Monetary Policy for Conventional Times: What Toolkit for the Future?

New Digital Currency (CBDC) Monetary Policy Tool To Stop Inflation Without Causing a Recession

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Lawrence C. Marsh
University of Notre Dame

Email: Lmarsh@nd.edu

Public webpage: http://sites.nd.edu/lawrence-c-marsh/home/

Inflation: too much money chasing too few goods.
Excessive demand and insufficient supply.

To fight inflation, we need more supply, not less.

When the Fed raises interest rates in New York financial markets, It becomes **more expensive for businesses to borrow**, which causes businesses to **cut hours, lay off workers, and close outlets**. Adding another line of production to meet demand becomes harder, not easier.

=> Don't suppress supply *!!!*

To stop inflation, people need a safe and secure place to save their money and not spend it.

Inflation can be stopped using a carrot or a stick.
The stick is the **cost-of-borrowing.**
The carrot is the **return-on-savings.**

When the Fed raises interest rates to stop inflation, most private banks anticipate a slowing economy, and
=> offer fewer loans. They don't want more money!!! **<=**

With inflation at 7 percent, many banks are offering less than 1 percent on savings.

4.

STOP INFLATION

without causing a

RECESSION

A **cost-of-borrowing tool** of raising interest rates in New York financial markets causes layoffs as businesses cut back.

Don’t trash the economy to stop inflation.

A **return-on-savings tool** can be created to stop inflation more effectively and more efficiently.

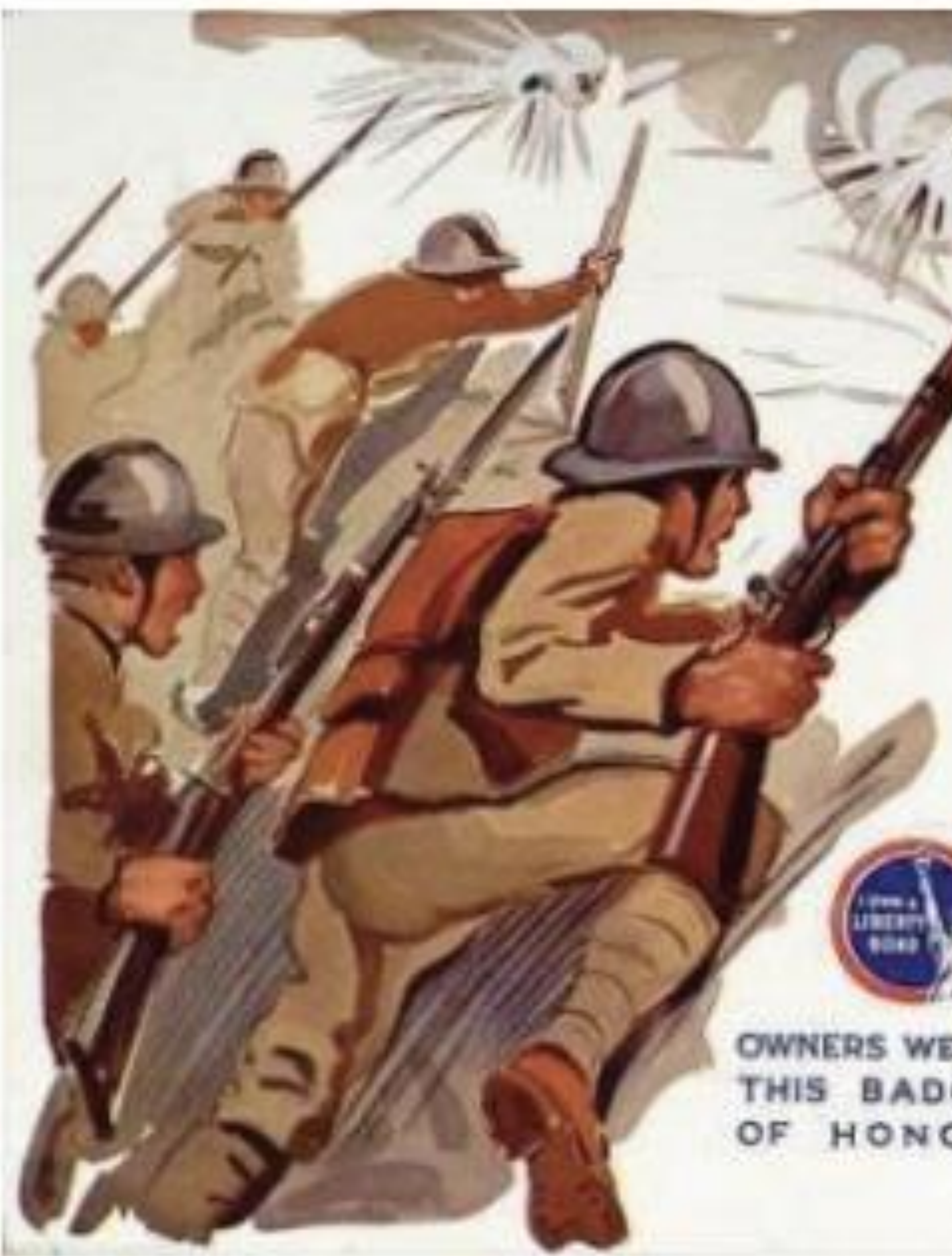
individual Fed digital currency bank accounts

