OnsGeld
GELDSCHEPPING IN ALGEMEEN BELANG

New instruments for monetary policy

For years, the ECB has been shooting with bazookas. It has rarely hit its target. Criticism is growing. How do we arrive at effective monetary policy? This is a regulatory issue which transcends the competence of the ECB. The legislator must act and change the institutional order, to enable the ECB to govern the euro sensibly.

The ECB is stuck in a straitjacket which it cannot undo on its own. Politics must furnish it with new instruments with which it can operate more efficiently and less distortionary. This involves the introduction of personal safe accounts. Personal safe accounts are an alternative to the bank account improving clients' negotiating power vis-à-vis the banks. With safe accounts, banks can be exposed to market discipline in a responsible way. Personal safe accounts also lay the foundation for digital cash.

New instruments

Personal safe accounts provide two new instruments to the ECB: (i) Determination of the amount that each person can hold freely on its safe account, and (ii) determination of the tax rates applied to the excess. With these instruments, the ECB can control the pace at which banks are exposed to market discipline. At the same pace lending can be liberalized and deposit guarantees can be phased out.

When the safe account is generally accepted, a third instrument for monetary policy comes into view. This instrument concerns the power to increase the money supply without increasing debt and without disturbing securities markets. This third instrument eliminates the need for an inflation target and enables the monetary authority to steer towards absolute price stability.

ECB policy

Today, ECB policies and criticism take on grotesque forms. The president of the central bank of The Netherlands (DNB) openly distanced himself from ECB policy and a group of former central bankers published a very disturbing message. They believe that the ECB is violating its mandate and running the risk of losing control. ECB policy also caused concern in the Netherlands' House of Representatives, particularly because of looming negative deposits rates.

Negative interest increases systemic risk. It is an incentive for reducing liquidity and increasing debt. This undermines the resilience of the economy and makes society more vulnerable to crises. Citizens and businesses should be encouraged to limit debt and build up sufficient liquidity buffers. The ECB, however, is pushing in the opposite direction; more debt and lower buffers to cause inflation. Prudence and price stability are hard to find in its policies.

Money, debt and inflation

The ECB is trapped in a straitjacket which it cannot resolve on its own. Its policy instruments stimulate debt growth and disrupt the markets.[1] Today, however, general debt burdens have reached such high levels that further debt growth is counterproductive.[2] The only remedy available to the ECB is inflation which generally decreases real debt burdens. This explains why the ECB strives for inflation, at all costs.[3]

To release the ECB from its straitjacket, the ECB must be equipped with tools that allow it to govern the euro more efficiently, without increasing debts and eroding liquidity buffers. These tools will become available with the introduction of personal safe accounts. Personal safe accounts offer the public a credit-risk free alternative to the bank account. They also provide the basis for a market-oriented development of digital cash.

Safe alternative to the bank account

Personal safe accounts were first proposed by Ons Geld in 2019. They are issued by a public full-reserve institution which undertakes nothing with the deposits it receives from its clients. It holds these deposits at the national central bank and keeps them constantly available to the right-full owner.

In 2016, in response to citizens' initiative 'Ons Geld', Parliament of the Netherlands already wanted to introduce a full-reserve institution.[4] The Minister of Finance (Jeroen Dijsselbloem)

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[1] The ECB does not increase the money supply by putting more banknotes into circulation. It expands the money supply by buying securities on credit and encouraging banks to grant more credit. With a stimulating policy, the ECB is putting both itself and society in debt.

[2] In 2015, the OECD wrote that further credit expansion has a negative effect on growth in most OECD countries. See: 'How to restore a healthy financial sector that supports long-lasting, inclusive growth?' That this is the case can be logically deduced. Today, money creation is in the hands of commercial banks. They create what we use as money in the form of interest-bearing credit. They do so to the extent it is profitable for them. This profitability is largely determined by the likelihood that borrowers can service their debts. As their debts increase, the risk that borrowers won't service their debts increases too, making it less attractive for banks to further expand lending to these borrowers. This explains why increasing debt levels turn off the money tab in society.

[3] More on this in 'Waarom de ECB naar inflatie streeft'. An English translation will be available soon.

