Submission calling for the Reserve Bank of New Zealand to issue all NZ money

Petition with 5,363 signatures delivered to Parliament on 12th September 2019

Received by Dr Deborah Russell MP

Petition Request

That the House of Representatives inquire into giving the Reserve Bank of New Zealand the sole ability to issue all New Zealand money, whether notes, coins, or electronic.

Petition Reason

Private banks create 97% of our money. They pump too much money into housing, creating huge profits for themselves but skyrocketing house prices, inequality, and poverty for ordinary kiwis. NZ successfully used Reserve Bank credit in 1936 to build thousands of state houses and we can do it again.

This submission is in response to the 25th September 2019 invitation to make a written submission to the Finance and Expenditure Committee in support of the above petition by Dr Stuart Bramhall.

Dr Bramhall is a Spokesperson for Positive Money New Zealand and this submission has been written by Positive Money New Zealand (PMNZ).

PMNZ is a not-for-profit, non-partisan advocacy group established in 2011. Its role is to advance the cause of replacing our current money supply, made up of interest-bearing private bank money, with debt-free public money issued by the Reserve Bank of New Zealand (RBNZ). PMNZ is the NZ affiliate of Positive Money UK (PMUK) established in 2010.

The PMUK advisory panel consists of prominent economists, bankers and economic commentators including Professor Ole Bjerg, Professor Victoria Chick, Lord Sharkey, Frances Coppola, Tony Greenham, Professor Joseph Huber, Professor Tim Jackson, Professor Steve Keen, Eric Lonergan, Dr Johnna Montgomerie and Dr Josh Ryan-Collins. A selection of resource material is referenced in the Appendix.

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Executive Summary

Despite widely held and unfounded beliefs to the contrary, almost all of New Zealand's (and the developed world's) money is issued by private banks as interest-bearing debt. Our Reserve Bank has been relegated to issuing our notes and coins which make up only 3% of our money supply.

The current process of issuing new money is simple: a commercial bank issues a mortgage or other debt instrument and new money equal to the amount of the loan appears as a deposit in the borrower's account.

The total money supply in the economy increases by the amount of the new loan. Conversely, when the loan (principal) is repaid, both the deposit in the borrower's account and the bank's loan book are reduced by the same amount. The repayment of a loan's principal cancels money out of existence.

The process is dynamic. In New Zealand, thousands of new loans and tens of thousands of repayments are made every day. Almost always, more new money is being issued than is being cancelled out so the country's debt and money supply both keep growing.

While there is considerable regulatory oversight from the Reserve Bank of New Zealand and the Basel Accords, any money created by a privately owned institution is first and foremost about maximising profit. Social, environmental and economic wellbeing have become incidental in the issue and allocation of new money by privately owned banks. More and more it is being used in ways that increase income and wealth inequality and financial instability rather than for the public good.

Our submission is not about creating ***more*** new money but about thinking a little differently about ***how*** new money is used and created.

It is about using any new money for the wider public good.

We submit that much better economic, social, environmental, and business outcomes can be achieved by having the Reserve Bank of New Zealand commit to replacing private bank money with debt-free public money.

The decision not to allow the government to issue debt-free public money has been political, not economic. A common argument used against this proposition is that it would be inflationary. As we show later on under 'The Inflation Myth' (page 16), the evidence used to justify this argument is fallacious.

It should be pointed out that all commonly-cited examples of hyperinflation from government-created money took place in the context of extreme social and economic disruption. There are no documented examples of hyperinflation affecting well-functioning societies in normal times.

The process of issuing debt-free public money (technically referred to as Sovereign Money) is very simple: the Reserve Bank issues new money to the government to spend into circulation for the public good. The Reserve Bank can also issue funds to private banks on the proviso that the funds are lent into the productive sector where goods and services are bought and sold.

An essential difference between the Positive Money approach and that of many alternatives is that how much money will be created is in the hands of an independent Monetary Policy Committee. Only after this independent decision can new money be transferred to government and the real economy.

The PMNZ proposal is set out in detail in *Positive Money - An Introduction* [1] and supported by economic modelling done by Benes & Kumhof of the IMF in 2012 [2].

Why Parliament should review the current money system

What comes first, the savings or the loan? Most people would say savings because banks need them to make a loan. But this answer is wrong, the loan comes first.

