

REFORM AND INNOVATION IN FINANCIAL REGULATION AND MONETARY POLICY

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“Strong and balanced growth”

March 13, 2018

- *As its work to fix the fault lines that caused the financial crisis draws to a close, the FSB is increasingly pivoting away from design of new policy initiatives towards dynamic implementation and rigorous evaluation of the effects of the agreed G20 reforms.*

Leveraged Loans Are Back and on Pace to Top Pre-Financial Crisis Records, WSJ
9.24.17

Where we are today

- Regulatory fatigue (or even rollback)
- Slow growth accepted as the new normal
- Low rates driving search for yield
- ETF inflows reach record high
- New speculative assets classes have emerged
 - Including crypto currencies
- Regulatory attention focused on Fintech and crypto assets
- Central banks are now considering issuing their own digital currencies
 - **Is this a good idea or not?**

Outline

- Challenges and opportunities of crypto currencies
- Different concepts of central bank digital currency (CBDC)
- Two schools of thought
- Some bigger policy issues
 - Role of central banks
 - Credit allocation
 - Safe assets
- The case for monetary reform

Cryptocurrency – challenges and opportunities



- Currency competition
 - “Dollarization”
- Investor protection
- Financial instability
- Systemic contagion
- Money laundering
- Terrorist financing
- «Crypto-assets has the potential to improve the efficiency and inclusiveness of the financial system and the economy more broadly» (G20, March 2018)
- “And, far more significant than the crypto token is the underlying blockchain technology that these tokens help to power” (MAS, I5.3)



Lagarde: An Even-handed Approach to Crypto-Assets (16.4.18)



- *In my view, the fintech revolution will not eliminate the need for trusted intermediaries, such as brokers and bankers.*
- *There is hope, however, that decentralized applications spurred by crypto-assets will lead to a diversification of the financial landscape, a better balance between centralized and de-centralized service providers, and a financial ecosystem that is more efficient and potentially more robust in resisting threats.*

Economists' cryptocurrency aims to avoid pitfalls of bitcoin (FT 22.3.18)

- The [Saga](#) token aims to avoid the wild price swings of many cryptocurrencies by tethering itself to reserves deposited in a basket of fiat currencies at commercial banks.
- “We are not aiming for Saga to replace any national fiat currencies but to be a complementary global currency”

<https://saga.org>



Sovereign ICO

Marshall
Islands



The Pacific island nation became the first country in the world to recognize a cryptocurrency as its legal tender when it passed a law on Feb. 26 to create the digital “sovereign” (SOV).

The Marshall Islands is partnering with Israeli company Neema to launch the SOV. It plans to sell some of the currency to international investors and spend the proceeds. The law states that the Marshall Islands will issue 24 million SOVs in what it calls an initial currency offering. Half of those will go to the government and half to Neema.

But one recent CBDC failure

- **The World's First Central Bank Electronic Money Has Come – And Gone: Ecuador, 2014-2018**
- In December 2017 Ecuador's National Assembly passed legislation to decommission the central bank electronic money system
- The entire episode is important internationally for the lesson it teaches us about the limits to a central bank's ability to launch a new form of money when the public prefers established forms



Lawrence H. White, Cato Institute

<https://www.cato.org/blog/worlds-first-central-bank-electronic-money-has-come-gone-ecuador-2014-2018>

Crypto currencies – tulips or money?



Crypto assets lack the key attributes of sovereign currencies

Central banks studying how to issue digital cash

- Canada (BoC)
- UK (BoE)
- Sweden (Riksbanken)
- Norway (Norges Bank)
- Singapore (MAS)
- China (PBoC)
- Uruguay (BCU)
- Ecuador (BCE)
- +++



BANK OF ENGLAND



中國銀行
BANK OF CHINA



Monetary Authority of Singapore



Different motivations

- Bitcoin
- Fintech
- Financial inclusion
- Competition
- Backup system
- Monetary policy (ZLB)
- Public good
- Seigniorage



