
- USA)**

The 'Great Moderation'

- ❑ “The name given to the period of decreased macroeconomic volatility experienced in the United States since the 1980s and other advanced economies. During this period, the standard deviation of quarterly real GDP declined by half, and the standard deviation of inflation declined by two-thirds, according to figures reported by U.S. Federal Reserve Chairman Ben Bernanke. *Increased economic volatility in the late 2000s has led many to question whether this period of economic stability was merely transitory*” [Source: www.investopedia.com]
- ❑ In a speech delivered in 2004, Ben Bernanke hypothesized three potential causes for this period of relative economic stability:

Free-Fall of the ‘The Great Moderation’

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- ❑ The ‘subprime’ crisis took the ‘Great moderation’ by surprise to let the world enter into the ‘abyss’ of ‘the great panic’ causing a ‘free-fall to the great moderation.

Fundamental Issues that Have not Been Addressed Yet

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- ❑ **“Of all the many ways of organising banking, the worst is the one we have today”.**
Lord Mervyn King, ex-Governor of the Bank of England (2003-2013)
- ❑ **“We do not want communism... but we do need a more humane brand of capitalism, based not only on better regulation but better values.”**
Richard Layard, founder, London School of Economics, The Centre for Economic Performance
- ❑ **“ [The] efforts [of financial regulators], in which I was deeply involved from 2008 to 2013, have been valuable, reducing the probability of another financial crisis in the short term. But they have still failed to address the fundamental issue – the ability of banks to create credit, money and purchasing power, and the instability which inevitably follows”.** *Lord Adair Turner, ex-chairman of the FSA (2008-2013)*
- ❑ **“We need a financial sector but not one like this, nor do we need Wall Street hitting us for its gambling debts”**, *Kotlikoff and Leamer, Profs. Of Economics at Boston University*

How Money is Created in a Modern Economy?

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Two postulations exist:

1

- The Money multiplier or the Exogenous money theory (i.e. banks role is to multiply existing money in the economy)

2

- The Endogenous or modern theory of money creation

The Money multiplier - the Exogenous theory (Sequence of Causality)

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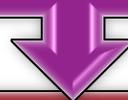
The central bank sets the reserve ratio, creates money base, and injects this money into the economy



Once in the economy this money circulates before being deposited with banks. Banks then lend out a fraction of the money deposited with them and keep a fraction back 'in reserve'



The loans are spent and the money circulates, before it is re-deposited into another bank. The bank uses this new (smaller) deposit to make a further (smaller) loan, again keeping a fraction of the deposit 'in reserve'