STOP INFLATION WITHOUT CAUSING A RECESSION

Search YouTube for “Lawrence C. Marsh” video on stopping inflation.

Watch YouTube video:

https://www.youtube.com/watch?v=nnMT7DVyK0g&t=1s



Our Boys in the Trenches

-is there anything they need that you would not give them? Every

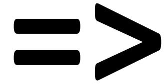
LIBERTY BOND

YOU buy helps *them* WIN the War. *Buy more Liberty Bonds!*

OWNERS WEAR THIS BADGE OF HONOR

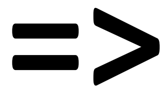
By the end of the war about 50 % of American families had purchased them.

U.S. Treasury 30-Year Series I-Bonds



Absolutely no withdrawal allowed for one year.
Heavy penalty for withdrawal up to end of 5th year.

Marginal-savers cannot afford to tie up their money**.** They need immediate access to their money to deal with an automobile accident, a medical emergency, an unexpected rent increase, or a job loss.



MBAs, Ph.D.s know about I-Bonds. But ask the person who changes the oil in your car, or the person who cuts your grass or rakes your leaves, or the check-out clerk at Walmart if they know about I-Bonds.

One thing about CBDC savings accounts needs to be made crystal clear:

No matter how high the interest rate offered, if marginal-savers with high marginal propensities to consume don't know about them, CBDC savings accounts will be useless in stopping inflation.

Just as War Bonds had to be vigorously promoted during World Wars I and II, these high interest rate CBDC accounts must be advertised in all the media accessed by marginal-savers with the high marginal propensities to consume.

Digital Currency Threat

Will Central Banks lose control of money?

Private banks creating their own money caused bank panics that continued even after adopting a common currency (e.g., dollars).

Wide use of **private digital currencies** could cause excessive volatility, tax avoidance, and criminal activities.

Central Banks need to create their own digital currencies.

Eventually one currency will dominate: US dollar? Facebook's Diem? China's e-CNY?

See book by Eswar S. Prasad: "**The Future of Money**:
How the Digital Revolution Is Transforming Currencies and Finance."

CBDC => avoid disrupting commercial banking:

(1) A high **positive** interest rate is only applied to one CBDC account per Social Security number and only on amounts up to $10,000.

(2) A **negative** interest rate is applied to all amounts above $10,000 or without a Social Security number.

(3) Account holders will access their accounts through bank and non-bank intermediaries except for people with IRS-certified incomes below $50,000 who can access their accounts through their local post office.

Get people to use CBDC and **save** more money!!!

Make interest earned on CBDC tax free.

Provide every newborn baby would get a Social Security number and CBDC account with $1,000 that cannot be withdrawn until after age 70.

But interest earned and any additional money put into the account can be withdrawn at any time.

Distorted Money Flow!

Why has GDP growth averaged less than 3 % a year while stock prices has risen by over 10 % a year?

Large amount of money <u>not</u> used for real investment (**physical** and **intellectual**) but goes into financial investments (**dividends** and **stock buybacks**).

Federal Reserve gives ineffective "pushing on a string" QE stimulus to Wall Street that drives up stock and bond prices and drives down interest rates with little trickling down to the people on Main Street.

See Karen Petrou's book: "Engine of Inequality: The Fed and the Future of Wealth in America" and Christopher Leonard's book: "The Lords of Easy Money."

When the economy is in a slump, the Fed needs to direct money to people who will spend it (and not just buy stocks and bonds).

In a recession the Fed could create CBDC accounts for every American who has a Social Security number and put money into their account.

See **Claudia Sahm's** Federal Reserve Board discussion papers on **automatic stimulus payments.**

Profits rise as labor, capital shares fall

Barkai (2020) calculated the capital costs for the U.S. non-financial corporate sector over the period 1984 to 2014 and found that while labor's share has dropped by 11 percent, the share of real capital has declined 22 percent with a corresponding increase in pure profits.