Actually, the common view is not completely wrong. It’s the way non-bank lenders must operate, but it’s not the way the twenty or so registered banks with privileged access to the Reserve Bank’s payment system work.

Central bankers, including our own Reserve Bank, now acknowledge that the common idea of money creation is wrong. As the Bank of England diplomatically puts it [3]:

> The reality of how money is created today differs 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.

It’s easy to see how a system designed with such a core misunderstanding by the public and experts alike could have ended up with design flaws. It would be more surprising if it hadn’t.

So what’s the problem with letting private banks create our money?

By itself, the fact that banks today create most of our money (about 97%) in the course of making loans isn’t right or wrong – it’s just a political choice and has benefits and drawbacks. If borrowing and lending actually functioned in the way described by the aforementioned economic textbooks, it could all be fine.

Unfortunately they don’t. What has gone wrong is that our banks have been creating too much money (which necessarily creates too much debt), they’ve been creating it for the wrong reasons, and they’ve raised a giant private debt mountain whose foundations are now very shaky.

Today’s system was ‘supercharged’ in 1989 when our Reserve Bank Act changed the way banks operate here. After this date:

- The money supply increased at more than twice the rate of GDP
- Real house price inflation grew at four times the rate of previous decades
- Household debt went from under a quarter of GDP to almost 100% of GDP

- Total private debt is almost double the value of our GDP — half a trillion dollars

House price inflation and debt: Can we do something about it?

In the 1960s lending from commercial trading banks made up about 10% of mortgage loans. The balance came from the State Advances Corporation, building societies, solicitors' trust funds and community savings banks. With the exception of the State Advances Corporation, these institutions could only lend out their contributors' funds. During this period house prices remained relatively stable.

By the 1990's (after the 'financial reforms' of the 1980's), lending by commercial trading banks made up about 90% of mortgage loans. Because the commercial banks could create money as a book entry, the main constraint was people's ability to take on new debt. It was at this point that house prices took off.

Positive Money's proposed solution would essentially return banking to the way most people (and those economic textbooks) think that it already works: by having banks act solely as intermediaries between depositors and borrowers. They would have no power to create new money. That power would reside exclusively with the Reserve Bank.

We believe this transition to debt-free money will make housing more affordable and borrowing for productive purposes easier.

References

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Section 1 - Why act now?

We're asking this committee to take a fresh look and review this basic piece of 'plumbing' in our economy. Understandably, it's not something that's reviewed very often but we think that now is a good time for a number of reasons:

- Our current system is reaching limits previously considered inconceivable - such as negative interest rates
- Houses are unaffordable for new buyers and households are debt-stressed from too much bank-created credit inflating a finite pool of land
- The global economy and financial system faces historic challenges and New Zealand is a part of it
- Technology now exists that has the potential to cause massive economic disruption, including private digital currencies such as Facebook's Libra. These digital currencies could circumvent the primacy of national currencies, with widespread adoption just around the corner

Our proposal presents an alternative that can improve and strengthen New Zealand's monetary system to address these modern challenges.

Some of these challenges could unfold with frightening speed and scale, giving us even less time in the future to review all viable options and alternatives. By acting now, this committee has an opportunity to do what its predecessors in the 1930's did as they confronted their own set of (different) challenges: to look closely at the core of our money and banking system and make it fit for the new era.

The digital transition — Sovereign Money and digital currency

At the core of the proposed Sovereign Money or Central Bank Digital Currency (CBDC) is the 'unbundling' of the payments and lending functions of commercial banks.

Instead of demand deposits being held in accounts at commercial banks, they are held in individual accounts ('Transaction Accounts') at the Reserve Bank. These funds — digital 'Sovereign Money' — are a form of Central Bank Digital Currency (CBDC).

A CBDC gets its value and trust from a central authority, i.e. the government through its central bank. Cryptocurrencies such as Bitcoin, on the other hand, are deliberately designed to sidestep central authorities. They use distributed technologies such as blockchain and distributed ledgers to provide trust where there is no central authority. As such, they are often seen as an electronic substitute for (anonymous) physical cash.

Unlike cryptocurrencies, CBDCs like the one described here can scale well. They do not require cryptocurrencies' massive amounts of computing power and electricity. They mesh seamlessly with existing ways of doing things and they support the high transaction rates required for payment systems.