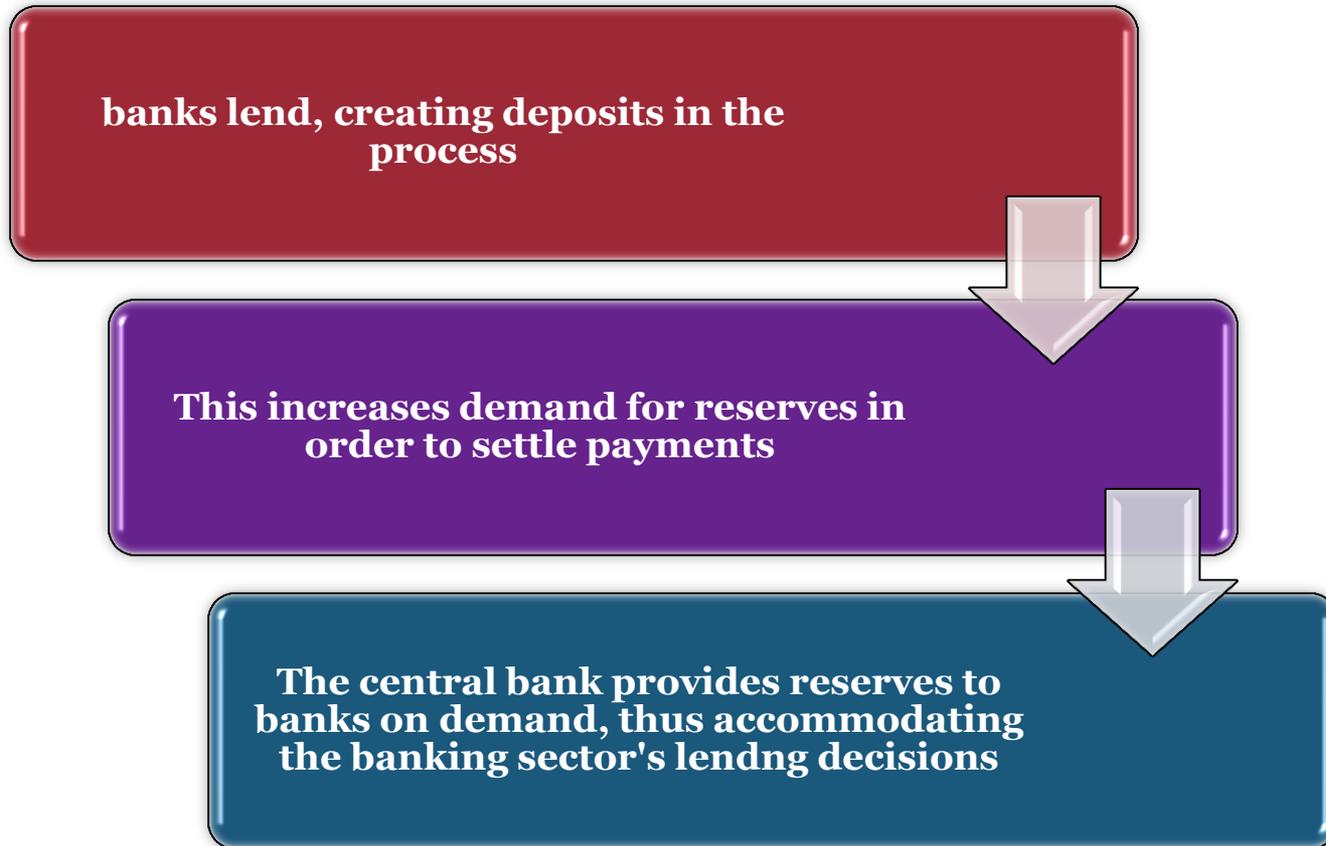


The process continues until the amounts relent are miniscule. The quantity of money in circulation is now a multiple of the base money (with the multiple determined by the reserve ratio).

Source: Modernising Money: Why Our Monetary system is Broken and How It Can Be Fixed? (2014: 77)

The Endogenous theory of money creation (Sequence of Causality)

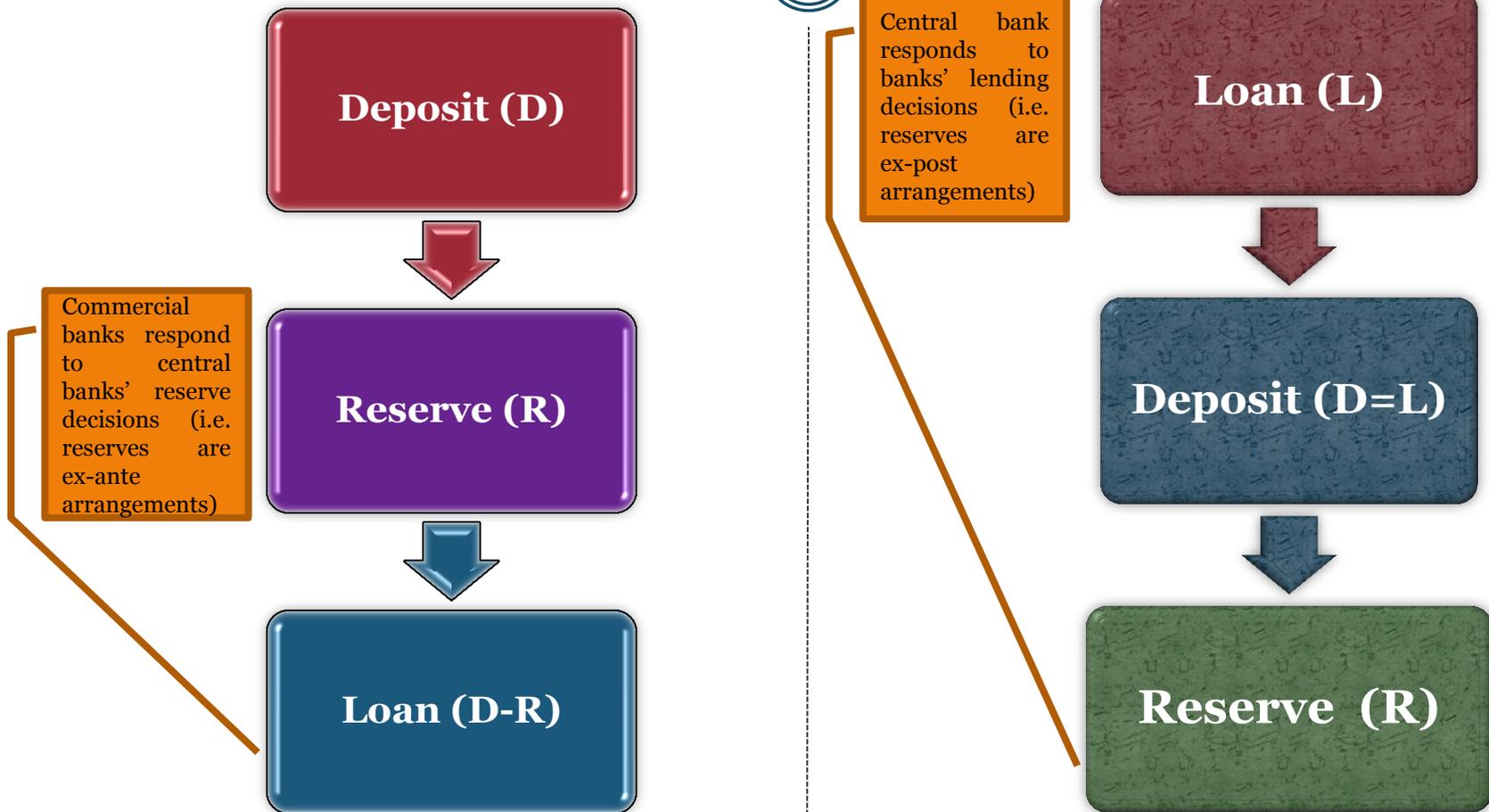
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Source: Modernising Money ... (2014: 80)