Barkai, Simcha. "Declining Labor and Capital Shares." *The Journal of Finance*, 75(5), pp. 2421-2463. 2020. https://doi.org/10.1111/jofi.12909

Adam Smith's second invisible hand of economic **concentration** or **collusion**.

"People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the publick, or in some contrivance to raise prices."

See book by Nomi Prins: "Permanent Distortion: How the financial economy abandoned the real economy"

Productivity Growth and Hourly Compensation Growth, 1948 - 2021

1948–1979:
Productivity: +118.4%
Compensation: +107.5%

1979–2021:
Productivity: +64.6%
Compensation: +17.3%

164.6% productivity

117.3% compensation

Cumulative change since 1948 (index 1979=100)

200%
150
100
50
0

1960
1980
2000
2020

Distorted Money Flow

private debt and **public debt**

Most of the money flow has been diverted to the already wealthy who put it into the New York financial markets (stocks and bonds).

The money flow has become so distorted the middle class can no longer afford to buy back the value they create.

Individuals go deep into **debt** while the government runs large **deficits** to keep the economy from sliding into recession.

Read Stephanie Kelton's book: "**The Deficit Myth**."

Beginning in 1980: Maximize shareholder value and CEO pay!!!

1945-1979: real wages rose with rising output per labor hour.

1980-2019: real wages flat as output per labor hour rose more slowly.

Hard work pays off. But not for the employees doing the hard work.
The employees hard work pays off for the shareholder.

America split between two groups:
(1) People with substantial money in the stock market.
(2) 2/3 with no college degrees living paycheck-to-paycheck.

=> Solution: Follow example of **Germany** and require (40%) employee representation on corporate boards.

=> Require all share buybacks be distributed to employees.

Money Flow Paradigm

Financial economy became separated from the real economy.

Money flows through the economy like blood flows through the body at different speeds to different places.

Banks create excessive credit in boom times. Banks withhold credit and exacerbate economic declines.

Target **marginal propensity to consume** of **marginal saver** and keep track of the **velocity of money** in the real economy.

Read book by Lynn A. Stout, "**The Shareholder Value Myth**."
Also, read book by Rana Foroohar, "**Makers and Takers**."

The **Keynesian paradigm** and its variations do not adequately focus on the importance of the marginal propensity to consume of the marginal saver.

The **Keynesian** variants take the Loanable Funds Theory for granted and don't fully recognize how the financial economy has become largely separated from the real economy.

The **Money Flow paradigm** rejects the Loanable Funds Theory and recognizes that fractional reserve banking often generates substantial excess reserves which are especially unlikely to flow into the real economy during recessions.

The Chicago Plan could change this and make monetary policy more effective by requiring 100 percent reserves which would remove the power of private banks to create money. It would help tighten the connection between the financial economy and the real economy.

Money Flow Paradigm => velocity of money falls

Milton Friedman $M V = P Q$ inflation always a monetary phenomenon with V constant, and P constant only if M rises at same rate as Q rises.

But V falls as lower-income population ages and V falls as economic inequality increases.

To keep Q growing at full employment, M must rise faster than V is falling so P can be constant.

USA economy has become much less competitive.
Anti-trust action has been curtailed in favor of
network effects and **economies of scale**.

Eyeglasses cost over a hundred dollars because of duopoly.

Patents have been extended so much that they suppress innovation.

Regulatory capture: Regulations used as barrier to entry.

Denise Hearn + Jonathan Tepper's book: "Myth of Capitalism"
about the dramatic drop in competition in USA economy.

How to Stop Inflation Without Causing a Recession

The rich have a very low marginal propensity to consume (8%) so offering them a higher or lower interest rate does not affect their consumption.

But lower-income people with very high marginal propensities to consume (94%) could cause demand to drop a lot if they would save more.

Getting the people on Main Street to spend less and save more is what is needed when too much money is chasing too few goods.

Increasing savings will make everyone better off.

Savings serve as an automatic stabilizer for everyone.

Money flow paradigm tracks the money flow and the velocity of money in low vs. high income households. Money flows to Wall Street (stocks + bonds) are separate from flows to people on Main Street (goods + services).

Government rules, regulations, taxes, and expenditures dominate the free market and should be recognized as the heart and soul of the free market. Without government, powerful corporations dominate and control all essential aspects of our economy.