How Sovereign Money functions as a Central Bank Digital Currency

Under the current model, each (registered) commercial bank holds customer funds and runs its own payment system within the bank. The Reserve Bank then acts as a 'clearing house' to settle payments between banks.

With the proposed Transaction Account model, all payments are made directly through this Reserve Bank system which is simpler to regulate and, importantly, safer.

And because all transactions — both within and between banks — happen directly within the Reserve Bank payments system, banks can no longer create new money. The simple double-entry bookkeeping procedure that underpins current bank money-creation is no longer available to them.

From a customer's point of view, nothing changes as their bank or payment service provider is still the point of access to their money. But with their deposits in Reserve Bank Transaction Accounts, they are now completely protected in the event of a bank failure.

However, Transaction Accounts earn no interest. To earn interest, customers open an Investment Account with their commercial bank. These deposits are subject to minimum terms or notice periods, like term deposits today. It's these funds that are available to banks for lending. While they earn interest, they are also subject to risk in the event of bank failure.

Lending then happens in the way most people and textbooks expect it to — through banks acting as pure intermediaries, taking in deposits and lending them out with an interest margin. It's the same way that non-bank lenders, such as cooperatives, finance companies, and building societies operate today.

The open banking revolution — Unbundling of banking has begun in New Zealand

Commercial banks are being pushed to open up customer data and payment systems to competitors, such as non-bank payment service providers. This move to 'unbundle' banking functions is called 'Open Banking.'

It accelerated this year in New Zealand when Payments NZ, which manages our payments infrastructure, launched its API Centre.

An API (application programming interface) gives one computer restricted access to another. For example, APIs allow apps to access certain data from Facebook user accounts.

It's also the way that commercial banks would access customer data held in Transaction Accounts at the Reserve Bank. In this respect, Sovereign Money implementation would mirror the way Open Banking works but with an important caveat.

The digital payments infrastructure should be publicly owned

Payments NZ is an industry-led consortium. In our view, control of New Zealand's money and payment system is too important to be split among numerous private banks and left to an industry consortium to manage. This system — a legacy of the paper-based world — worked in the past but at present increases risk and regulatory complexity.

We recommend that New Zealand follow the lead taken by some other central banks (including the Bank of England) and move to centralise control of the payment system.

Tighter control of money and customer data will serve New Zealand much better as new entrants from fintech start-ups to powerful tech conglomerates (such as Facebook, Google, Amazon, and Apple) seek access.

The threat of a private global digital currency

As Facebook has shown with its Libra currency initiative, the potential now exists for new private currencies to undermine national currencies. Such threats are real and just around the corner.

Libra's design (and probably its intention) will allow it to serve as an alternative currency, not just for foreign transactions but for purchases between parties within the same country. It's likely it will also expand its services to lending.

The reach of Facebook and its partners makes it conceivable that the share of Libra transactions inside New Zealand's domestic economy could make it a systemic threat and complicate economic management — as it would be effectively competing with the NZ dollar on its home turf.

How Sovereign Money can lower risk while encouraging financial innovation

We know that the public's demand for new financial products and convenient digital access to their money will only increase, driven further and faster by the Open Banking movement.

The New Zealand Government must take steps to satisfy this demand while increasing the security, control, and value of our national currency.

Sovereign Money can provide the foundation that we need.

- Its design is digital from the ground up, unlike the current system which retrofits a paper-based legacy system
- At its core, it includes a central bank digital currency
- It can support financial innovation through initiatives such as Open Banking while improving security and control
- Its regulatory system is designed to improve government control over New Zealand's currency — a prudent move as new threats and opportunities rapidly emerge
- It secures cash deposits at a time of higher risk from rapid technology change and competition

As we face far-reaching, technology-driven change, our response must begin with a 'first principles' re-examination of money itself. Today's fiat money is a social construct, not a commodity. It's defined by rules and backed solely by trust in its issuer. We make those rules and create that trust.

Now is the time to examine our money system's very foundations. Perhaps that will mean some new rules or features that will work better to protect our dollar's status as the trusted unit of account, store of value, and means of payment.

For a time like now, we need to lead this reform from the driver's seat, not from the passenger seat as a mere regulator or even worse - from the back seat as a powerless spectator.