Different CBDC concepts

- Large Value Systems (RTGS)
- Accounts based (retail)
- Tokens
- ICO

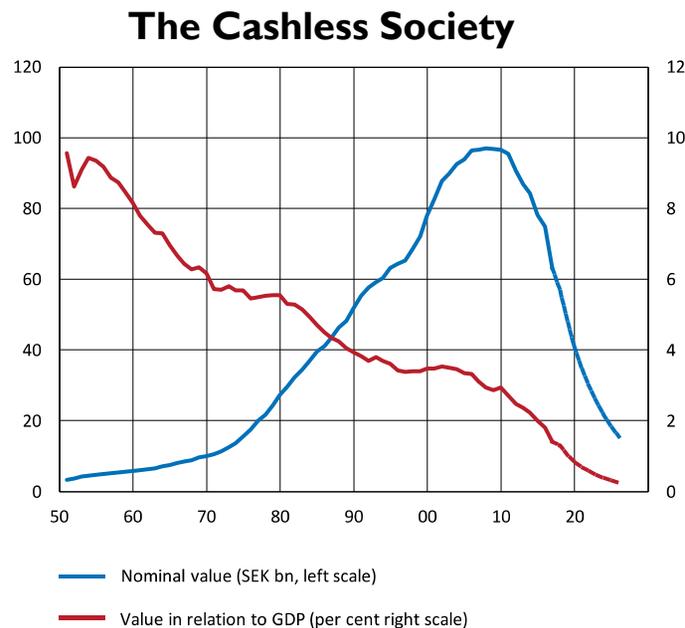
- CB operated
- Outsourced
- State run (“postal bank”)

CBDC = Central Bank Digital Currencies

Ingves: Sweden needs change to stop cashless future creating problems in time of crisis

- *Sweden is moving towards a situation in which all means of payment to which the general public has access are issued and controlled by commercial agents, at the same time as new so-called electronic currencies of varying types are emerging.*
- *For me, this vision of the future is problematic; **the payment system is often said to have an element of public good**, which implies that the public sector has an important role – in this case in ensuring that payments can be made safely and efficiently at all times.*

Sweden: The e-krona concept



https://www.riksbank.se/globalassets/media/rapporter/e-krona/2017/rapport_ekrona_uppdaterad_170920_eng.pdf

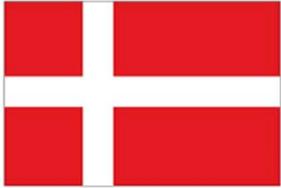
- Primarily intended for smaller payments
- Constitutes a direct claim on the Riksbank
- Accessible in real time, 24 hours a day, seven days a week, 365 days a year
- Does not accrue any interest now
- A register-based e-krona combined with a value-based solution makes offline payments of small amounts possible
- The Riksbank provides the basic functions for the e-krona

Switzerland: Sovereign money initiative



- The Swiss National Bank would create money – not only cash and coins, but also the electronic money in our bank accounts

- **There is no fundamental problem that needs fixing.**
- A radical overhaul of Switzerland's financial system is inadvisable and would entail major risks.



Different camps



- **A CBDC would be a solution to a non-existing problem**
- A CBDC would change the role of the central bank and increase risk of financial instability
- We prefer to stick to a well-regulated banking system with a deposit guarantee system and a EU resolution regimes
- The CB should remain a bank for the banks

<http://www.nationalbanken.dk/da/presse/Documents/2017/10/HF%20MFIF%20presentation.pdf>

- An e-krona would have the potential to counteract some of the problems that could arise on the payment market in the future when the use of cash is rapidly declining.
- **An e-krona would give the general public access to a digital complement to cash** guaranteed by the state and several payment services suppliers could connect to the e-krona system.

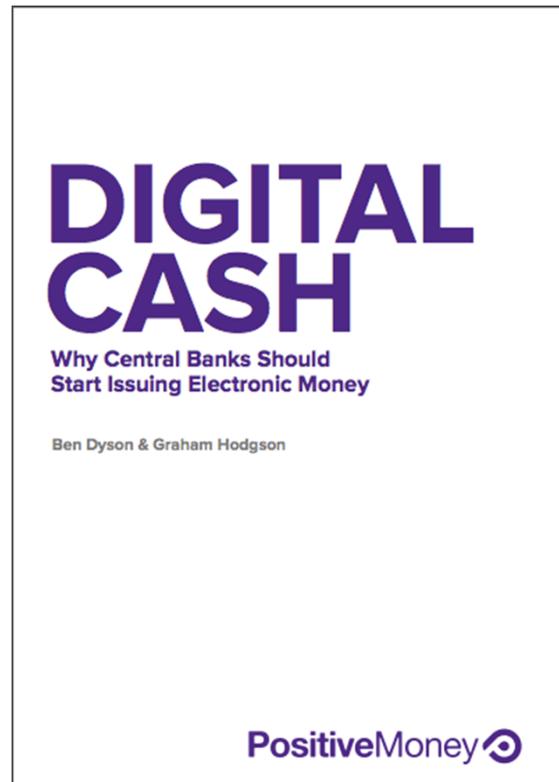
https://www.riksbank.se/globalassets/media/rapporter/e-krona/2017/rapport_ekrona_uppdaterad_170920_eng.pdf

Some bigger policy issues

- Role of central banks
- Credit allocation
- Reserves for all?
- Safe assets

- *I will note that a general purpose CBDC could mean a much greater role for central banks in the financial system. Central banks may find themselves disintermediating commercial banks in normal times and running the risk of destabilising flights to quality in times of stress*
(M. Carney, 2018)

A new role for central banks?