[4] In response to citizens' initiative 'Ons Geld', Parliament of the Netherlands voted unanimously in favour of introducing a full-reserve institution to enable the Dutch to hold money on account, free of credit risk. To this end, it called on the government to "*investigate how financial regulation should be altered to enable the establishment of a full-reserve institution*" (TK 34346-13). This way, Parliament wanted to implement a safe alternative to the bank account.

however, decided not to go along referring to ongoing research from the Scientific Council for Government Policy (WRR) concerning the money system. He wanted to await their report before making any decision. That report was published at the beginning of 2019.[5] The WRR advised in conformity with the wishes of Parliament. It stated that the introduction of a safe alternative for the bank account makes the monetary-financial system more stable.[6]

The WRR did not stipulate how this safe alternative should be implemented. Ons Geld filled the gap by proposing the introduction of personal safe accounts. With these accounts the safe alternative can be introduced seamlessly, without delay and on the basis of proven technology.

Personal safe accounts

Personal safe accounts are held at a public depository and accessed via a payment service provider of choice.[7] The account holder decides who has access to his data and for what purpose. Whenever he changes his bank, he takes his personal safe account with him. The payment service provider that gives access to the account can change. The safe account, however, remains the same. The IT around the safe account can be developed and maintained in a public-private partnership with the banks. That reduces costs and improves the efficiency of know-your-customer processes and the detection of suspicious transactions.[8]

A full-reserve institution undertakes nothing with its clients' money, apart from keeping it in custody on its account at the national central bank (DNB).

[5] See the presentation of January 17, 2019 of the WRR report 'Money and debt' which was drawn up in response to citizens' initiative 'Ons Geld'.

[6] The WRR agues that: *"(...) creating a safe alternative can contribute to a more stable system. The fact that one has an alternative will have a disciplinary effect on the existing banks. It will force banks to finance more responsibly, with more equity (capital) and long-term debt. In this way, the creation of money and debt by commercial banks is also better contained."* WRR (2019) Geld en schuld: De publieke rol van banken, page 237.

[7] The safe account was first proposed in 'Public depository: safe-haven and level playing field for book money'. A further elaboration is given in 'A personal safe account for everyone'.

[8] The fact that banks have an interest in this is illustrated by the proposal of Triodosbank for a 'bankgirocentrale 2.0' and efforts of the Netherlands banking association to institutionalize the cooperation between banks and the government for monitoring payment transactions.

Some argue that the Netherlands' central bank (DNB) should provide the safe accounts to the public.[9] We consider that inappropriate though. The central bank must not undertake those activities it is supposed to supervise. Nor should it compete with the banks and other payment service providers under its supervision.[10] Safe accounts should therefore be issued and held at a separate institution residing under the Treasury (Finance Ministry). This public depository is a full-reserve institution. It holds the funds received from its account holders at the national central bank. It does not engage in any activity other than issuing personal safe accounts and ensuring that each holder has access to its safe account. Access is typically provided by a payment service provider designated by the holder of the safe account. This does not exclude however, that the public depository offers basic payment services itself, to ensure that everyone can participate in payment transactions.

Supervision and monetary policy

The public depository is not a bank and not exposed to liquidity risk.[11] It requires supervision under an appropriate regime that fits with its special position within the monetary policy framework. This regime must encourage everyone to build up substantial liquidity buffers on their safe accounts. It must also encourage account holders with sufficient liquidity buffers to invest the excess in the economy, for example by lending it to banks.

Initially, monetary policy for safe accounts is conducted to control the outflow of deposits from banks to safe accounts. This outflow must happen gradually, allowing banks the time to refinance themselves in a market-oriented way. This requires that the amount that each person can hold freely on its safe account is limited, and that any excess balances are taxed progressively. Determining the free amount and the tax rates for excess balances are part of monetary policy and fall under the discretion of the European System of Central Banks

[9] See the letter sent by members of the Sustainable Finance Lab (SFL) to the Standing Chamber Committee for Finance, on October 10, 2019.