Section 2 - Our current money system doesn’t work for ordinary Kiwis

Our main concerns about New Zealand’s current debt-based money system are 1) the unfairness of the way this debt is created, 2) its direct role in high house price inflation, 3) the fragility it causes in our banking system, and 4) the indirect role it plays in starving public services (such as health, education and housing) of vital funding.

The unfairness of our debt-based monetary system

Private banks create most of our money ex nihilo (out of nothing) and then ‘lend’ this money to us with interest. Nearly every dollar that exists in the economy today was created because somebody went into debt.

As the banks create the money themselves, the main constraint is people’s ability to take on higher and higher levels of debt. Banks make enormous profits from money creation (more than $5 billion dollars every year - $12 million dollars a day) and most of that money disappears overseas. This is a huge drain on our economy.

In order to create enough money to keep our economy running smoothly, more people must take on debt than pay it off. When business confidence falls, banks become reluctant to lend money causing the available money supply to shrink. This subsequently creates what is known as the ‘bust’ cycle or a ‘recession.’ Conversely, when business confidence picks up, banks are eager to lend money and we have a ‘boom’ cycle and, in most cases, inflation.

This boom/bust cycle is an artificial construct based on the willingness of people to take on more new debt than what gets repaid. As more and more funds are siphoned out of the economy to service public and private debt, more and more families struggle to meet basic needs. Meanwhile, the government is increasingly starved of resources to maintain infrastructure and fund basic services.

When used productively, credit creation (and the debt that results) can be good for people, good for business, and good for the economy. Presently however, private banks are using credit creation to generate large profits for themselves while creating poverty and hardship for an increasing number of New Zealanders.

Although the state has the power to create the money supply at no cost, we instead choose to rent our money supply from private banks, at interest. We also allow them near total discretion in deciding where the credit they create will be directed.

At present, banks are pumping far too much credit into housing, creating house price and rent inflation. When high housing costs stretch their budgets, low income families take on more credit card and other private debt (from banks) to bridge the gap. Instances of financial hardship increase as payments to service this private debt increase.

Our present government’s Budget Responsibility Rules, which are a form of austerity, results in pressure to cut public spending and produce a budget surplus. This, in turn, removes money from the economy, requiring families to take on even more debt.

The role of private money creation in high house prices

For decades, commercial banks in New Zealand have expanded the money supply much faster than required to support economic growth. In the thirty years from 1989 to 2019, GDP grew by a factor of 4.2[1]. In the same period banks expanded the money supply by a factor of 8.8[2]. Banks expanded the supply of NZ dollars *more than twice as much* as was needed for economic growth and allocated more than 90% of new money to buying houses. The results have been sky-rocketing prices - creating some of the most unaffordable housing in the world[3] - and in turn creating unsustainable debt, poverty, and hardship for regular New Zealanders.

Much has been written about the causes of high demand (e.g., immigration, population growth, speculation by investors, and foreign buyers) and about lack of supply (e.g., Resource Management Act restrictions, council inefficiency, lack of infrastructure, land-banking), but almost nothing has been said about the second cause: excess money[4]. Unlike goods inflation (which has a target band of 1% - 3%), there is no such limit on house price inflation.

In our view, the root cause of the issue is that banks decide what quantity of money to create and where to inject it into the economy. Because capital ratios imposed by the Reserve Bank dictate that banks must hold more capital for business loans than for housing loans, mortgage lending becomes more profitable.

Banking fragility under our current money system

Under our current money system, private banks hold only a small fraction of deposits as cash-on-hand available for withdrawal. For example, according to its financial statements at 30th September 2018, the ANZ Bank held 0.2% of its deposits as cash [5]

During normal times, this level is sufficient to cover the day-to-day cash transaction needs of customers. However, in times of economic crisis, a lot of people may try to withdraw their money all at once (a 'bank run'). Under this scenario, banks will have grossly insufficient cash reserves to service all of their customers with chequing and savings accounts.

Nearly 97% of the money we use to conduct business is not cash, but electronic money created by private commercial banks when they issue loans. We swap these electronic deposits back and forth amongst ourselves when we are paid wages and buy our goods and services.

Again, during normal times this arrangement of paying by swapping bank deposits works well. However, if a bank is in financial trouble (perhaps due to making risky loans?), then its deposits become unavailable when depositors seek to withdraw their funds.