Exogenous vs. Endogenous Theories of Money Creation

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Summary of the modern Process

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“In the modern economy, most money takes the form of bank deposits. But how those bank deposits are created is often misunderstood: the principal way is through commercial banks making loans. *Whenever a bank makes a loan, it simultaneously creates a matching deposit in the borrower’s bank account, thereby creating new money.*

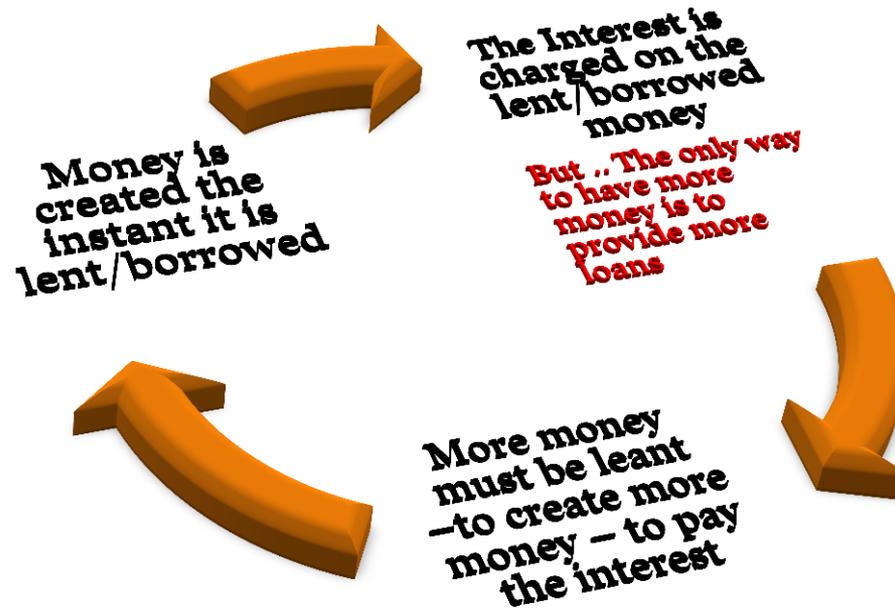
[This] reality ... differs [significantly] from the description found in some economics textbooks:

- ❑ *Rather than banks receiving deposits when households save and then lending them out, bank lending creates deposits.*
- ❑ *In normal times, the central bank does not fix the amount of money in circulation, nor is central bank money ‘multiplied up’ into more loans and deposits”.*