- Central bank digital cash
- Public accounts at the central bank
- Digital CB cash (tokens)
- Central bank direct financing
- Qualitative credit control
- More Treasury-central bank coordination

Reintroducing Postal banking



- **Tobin's Deposited currency:**
- *Allow individuals to hold deposit accounts in the central bank, or in branches of it established for the purpose and perhaps located in post offices*

[Some] Essential Prerequisites for the Good Financial Society

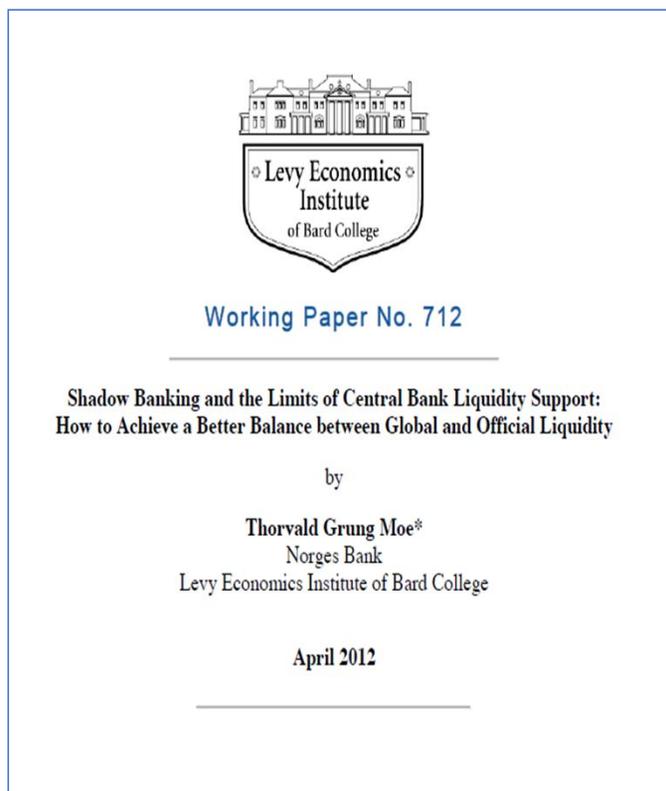
- A central bank that prevent debt deflations through its lender-of-last-resort powers
- More qualitative credit controls; direct credit toward socially desirable activities
- A national network of *community development banks*
- A return to the early postwar policy of low and stable interest rates

Minsky's case for monetary reform

*We have to establish and enforce “**a good financial society**” in which the tendency by business and bankers to engage in speculative finance is constrained*

Lender of last resort (backup slides)

Policy challenge for central banks



- **Should central banks take on the role as market maker of last resort (MMLR)?**
- *Should we hardwire CB liquidity support for the shadow banking system?*

The ebb and flow of “near-monies”

- *When confidence rises to a certain height in a country, it occurs to some persons, that profit may be obtained by issuing notes, **which purport to be exchangeable for money**; and which, through the known facility of thus exchanging them, may circulate in its stead.*

Thornton: Paper Money ... (1802)



Should central banks validate private money?

- *The characteristic peculiarity of these circulating forms of credit is that they spring up without being subject to any central control, but once they have come into existence their convertibility into other forms of money must be possible if a collapse of credit is to be avoided*

Hayek: Prices and Production, 1931

A new social contract for shadow money

- Collateral market liquidity critical for convertibility of shadow money
- Central banks needs to backstop markets
- Need for formalized coordination between CB and Treasury on debt issuance and debt management

Daniela Gabor: Towards a theory of shadow money, 2016

BoE has taken the lead

- Importance of core funding markets and OTC derivatives markets
- Collateral management is a cornerstone of resilient markets
- **Central banks need to keep up by backstopping private markets**

Carney (2013): “We are open for business”

Which markets should CBs support?

- A key lessons from the crisis:
 - Core funding markets need to be continuously open
- **Core markets:**
 - Sovereign debt, repos, securities lending, unsecured short-term bank debt and FX
- **Central bank support of the core funding markets needs to be permanently available**

Johnson & Santor (2013): *CB liquidity provision and core funding markets*

The policy dilemma for central banks



- Central banks have pledged not to use tax payers money to bail out systemic banks (TBTF)
- Why should they then commit tax payers monies to underwrite systemic markets?

Minsky on lender of last resort (Kregel 2010)

- The Federal Reserve could provide a floor of financial stability by abolishing the various special facilities and simply declaring that the discount window **would be available to all financial institutions**
- Lender of last resort powers provide the Federal Reserve with powerful medicine, but like most powerful medicines, they can have serious side effects
- Institutional reforms that constrain corporate external finance and the capabilities of banks and other financial institutions to support explosive situations may be needed