[10] According to article 127 TFEU, the European System of Central Banks (ESCB) promotes the smooth operation of payment systems, whereby the ESCB must act in accordance with the principle of an open market economy with free competition. Therefore, under European law, central banks must not offer payment services themselves. They must not conduct the activities nor compete with the entities it is supposed to supervise.

[11] A bank ('credit institution') is an organization that borrows money from the public and grands credit for its own account (article 4 Capital Requirements Regulation 2013). The public depository does receive repayable funds from the public. Yet, it is not a bank because it undertakes nothing with these funds apart from holding them in custody at its account at the national central bank.

(ESCB).[12] The safe account thus requires active involvement of the monetary authorities. It provides them with new instruments which enable them to fundamentally improve the stability of the euro and reduce the need to prop up banks with taxpayer's money. Involvement of the European Union is also desirable as establishing a national system of personal safe accounts in each Member State has a stabilizing effect on the euro area. It curbs capital flight and the associated imbalances within the ESCB.

Interest

Money on safe accounts is interest-free. After all, it is not lent to a bank that finances its business with it. It is held in custody. Everyone must be able to hold sufficient liquidity buffers on their safe account, which is therefore free of charge. The deposits of the public depository at the central bank must also be interest-free.[13] It is appropriate, however, if the central bank offers inflation compensation in so far as its policy is still geared towards inflation.[14]

Regarding safe accounts, monetary policy is not conducted on the basis of interest. Instead, the central bank obtains the two new and related policy instruments mentioned above. With these instruments, the amount of money on safe accounts is managed by progressive taxation of excess balances on safe accounts. Account holders with excess balances on safe accounts thus pay for the safety the government provides. The treasury is the beneficiary of the revenues, which is fair because the stability of the euro ultimately stems from the government and its power of taxation.

Gradual transition

The central bank will determine and adjust the amount that each person can hold freely on its safe account. It will also determine and adjust the rates at which balances in excess of this free amount are taxed. In the beginning the free amount is low and the excess heavily taxed. This keeps the outflow of savings from the banks under control. Over several years, the

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[12] The European Union has exclusive competence regarding the monetary policy for Member States whose currency is the euro (article 3 TFEU). Monetary policy of the Union is defined and implemented through the ESCB (article 127 TFEU).

[13] This fits with the current policy of the Bank of England regarding non-bank payment service providers ('non-bank PSPs'). Settlement accounts of non-bank PSPs at the Bank of England are not remunerated because non-bank PSPs are not part of the monetary policy transmission mechanism and not exposed to inherent overnight liquidity risk. BoE, 2017, A blueprint for a new RTGS service for the United Kingdom.

[14] Inflation compensation in relation to personal safe accounts is briefly explained in 'A personal safe account for everyone'.

free amount is gradually increased, replacing deposit guarantees which are ultimately phased out.

For example, the amount that anyone can hold freely in its personal safe account is initially set at € 10,000, and annually increased by € 10,000, while the amount covered by deposit guarantees is reduced by € 10,000 each subsequent year. In the end, the deposit guarantee system is then replaced by a system in which money can be stored free of credit risk.

Future policy

When the deposit guarantee system is completely abolished, the amount that can be held freely on a safe account remains limited. This limit is important to keep the money system manageable and to keep the financing of the economy going. Progressive taxation of excess balances is, after all, an incentive which stimulates the wealthy to lend, invest or spend their money.

With personal safe accounts, monetary policy can focus on the resilience of society based on the safe liquidity buffers that each person can hold freely. At the same time, it stimulates the financing of the economy by progressively discouraging holding excess balances idle on safe accounts. The latter only concerns persons who are sufficiently wealthy that it is justified to subject them to incentives to invest.

Negative interest

The safe account also addresses a current concern of politicians: negative deposit rates. By giving depositors a safe place for book money they get real negotiating power vis-à-vis the banks. It enables depositors to conveniently withdraw their money from the banks whenever they believe they are insufficiently rewarded with interest. This enhances market functioning regarding the way banks finance themselves. Providing funding to banks will then become a deliberate choice which requires risk transparency on behalf of the banks. One consequence of this is that interest rates will start to reflect the risk implied in lending money to each specific bank.