The Money supply

A Continuous cycle of Credit-Debt-Interest & The creation of more Money

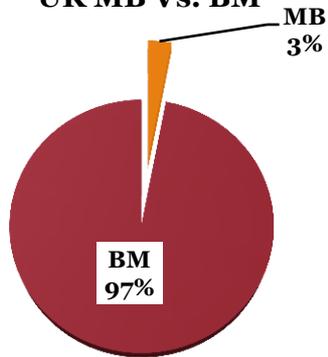
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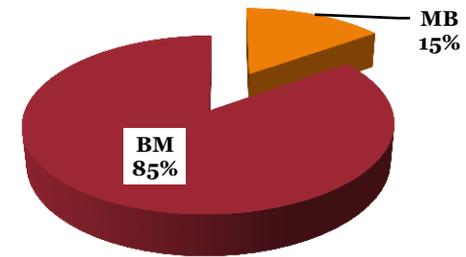
The Result: Majority of Money is created Privately

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UK MB Vs. BM

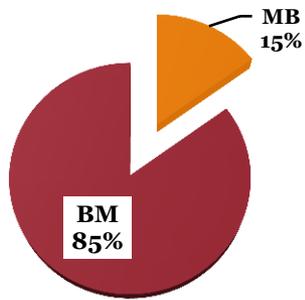


USA Money Supply (MB vs. BM)
June 2015



MB = Money base or high powered money; **BM** = Broad money

MB vs. BM in Saudi Arabia Money Supply
May 2015



Nigeria's MB vs. BM
March 2015



Source: Central Banks of respective Countries

Implications

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The Exogenous Theory

1. Bank (s) await (s) for someone to deposit money
2. The central bank has the overall control over the stock of money in the economy
3. The amount of created money can never get out of control

The Endogenous Theory

1. Bank (s) does/do not await; they are able to lend *'as and when they want'*
2. Loans create deposits
3. Reserve levels and arrangements respond to the lending decisions of banks

Source: Modernising Money ... (2014: 78-80)

Consequences

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1 – Instability: Boom & Bust Cycles

• **“Stability is destabilising”**: Inherent and endogenous fragility of the system (**FIH of Minsky**)

2 - Injustice

• Money is a common and a social good. It has to belong and work for the society as a whole

3- Increase in debt levels

• The incentive of benefiting from money creation drives ‘creators’ to issue more in normal times. This will increase the levels of private and public debts

4 – Increase in Inequality

Money is created as debt. This leads to concentration of wealth in the hands of the few:
See: “Inequality, Leverage and Crises (IMF: 2010)”

5 – Not so inclusive system

The ‘unbanked population’, ‘micro-financing’ and recently ‘alternative finance’ growing phenomena

The Origins of The SMS: A Brief History

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Date	Who .. Stands for What?
1705	John Law offered ‘several proposals to remedy the difficulties the nation is under from the scarcity of money. He called for ‘a commission to be <u>appointed by the parliament to create and lend paper money</u> on the security of land ownership’
1793	Edward King called for a government control and the issuing of notes for general circulation
1814	William Cobbett wrote against banks and paper money due to the severe economic conditions that England went through between 1814 and 1816
1823	David Ricardo call for the establishment of a national bank to take out the responsibility of money issuance from the Bank of England
1844	Pelee act visualizing some Ricardo’s ideas
1850s	<i>Westminster Review</i> wrote about money issuance after the Peel act of 1844 had twice been suspended; “the power of issue [of money] is, ought to be, a sovereign right’
1865	Abraham Lincoln (US president) declares his ‘monetary policy’ which calls for government sole and ‘ exclusive monopoly ’ for the creation and supply of money. The reform never came to being as Lincoln was assassinated in ‘a matter of weeks’ after the declaration.
1893	H. D. Maleod -a leading authority on the theory of banking- wrote “at present – the merchants who trade in debts –namely banks- are now the rulers and regulators of commerce; they almost control the fortunes of states”.