When banks become too big to fail

Due to their key role in creating 97% of our money supply, the functionality of the New Zealand economy depends on private banks remaining solvent. This is particularly apparent in an economy the size of New Zealand's, as our largest banks are considered 'Too big to [let] fail'. A failure of one bank puts the whole economy in jeopardy. Historically when a bank failed, the government was forced to step in and bail out the bank, usually at great cost to taxpayers.

During the financial crisis of 2008, the Reserve Bank provided 'crisis liquidity facilities' to banks, the government guaranteed 'wholesale funding to enable banks to continue to issue debt'[6], and the government guaranteed deposits at banks and finance companies, eventually paying out over $2 billion to depositors of failed finance companies.

With the passage of the 2013 Open Banking Resolution (OBR)[7], the New Zealand government shifted responsibility for bailing out banks from taxpayers to creditors and depositors. In order to keep a failing bank open, the OBR allows the Reserve Bank of New Zealand to freeze a portion of all the failing bank's deposits and liquidate the assets of shareholders and unsecured creditors. It will then (if necessary) 'haircut' the depositors by essentially confiscating a proportion of their chequing and/or savings accounts to recapitalise the bank.

In theory, the Reserve Bank of New Zealand (RBNZ) controls the money supply by setting the Official Cash Rate (OCR), the interest the RBNZ charges banks on overnight loans (reserves). The implication is the RBNZ can control the total volume of money in the economy by controlling the interest charged on reserves. However, in practice, the OCR has very little impact on the amount of money in circulation. Evidence shows banks create deposits when they make loans and seek out reserves later.[8]

At present, the RBNZ sets out 'capital adequacy requirements,' requiring banks to hold a minimum percentage of the loans they issue as capital. At present this percentage amounts to a weighted average 10.5% [9], though big banks are allowed to develop their own capital adequacy regimes (some 4% or less) depending on the level of loan risk.[10]

The RBNZ enforces these capital adequacy requirements very weakly if at all, as shown by recent scandals at Westpac [11] and ANZ.[12]

The major banks strenuously oppose efforts by the RBNZ to increase capital adequacy requirements to 16%. New Zealand's largest bank (ANZ) is threatening to withdraw services from New Zealand if this new regulation is adopted.[13]

Why regulation isn't working

Conduct by banks is meant to be monitored by the Reserve Bank. However, the rules are so complex and the Reserve Bank so under-staffed that the Reserve Bank can only perform 'light handed' oversight. Basically, banks monitor themselves and calculate their own risk, with the Reserve Bank occasionally providing oversight and only after the fact.

With banks creating more than 97% of our money supply, while holding insufficient cash and reserves to protect themselves during a crisis, financial trouble at one bank can threaten the entire New Zealand economy. In an ideal monetary system designed to work for ordinary Kiwis, the power to create money would return to the state.

Underfunding of essential public services

Finally we're very concerned about the way a growing debt burden is used to justify starving our public services of adequate funding. It's extremely discouraging to see New Zealand nurses and teachers striking for the first time in a generation. Our current Labour-led government is reluctant to restore de facto spending cuts in health and education, in the mistaken belief they must increase debt to do so [14]. The ballooning DHB deficits [15] [16], long waiting lists for urgent specialty services, [17] [18] [19] [20] [21] and difficulty in recruiting doctors and nurses [22] (which also relate to health sector underfunding) are equally disheartening and problematic.

We also see the detrimental effect of inadequate funding in the worsening homelessness crisis [23] and the continuing absence of public housing options. This, in turn, is leading to a growing number of housing grants for motel accommodation [24]. Data shows New Zealand now has the highest house prices relative to income in the OECD. Each quarter the number of families needing help to pay for accommodation grows. At last count, 13,500 households were on the state house waitlist and about 66,500 families were living in state housing (defined as living in a public housing placement and receiving the Income Related Rent Subsidy).

According to Treasury, demand for assistance will only continue to increase, as the national average asking price for rent creeps above $500 a week. Many of those in need will be low-income families - 1 in 5 of those currently on the Accommodation Supplement are working households. However they will also include burgeoning numbers of retiring baby boomers who have not bought property and cannot afford rent. [25]

Changing the way money is created in New Zealand could begin to address these funding crises within weeks or months, without raising taxes and without increasing borrowing or debt.