As pointed out, market processes for bank financing must be introduced gradually. Banks need time to adjust the composition of their funding to free market conditions. As explained, the central bank will be able to make sure that banks are not suddenly deprived of funding. It will do so by determining the amount that each person can hold freely on its safe account and the rates by which excess balances on safe accounts are taxed.[15] This way, banks can refinance

[15] Negative interest rates should not be confused with taxation of excess balances on personal safe accounts. The latter is an instrument to manage the monetary system. The revenues derived from taxation accrue to the treasury, which is fair because the safety of money is ultimately derived from the state and its power of taxation. Interest on the other hand, is a reward for providing funding. It

themselves in a market-oriented way, as money is gradually secured on safe accounts. This forms the basis for a step-by-step process in which lending is liberalized and deposit rates are increasingly determined by undistorted market processes for assessing, pricing and acceptance of risk.

Cash

With personal safe accounts, negative deposit rates will ultimately become impossible.[16] This eliminates the need to ban cash. With current monetary policy, on the other hand, cash is under pressure. Illustrative is a publication from the IMF proposing strategies to curtail the use of cash.[17] The background to this is the expectation that policy rates might become deeply negative in the future. Abolition of cash is undesirable however, as it plays a vital role for personal privacy and as a backup in the event of power outages and cyber-attacks. Moreover, as the WRR argues, the monetary system has become unbalanced, partly due to the marginalization of cash and other publicly issued monies.[18] It is therefore important not to abolish cash but to rehabilitate it. The personal safe account makes that possible. It ensures that cash does not have to be abolished. It also lays the foundation for the development of digital cash and will ultimately put cash at the center of monetary policy.

Digital cash

Both the finance minister (Wopke Hoekstra) and the Sustainable Finance Lab (SFL) seem to believe that digital cash should be developed by the central bank.[19] This is inconsistent, however, with the need for innovation and the principle of an open market economy with

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compensates for the risk attached to a loan. Occurrence of negative interest rates indicate that market mechanisms concerning the funding of banks and governments don't function properly. These mechanisms should therefore be revised. On a well-functioning market, negative interest rates for lending are impossible. After all, market participants don't provide funding at negative interest rates out of free will. In the present system, however, they are coerced to do so because they are denied a safe place for book money. Only banks have access to central bank accounts. Non-banks can hold cashless money only by providing it as funding to financial institutions. That is a deficiency in the organisation of the money system which can be resolved by introducing personal safe accounts.

[16] Provided that the amount that each person can hold freely on its safe account is gradually but steadily increased until lending is fully liberalized.

[17] IMF working paper, WP/19/84, Enabling Deep Negative Rates to Fight Recessions: A Guide, Ruchir Agarwal and Miles S. Kimball.

[18] WRR (2019) Money and debt: The public role of banks.

[19] Both the cabinet (TK 35107-2) and the SFL (letter of 10 October 2019) refer in their response to the WRR report 'Money and debt' to 'central bank digital currency' (CBDC), a collective term for digital monies issued by a central bank.

free competition to which the central banks are bound.[20] Digital cash technology is still in its infancy. It needs to develop in a competitive market. It would be inappropriate for the supervisor to take that development in its own hands. Its function is to set the conditions for fair competition and not to set competition aside. This is not to say that the government must stay aloof from digital cash. The development of digital forms of money must obviously take place under government supervision and without systemic risk. The personal safe account makes that possible.

The safe account provides the foundation on which market participants can base digital forms of money. The network advantage of the general monetary system will then become available to all market participants under equal conditions. This way, the government can enhance innovation without compromising the stability of the money system. It will be able to control the amount of digital money that comes into circulation and to prevent powerful market participants from dominating the monetary-financial system and distorting competition.

Debt-free money

When the safe account is generally accepted, the money on safe accounts can become debt-free. This means that it is no longer considered a claim on the public depository.[21] It has then become the digital embodiment of the general unit of value; digital cash.[22] Unlike physical cash, digital cash can be used as a monetary policy instrument.[23] This makes it possible to

[20] Article 127 TFEU.