The Origins of The SMS: A Brief History –Cont.-

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Date	Who .. Stands for What?
1920s	<ul style="list-style-type: none"> - According to Brynjolf Bjorset (Swedish economist) “over 2,000 schemes for monetary reforms were advanced during the period from 1925 and 1930” - Lord Josiah Stamp (1880-1941), former director of the Bank of England, was very critical and vocal about the role of banks in creating money. He once attested: “The modern banking system manufactures money out of nothing ... , <i>if you want to continue to be the slaves of bankers and pay the cost of your own slavery, then let bankers continue to create money and control credit</i>” - Others: e.g. Frederick Soddy (Noble laureate in Chemistry), and Major C. H. Douglas; a British engineer who created ‘the social credit movement’ that was spread outside UK.
1930s	<ul style="list-style-type: none"> - The Chicago plan (1933) (100% reserve and other reform elements) by some leading economists like, Henry Simons, Paul Douglas, and endorsed Irving Fisher - A Program for Monetary Reform (1939) attributed to six American economists: Paul H. Douglas, Irving Fisher, Frank D. Graham, Earl J. Hamilton, Wilford I. King, and Charles R. Whittlesey
1960s - 1980s	<ul style="list-style-type: none"> - Support of the Chicago plan by Milton Friedman (1969) - “Narrow” or “core” banks proposals (Tobin 1985, 1987; Bryan 1988, 1991)
1990s -2000	<ul style="list-style-type: none"> - The work of Maurice Allais; the French noble laureate economist, on monetary reform became known to Muslim economists (IDB invitation in 1993) - The new economics foundation (NEF) (Money creating new money report: Seigniorage reform). Both Allais & NEF report share ‘<i>counterfeiting and forgery</i>’ guilt for non-state issuing and creation of money by any person or organization

The Origins of The SMS: A Brief History –Cont.-

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Date	Who .. Stands for What?
2009 - 2010	<ul style="list-style-type: none"> - Kay's Narrow banking proposal (2009) - Kotlikoff and others (2009, 2010, 2012) Limited Purpose Banking (LPB) proposal - The creation of the positive money movement (PMV) (2010)
2012	<ul style="list-style-type: none"> - The Chicago plan revisited by IMF economists; Benes & Kumhof (developed a model to evaluate the core advantages of the plan). They found their study supports all them: <i>elimination of business cycles, complete elimination of bank runs, massive reduction in public debt and massive reduction in private debt as well</i>). They further claims '<i>long-term increase in output [If plan implemented] of 10 per cent</i>'. - The two-tier windows <i>Mudarbah</i> (with 100% reserve); "Risk Sharing in Finance: The Islamic Finance Alternative", (Askari et al (2012))
2014 - 2015	<ul style="list-style-type: none"> - 2014: Two important books by PMV (<i>Modernising Money ...</i>) and NEF (<i>Where Does Money Come from? ...</i>) spelling out the SMS proposal - 2015: a commissioned report was prepared to the prime minister of Iceland embracing the ideas of a Sovereign Monetary system (SMS) - "<i>A Better Monetary System for Iceland</i>"-

Building Blocks of the SMS

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1. State exclusive monopoly of money, in whatsoever form; physical, electronic, or other



2. Separating the powers of creation and allocation of money: Two distinct A/Cs



3. Independent public entity for money creation(e.g. The Money Creation Committee)



4. Deciding how much money to create to support non-inflationary economic growth



5. Introducing new money into the economy



6. Banks to act as 'true' and 'pure' intermediaries in channeling exiting funds

Source: Sigurjónsson. (2015: 78-82). & Modernizing Money ... (2014: 173-218)

Features of the Proposal: Some Details

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1. The payment system (**i.e. transaction accounts**) is separated from lending investing activity (**i.e. investment accounts (INV-A/Cs)**)
2. Clear distinction between truly risk-free money in a bank account, and a risk-bearing investment that could lose value
3. Banks become money brokers, not creators; act as true intermediaries
4. Bank lending will not increase the amount of money in the economy; the money supply will be stable
5. Risk-alignment on all investment account [**'no pain, no gain'**]; gaining in the upside of the normal business cycle, will result in bearing and [sharing] the burdens of the downside
6. Different INV-A/Cs for different investment opportunities; rate of return, risk, maturity and liquidity
7. Banks that fail will be liquidated; no room for 'too-big-to-fail', no deposit insurance either

Source: Modernising Money ... (2014: 177 – 178)

Anticipated Merits

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In 2012 Benes and Kumhof (IMF) created a model to evaluate the claims made for the Chicago Plan by ‘*embedding a comprehensive and carefully calibrated model of the banking system in a DSGE model of the U.S. economy*’. They found support of all of the four advantages of the Plan as claimed by Irving Fisher (1936):

1. **Elimination of Business Cycles**
2. **Complete Elimination of Bank Runs**
3. **Dramatic Reduction of Public Debt**
4. **Dramatic Reduction of Private Debt**

Due to Credit-Debt Decoupling

Furthermore, they also claim that : “... **output gains approach 10 percent, and steady state inflation can drop to zero without posing problems for the conduct of monetary policy**”

