# No, there need not be lack of credit with "100 % money"

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**Abstract**

This is a defense of "100% money" as in the famous Simons, Fisher et al Chicago Plan 1933 - 1936, recently supported by Kumhof and Benes in a paper. I argue on this point against another paper by Ann Pettifor, who holds that 100% reserve requirements means that society will be starved of credit. That said, I am in agreement with Pettifor on her other points, for instance her critique of the theory of the money multiplier, unregulated banks and neoclassical economics more generally.

The famous Fisher et al *Chicago Plan*, was recently re-examined, and in conclusion supported, by Kumhof and Benes (2012) in a paper[1], where they write in the abstract:

> At the height of the Great Depression a number of leading U.S. economists advanced a proposal for monetary reform that became known as the Chicago Plan. It envisaged the separation of the monetary and credit functions of the banking system, by requiring 100% reserve backing for deposits. Irving Fisher (1936) claimed the following advantages for this plan: (1) Much better control of a major source of business cycle fluctuations, sudden increases and contractions of bank credit and of the supply of bank-created money. (2) Complete elimination of bank runs. (3) Dramatic reduction of the (net) public debt. (4) Dramatic reduction of private debt, as money creation no longer requires simultaneous debt creation. We study these claims by embedding a comprehensive and carefully calibrated model of the banking system in a DSGE model of the U.S. economy. We find support for all four of Fisher's claims. Furthermore, output gains approach 10 percent, and steady state inflation can drop to zero without posing problems for the conduct of monetary policy.

Pettifor (2013:20) disagrees, and argues that 100% reserve banking will lead to lack of credit:

> The Kumhof and Benes proposal is indeed based on the monetarist ideas of the Chicago School, one that seeks to limit the quantity of money, and that would restore the role of banks to intermediaries between savers and borrowers. Only now the proposal is to eclipse the role of the private sector altogether, and only allow lending backed by a 100% reserve requirement. In other words, all banks or lenders would first have to mobilise 100% of the funds needed for lending. This would massively constrain the availability of credit.
> ...
> Limiting the quantity of credit is certainly one way of limiting employment. Thus monetarist theory and policies both tolerated and sustained a massive rise in unemployment in the 1930s and 1980s. The Kumhof and Benes proposal is no more than a revival of these policies: the 'barbaric relic' that was the gold standard.

My impression is that not only Pettifor, but also many proponents of Modern Monetary Theory, are either indifferent or hostile to the 100% reserve concept. While not defending DSGE modeling and all details in the Kumhof and Benes proposal, I don't understand why a 100% reserve system must mean that credit will be constrained in a harmful way. Since this author considers himself to belong to the MMT school, this is an important disagreement seen from my position.

[1] Click on an author name for referenced papers.

## Let us consider an economy that is run according to MMT principles, and where all money is base money (high-powered money, HPM):

Why can't banks – if they mean they have a worthwile and fairly safe lending opportunity – borrow from the Central Bank? -Such bank borrowing from the CB implies that HPM will grow as an effect of this, not only through government deficit spending. This is in contrast to today's state of affairs where credit money is created directly through bank lending, dominating money growth.

The amount of extra money created and subsequently put in circulation due to bank borrowing from the CB will be (100% safe) HPM, not credit money which which has some risk.

If banks also gather money for their lending by selling bonds or offer time deposits to the public, the amount of extra money created by bank borrowing from the CB will constitute only a share of new loans given. One could – however – dispense completely with banks selling bonds or offering time deposits to the public, and let *all* lending that is done by banks be financed via their borrowing from the CB. The banks will then resemble "franchisees" of the CB. If a bank defaults, no one but the bank owners and the CB would lose money.

On the savings side, the CB can offer individual deposit accounts for all citizens and firms, both a checking account and a spectrum of time deposits with different rates and maturities. Since individual depositors' money at the CB – whether from persons or businesses – would be completely risk-free, a checking account there should yield zero interest. But such accounts should be cost-free for the user, considered part of a modern welfare state's shared infrastructure, like free healthcare and schools.

Technically, all transactions by account holders can be done via computer or mobile phone, thus eliminating – or at least dramatically reducing – the need both for branches, ATMs and physical cash. There is then no need for individuals and businesses to have checking or savings accounts at a bank. The role left for banks is to be pure intermediaries.

In this scenario, the (sufficient) disciplining factor for banks will be the risk of going bankrupt and the owners losing it all. This will be a no-bailout system – giving strong incentives for banks to behave responsibly. It will also be a system that – even with interbank lending – is 100% robust.

By tweaking interest rates on its lending, the CB can ensure that banks get the necessary incentive to lend, by a sufficient difference between bank lending rates and CB borrowing rates. On the other side, by offering sufficient rates on its spectrum of time deposits, the CB can withdraw money from aggregate demand.

In this system, the government runs more or less persistent fiscal deficits – the nomal state of affairs recommended by MMT – by "borrowing" from the CB. There are no need of government bonds. The CB only offers a spectrum of shorter term time-deposits as an adjustable tool for short and medium term monetary control, and not to gain money to finance government spending.

Money supply may then be better controlled to grow harmoniously with physical growth, since banks play no role in this, as they do today.

There will be no lack of flexibility and agility in this scenario, since licenced banks will enjoy ample credit lines to the Central Bank to access the necessary HPM in time, when giving a new loan. They can also borrow from other banks. By this, they can grant a loan just as easily as they do today.

And banks that currently have too much HPM and see too few lending opportunities can save at the Central Bank, using the spectrum of available maturities and interest rates offered by the Central Bank for that purpose.

The amount of HPM created through deficit spending plus that created through banks borrowing from the Central Bank, can be controlled by fiscal and monetary policy to be sufficient, among other things so that there is no harmful lack of credit, as Pettifor fears.