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Section 3: How the Positive Money proposal would work

What Positive Money NZ proposes is a system of managing New Zealand’s money supply under which the Reserve Bank creates all the country’s money (coins, notes and electronic) debt-free. This type of publicly created money is commonly known as Sovereign Money. The decision on how much or how little money needs to be created would be taken by an independent body called the Monetary Policy Committee (MPC). The MPC would be completely separate and insulated from any kind of political control or banking industry influence - in other words, the elected government would not be able to specify the quantity of money that should be created.

Upon making a decision to increase the money supply, the MPC would authorise the Reserve Bank to create new money by increasing the balance of the government’s ‘Central Government Account’. This newly-created money would be non-repayable and therefore debt-free and would be added to tax revenue and distributed according to the elected government’s manifesto and priorities.

To the average person, banks would appear to operate very much as they do now. However, the necessary ‘behind the scenes’ changes required to prevent banks from creating money would mean that there are a few subtle changes to the terms of service on current accounts and savings accounts.

Banks would not be permitted to lend the money held in Transaction Accounts (the equivalent of today’s current accounts). Instead, any money held in these accounts would be held in ‘fiduciary trust’ by the Reserve Bank on behalf of the customers. In practical terms the money would be held in a ‘Customers’ Funds Account’ - the equivalent of putting the money into a safe-deposit box with the customer’s name written on it.

These Transaction Accounts could then be considered 100% safe. Since the money is technically held at the Reserve Bank, the customers are guaranteed to be repaid, even if their bank becomes insolvent. This guarantee does not expose either the government or the Reserve Bank to any financial risk since Transaction Accounts are inherently risk-free for the customer.

In order to lend money, banks would need to find customers willing to give up access to their money for a certain period of time. In practice, this means that the customer will need to invest their money for a defined time period or set a minimum notice period that must be given before the money can be withdrawn.

Banks would then operate in the way that most people think they currently do - by taking money from savers and lending it to borrowers.

Benefits of the Positive Money proposal

Money where needed

The money supply will be expanded based on the needs of the productive economy (businesses) and the need for infrastructure, not based on what maximizes bank profits. There will be money available for fixing water and wastewater systems, for transport projects, and for other key community assets such as schools and hospitals. Any infrastructure projects that are currently on hold because of fears of growing government debt can finally move forward.

Stable house prices, more affordable housing

New money will not be created for speculation on existing housing and shares. When people borrow money to purchase assets, it will come from existing money invested with banks. With bank loans created purely from existing funds, there will be far less pressure on house prices, and homes will become more affordable for the average New Zealander.

Lower interest costs for government

Instead of borrowing from banks, the government, via the Reserve Bank, will spend Sovereign Money directly into the economy to fund expenditures. This means government debt will decrease, along with the associated interest expense.

Instead the $4.7 billion of tax dollars currently spent on interest can be used to fund public services, reduce taxes, reduce public debt, pay a citizens dividend, and/or provide extra funds for business lending.

Safer, more reliable monetary system

The monetary system will be safer by design.

With private banks playing a purely intermediary role, private banks will cease to be 'too big to fail.' The risk of bank runs will be greatly reduced because deposits on Investment Accounts have maturities that are distributed over a longer period, allowing troubled banks more time to liquidate assets. With Transaction Accounts held separately at the RBNZ, if a commercial bank failed, the administration of its Transaction Accounts could be transferred to a different bank, with no loss to the taxpayer or account holders.

Ideal platform for digital currency

Sovereign Money is an ideal platform for a Central Bank Digital Currency (CBDC). Sovereign Money implementation would mirror the way Open Banking works but with an important caveat: the digital payments infrastructure will be publicly-owned.

The inflation myth

A common reaction to the proposal to allow the government to create our money is to claim it would be inflationary. This argument does not stand up to scrutiny. Transferring the creation of a similar volume of money from private banks to the government would not be, in itself, inflationary.

All commonly-cited examples of hyperinflation from government-created money took place in the context of extreme social and economic disruption.

Some critics point to the hyperinflation of the Weimar Republic after World War 1 which was supposedly caused by excessive government money printing. In reality, in May 1922 the Allies insisted on privatising the Reichsbank. This institution then allowed private banks to issue massive amounts of currency, as well as enabling speculators to short-sell the currency.