Critiques

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IT WON'T WORK

- Little scope for credit intermediation & maturity transformation
- Not feasible for the state to establish control over the money supply
- A committee cannot accurately decide how much money should be created
- It would be difficult to judge the performance of central banks
- It's impossible for banks to be profitable in this model (i.e. Banking would be unviable)

IT'S UNNECESSARY

- It would lead to a shortage of credit, deflation and recession; and it may even be inflationary / hyperinflationary
- Interest rates would be too high
- It would hand over the printing press to politicians; and It would be difficult to prevent partisan behaviour by the central bank

EVEN IF IT WORKS IT WILL BE DAMAGING

- It is over reliant on central planning; and may require control by an 'army' of technocrats
- The shadow banking sector would simply create substitutes for money. Near-monies would emerge and the central bank would lose control of money creation

Source: <http://positivemoney.org/2015/08/sovereign-money-common-critiques>

The relevance of the SMS to Emerging and developing Economies

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Since:

- 1. The same practice of money creation is followed**
- 2. The same monetary policies are adopted.**
- 3. Almost the same disorders are facing.**
- 4. These economies are interrelated and linked to advanced world economies**

Then

The SMS proposal is very relevant with variations and amendments that account for the socio-cultural and economic contexts of these countries

The Way forward

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1. The central message of the SMS proposal and the like ‘*Whether the reforms are called the Chicago Plan, Limited Purpose Banking, narrow banking or the sovereign monetary system, the message is unified: the world needs a financial system that makes a dramatic shift in its paradigm and practices towards the issue of money as “money creation is too important to be left to bankers alone”*’ [Turner 2015].’
2. A shift is also needed to depart from the heavy reliance of the financial system on risk-shifting and debt financing to provide ‘*a level playing field*’ for more risk-sharing and equity financing:
 - “*If too much debt and too little capital are (part of) the problem, then the conversion of debt into equity is (part of) the solution*”, Willem Buiter, an Ex-LSE professor of Economics & Ex-member of the monetary policy of the BoE; (July 2009): blogs.ft.com
 - “*Western policymakers and economists often portray Islamic financial systems, with their emphasis on shared risk and responsibility in lending, as less efficient than western systems that put no strictures on debt. Yet one can equally argue that Western financial intermediation is far too skewed towards debt, and as a consequence generate many unnecessary risk. [Thus] those policymakers ... ought to be looking at these systems for positive ideas that they might adopt*”,
Kenneth Rogoff, Prof. of Economics & Public Policy, Harvard University: www.project-syndicate.org & www.banque-france.fr (2011)
 - **The tax, regulatory, and other biases in favour of debt instruments over equity**, have distorted the functioning of the system, need due consideration and fixation; IMF (SDN/11/11, May, 2011) & EU Commission (WP No. 33-2012)

Useful References & Resources

1. ***“The Grip of Death: A Study of Modern Money, Debt Slavery, and Destructive Economics”***. Rowbotham (1998)
2. ***“Creating New Money: A monetary reform for the information age”***, Robertson and Huber (2000); the New Economics
3. ***“The Lost Science of Money: The Mythology of Money-The Story of Power”***, Zarlenga (2002), American Monetary Institute:
[http://library.uniteddiversity.coop/Money and Economics/Lost Science of Money.pdf](http://library.uniteddiversity.coop/Money_and_Economics/Lost_Science_of_Money.pdf)
4. ***“Rethinking Money: How New Currencies Turn Scarcity into Prosperity”***, Lietaer and Dunne (2013):
[http://www.bkconnection.com/static/Rethinking Money EXCERPT.pdf](http://www.bkconnection.com/static/Rethinking_Money_EXCERPT.pdf)
5. ***“Modernizing Money: Why Our Monetary System is Broken and How It Can Be Fixed”***, Jackson, and Dyson (2014), Positive Money Movement.
6. ***“Where Does Money Come From? A Guide to the UK Monetary and Banking System”***, Ryan-Collins et al. (2014)
7. ***“Money Creation in the Modern Economy”***, BoE (2014): www.bankofengland.co.uk
8. ***“Monetary Reform: A Better Monetary System for Iceland.”***; Sigurjónsson, Frosti. (2015): <http://www.forsaetisraduneyti.is/media/Skyrslur/monetary-reform.pdf>
9. Ellen Brown: web of debt: www.webofdebt.com
10. Positive Money Movement: www.positivemoney.org

Thank you for

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Your attention &

.. Care

Wassalam