[21] At the same time, bank deposits should be demonetised, meaning that they get a free exchange rate with the euro. The central banks can then discontinue all distortionary activities including the sale and purchase of securities and their acting as a lender-of-last-resort. Their assets are then no longer needed for monetary policy and can be used to providing a soft landing for the over-indebted monetary-financial system via a modern debt jubilee.

[22] A similar situation occurred in relation to bank notes of the Netherlands central bank (DNB). Until 1948, these bank notes were promissory notes, convertible in ‘real money’ (gold and specie) on demand. In 1948 convertibility was abandoned which improved the status of those notes. They transformed from being representations of claims to money (financial assets) into the embodiment of the general unit of value: cash. As a result, the – at that time – questionable content of the vaults of the Netherlands central bank no longer casted a doubt over the value of its notes. That value was now derived from their general use as money. The dichotomy between nominal and underlying value disappeared. Trust in the notes no longer depended on the (questionable) assets of the central bank. In became fully dependent on the governance of the money system.

[23] Cash currently exists only in the form of euro notes and coins (‘physical cash’). These notes and coins are debt-free because they do not represent a claim on the issuing entity. Theoretically they can be used to expand the money supply without increasing debt, simply by printing notes and handing them out for free. They are, however, not used in this way. Notes and coins are generally unfit for use as

expand and control the money supply without increasing debt, and without pursuing inflation. This is the key instrument that is needed to manage the euro efficiently. Debt growth, market distortion and inflation are then no longer inherent to monetary policy. Central banks, however, cannot obtain this instrument on their own. Only the legislator can call digital cash into existence. As a debt-free *intangible liquid asset* digital cash requires a legal basis.[24] It is therefore a political responsibility to introduce this form of money and to determine the way it is organized. It is thus not the ESCB but the legislator who holds the key to making monetary policy effective and non-distortionary.

It is up to politics

The ECB can hardly be blamed for shooting around with bazookas. It uses the instruments available to it. Under current market conditions, however, these instruments are completely ineffective. Harmful side effects dominate their use. The ECB itself is now a major cause of financial instability.

The ECB should call on politicians to free it from its dysfunctional straitjacket. Now that it fails to do so, politicians must set the course on their own initiative. In the Netherlands there is broad consensus on the first step that should be taken; the introduction of a safe alternative to the bank account. This has received wide acclaim from citizens, politicians and scientists.[25]

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monetary policy instruments. Their circulation is uncontrollable and opaque. Digital cash, on the other hand, could perfectly be used for efficient and non-distortionary monetary management. Today, however, neither banks nor the central bank can generate digital cash as an intangible liquid asset. In the digital domain, their power is limited to generating monetary instruments based on debt ('financial assets'). Digital cash, however, has its basis not in debt (contract) but in the law (legislation). It needs to be 'coined'. The legislator is the only one that can charter the coinage of a digital euro. As it does so, it should obviously also determine under what conditions and by whom digital euros are created and put into circulation and who should benefit from it.

[24] An asset which is intangible and not a claim involves legal complications. The ownership and legal transfer thereof require a legal basis, such as exists for copyright and other intellectual property rights. For a detailed analysis of this problem under English law, see: Jean Bacon, Johan David Michels, Christopher Millard & Jatinder Singh, Blockchain Demystified: A Technical and Legal Introduction to Distributed and Centralized Ledgers, 25 RICH. JL & TECH., No. 1, 2018. Regarding the law of the Netherlands we should point at article 3:83 of the Dutch Civil Code, which provides that rights other than ownership, limited property rights and debt-claims are only transferable if this is provided by statutory law. Under article 5:1 and article 3:2 of the Dutch Civil Code ownership relates only to physical objects susceptible to human control. Ownership of intangible objects is not impossible but needs a statutory basis.

[25] See WRR (2019) Money and debt, the letter of October 10, 2019 from SFL and the public hearing of June 13, 2019 which was held in response to the WRR report.

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Even the banks are no longer opposed to it. Only central banks continue to shudder at the idea that banks are being exposed to market discipline. After all, due market processes are at odds with the blind confidence that the public is supposed to have in banks. However, the personal safe account removes the ground for that shudder. It gives the central banks the tools to gradually introduce market processes to bank financing in a responsible way.

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