It was only when the government took back control of the Reichsbank that the hyperinflation was brought under control. In other words, this episode clearly cannot be blamed on excessive money printing by a government-run central bank. It rather resulted from excessive money creation by private speculators, aided and abetted by a private central bank, in addition to excessive reparations claims.

It should be pointed out that more recent cases of hyperinflation in emerging markets also took place in the presence of large transfer problems and intense private speculation against the currency. The example of Zimbabwe is a case in point.

In contrast, a paper for The Levy Economics Institute of Bard College entitled *'Is Monetary Financing Inflationary? A Case Study of the Canadian Economy*, 1935–75' by Josh Ryan-Collins supports this view. [1]

The abstract of the paper states

> We find little empirical evidence to support the standard objection to such policies: that they will lead to uncontrollable inflation. Theoretical models of inflationary monetary financing rest upon inaccurate conceptions of the modern endogenous money creation process.
>
> This paper presents a counter-example in the activities of the Bank of Canada during the period 1935–75, when, working with the government, it engaged in significant direct or indirect monetary financing to support fiscal expansion, economic growth, and industrialization.
>
> An institutional case study of the period, complemented by a general-to-specific econometric analysis, finds no support for a relationship between monetary financing and inflation. The findings lend support to recent calls for explicit monetary financing to boost highly indebted economies and a more general re-think of the dominant New Macroeconomic Consensus policy framework.

The paper makes reference to the pre-war period between 1935 and 1939, when the Canadian central bank played a major role in the country's recovery from the Great Depression. It funded over two-thirds of government expenditure over these five years.

Nominal gross national product (GNP) expanded by 77% in contrast to the 70% contraction in the previous five years, with a sharp increase in capital investment and private expenditure. Bank deposits expanded by a similar amount, while currency in circulation increased by 70%. Deflation was reversed but inflation remained stable despite the massive expansion in the money supply.

[1] http://www.levyinstitute.org/pubs/wp_848.pdf

Section 4: The question of implementation

New Zealand, Canada, Australia, and Guernsey have done it before

New Zealand

Back in the 1930s the Reserve Bank successfully created money to build the first state houses, fund infrastructure and new businesses. [1] 'The sums advanced by the Reserve Bank were not subscribed or underwritten by other financial institutions. This action showed the Government's intention to demonstrate it was possible for the State to use the country's credit in creating new assets for the country.' [2]

Many older people remember the low interest loans received from the State Advances Corporation (1936-74) for their homes or businesses. What they may not realise is that the source of these funds was Sovereign Money created by the Reserve Bank and issued directly into the economy. The money was not borrowed from commercial banks, not borrowed from overseas, did not come from Private Public Partnerships or Special Purpose Vehicles.

With the money created by the Reserve Bank, many Kiwis were able to buy houses, were lifted out of poverty, and were able to start businesses. New Zealand came out of the Depression faster than most other countries in the world. [3]

The Canadian (1935-1975) Experience [4]

As mentioned earlier, Canada also issued Sovereign Money directly into the economy during the Depression. In the prewar period between 1935 and 1939, the Bank of Canada issued money both to repurchase government securities and to pump large quantities of cash reserves into chartered banks.

Canada's central bank continued these and similar policies to support the war industry during World War II. In 1944 the Canadian government created the International Development Bank to support Canada's medium and small enterprise sector. In contrast to most public development banks, which were capitalized with taxpayer funds and leverage-in private finance, the IDB was entirely funded via money creation by the Bank of Canada. During the period 1960–75, the federal government introduced virtually all of the major policy innovations that make up Canada's system of social programs: Canada-wide Medicare, universal pensions, the modern unemployment insurance system and cost-sharing with the provinces for higher education and welfare. It also relied on this money to build the St Lawrence Seaway. Despite this massive expansion in spending, the average federal deficit from 1950 to 1980 was an insignificant 0.3% of GDP. Inflation ranged between 2 and 5%.

The Commonwealth Bank of Australia [5]

The Commonwealth Bank of Australia was a government-run bank founded in 1911. In addition to assuming sole responsibility for issuing Australian notes, it funded the entire Australian World War I effort by issuing £350 million ($700 million) at approximately 0.5 % interest. At the time, private banks were charging 6% for loans that had to be negotiated via London. The bank also directly issued $872 million to help finance wheat, wool, meat, cheese, and sugar pools for primary producers, as well as lending $8 million for home purchases and $18.72 million to local government bodies for the construction of roads, railways, tramways, harbours, gasworks, electric power plants, and the like.

Despite the bank generating a total profit of over $23 million, Parliament voted in 1924 to take the Commonwealth Bank out of government hands and allow a consortium of private bank directors to run it. This change essentially eliminated its role as a creator of Sovereign Money.

Guernsey [6]

In 1816 the Governor of the island of Guernsey decided to bypass the banks and issue interest-free currency to pay workers to undertake essential infrastructure projects.These included rebuilding roads and seawalls that had been washed away and also building a market hall to shelter market traders. By 1837, notes to the value of £55,000 (issued by the State) were in circulation on the island, enabling Guernsey to build a new college and new schools.

The program is credited for greatly enhancing trade, tourism and prosperity on the island.

In the 1830’s the first commercial banks moved in; after some years of persuasion and political pressure, Guernsey abandoned this interest-free source of funds and exchanged it for interest-bearing debt from the banks.

Transition to a Sovereign Money system in New Zealand

There are two broad choices for the transition process – either a phased-in approach, or an immediate switch. Our proposals ensure that either approach could be implemented without disruption to the wider economy. In the first, phased-in approach, the RBNZ would start to create money directly, transferring this money to the government for spending into the economy, as described above. However, banks would still be permitted to operate as they currently do, creating money in the process of making loans.

Over time, the amount of money that banks could create would be progressively restricted. A larger proportion of new money needed to replace the money cancelled out by loan repayments, and any necessary additions to aggregate demand, would come from money creation by the Reserve Bank. While in place, this hybrid arrangement would constitute a partial Sovereign Money system. Eventually a conversion date would be agreed, at which banks would be required to switch over to the structure of banking described above and would therefore lose their ability to create money.

A more rapid approach would be to transfer the power to create money from banks to the RBNZ overnight, switching immediately to a full Sovereign Money system. This could be done without changing the net wealth of banks, businesses or households and without causing a damaging contraction in the amount of credit available. In this overnight process, the bank-issued demand deposit liabilities to the general public would be taken over as liabilities of the Reserve Bank and converted into state-issued Sovereign Money held there in accounts for the public.

Instead of having a liability to their customers, each bank would then have an equivalent liability to the Reserve Bank (so that there would be no overall impact on the size or nature of each bank's balance sheet and no windfall profit for the banking sector). The state-issued Sovereign Money would be recorded as an accounting liability of the RBNZ, balanced on the balance sheet by these new liabilities of the commercial banks and by non-interest-bearing zero-coupon bonds.

References

[1] State Housing in New Zealand, Cedric Firth, Ministry of Works, 1949, page 7.

[2] http://nzetc.victoria.ac.nz/tm/scholarly/tei-GovCour-t1-body-d5-d23.html

[3] https://teara.govt.nz/en/1966/finance-public/page-9

[4] http://www.levyinstitute.org/pubs/wp_848.pdf

[5] https://alor.org/Storage/Library/PDF/Amos%20DJ%20-%20Commonwealth%20Bank.pdf

[6] https://monneta.org/en/the-guernsey-experiment/

Appendix - Additional Resources

1. *Sovereign Money - An Introduction*

https://positivemoney.org/wp-content/uploads/2016/12/SovereignMoney-AnIntroduction-20161214.pdf

2. *The Truth about Banks* by Michael Kumhof and Zoltán Jakab (IMF, FINANCE & DEVELOPMENT, March 2016, Vol. 53, No. 1)
   https://www.imf.org/external/pubs/ft/fandd/2016/03/kumhof.htm

3. *Monetary Reform: A Better Monetary System for Iceland*

https://www.stjornarradid.is/media/forsaetisraduneyti-media/media/skyrslur/monetary-reform.pdf

4. *Is Monetary Financing Inflationary? A Case Study of the Canadian Economy, 1935–75*

http://www.levyinstitute.org/pubs/wp_848.pdf

5. *The Chicago Plan Revisited*

https://www.imf.org/external/pubs/ft/wp/2012/wp12202.pdf

6. *Bank of England Quarterly Bulletin* (2014) Money Creation in the Modern Economy

https://www.bankofengland.co.uk/quarterly-bulletin/2014/q1/money-creation-in-the-modern-economy