Previous paradigms viewed government intervention only needed (**Keynesian paradigm**) or not needed (**Austrian paradigm**) in response to disruptions in free market. Pretending that government is not needed (**neoclassical paradigm**) or should totally dominate every major economic decision (**Marxian paradigm**) does not provide us with a true path to the efficient allocation of resources, which, after all, is what economics is all about.

Using a **cost-of-borrowing tool** to stop excessive inflation is both brutal and clumsy. It suppresses supply as well as demand and punishes the poor while rewarding the rich.

Most literature on using monetary policy to stop inflation has ignored the most important variable which is the marginal propensity to consume.

A potentially more effective tool to deal with both inflations and recessions is a new CBDC **return-on-savings tool**.

A high interest rate CBDC could be effective in stopping inflation if advertised and promoted very widely and very aggressively to marginal-savers, who are the swing "voters" in spending/saving.

Fed anti-inflation policy suppresses supply.

To fight inflation, we need more supply, not less.

Adding another line of production becomes harder, not easier.

When the Fed raises interest rates in New York financial markets, It becomes more expensive for businesses to borrow, which causes businesses to cut hours, lay off workers, and close outlets.

Private and Public Debt

Decline of unions and Citizens United's one dollar = one vote cuts workers' real pay.

Middle-class **unable to buy back** the value of the goods and services they can produce.

Low pay and **low interest rates** drive people on Main Street deep into debt as more and more money flows to Wall Street.

Government debt needed (to fill in for the money flow diverted to Wall Street) to maintain full employment.

The fundamental contention of the Money Flow Paradigm is that after 1979, the focus of corporate boards shifted from innovation and creativity that would increase productivity to instead maximizing shareholder value with dividends and stock buybacks along with financialization and cost cutting where employees were no longer paid the value of their marginal products. After 1979 employees were not seen as having agency, but were instead treated as just another factor input like steel or plastic that should be minimized in quantity and cost. This threatens the foundation of free enterprise by failing to recognize employee agency and destroying incentives and undermining both productivity and economic growth. A classic example of this is when John Sculley replaced Steve Jobs at Apple, Inc. in the 1990s to replace innovation and creativity with financialization and cost cutting. Maximizing shareholder value also diverted and redirected huge amounts of money from the people on Main Street to the New York financial markets on Wall Street. For several decades this created inflation on Wall Street where stock and bond prices grew at more than 10 percent while the overall economy grew by an average of less than 3 percent. Meanwhile the people on Main Street were no longer able to buy back the value of the goods and services they created. Marie Antionette, instead of saying: "Let them eat cake." handed out lots of credit cards to everyone and said: "Let them eat plastic." All the money flowing to Wall Street drove down interest rates which facilitated and encouraged people on Main Street to build up mountains of debt. But all that private debt has not been enough to compensate for the diversion of money from Main Street to Wall Street so the Republicans have run large deficits with their unpaid for tax cuts and the Democrats have run large deficits with unpaid for government expenditures to try to keep the economy from sliding into recession. Under fractional reserve banking the financial markets on Wall Street have become more and more separated from the real economy on Main Street. Local banks no longer had to worry about the unique attributes of potential loan borrowers, because the banks could quickly sell off their mortgages in tranches of mortgage-backed-securities (MBSs) and ignore the risks that they perceived but the financial markets could not see. Banks with lots of excess reserves could get carried away in creating lots of money in the form of deposits for new loans in the face of the irrational exuberance of rising stock prices or quickly reduce the money supply as loans are paid off and new loans applications are rejected in the face of a downward economic spiral exacerbated by the banks shrinking of the money supply. The Chicago Plan would require 100 percent reserves and stop the creation and destruction of money by the private banking system to bring about a more stable economy. To counter shareholder value maximization, and instead focus on the creative potential of companies, we should follow the example of Germany and require the representation of employees on corporate boards. In particular, we should require that 40 percent of all corporate board members be elected by a company's rank-and-file employees with the aim of getting representation from product development, production, marketing, sales, and distribution. Stock buybacks should only be allowed if the purchased shares were then all distributed to employees on the basis of their productivity and legacy. Recognizing employee agency and providing appropriate incentives will help rebuild companies as teams focused on productivity and growth and away from financialization and decay. It will restore free enterprise and make America great again as the leader in economic innovation and creativity.

Footnote: As a former CEO of the employee-owned business, Burns & McDonnell, Greg Graves wrote the book "Create Amazing" to tell the story of the fully employee-owned company (https://www.hoopladigital.com/title/14001311).

How to Use Savings Accounts to Stop Inflation Without Causing a Recession:

To stop inflation the government has been raising the cost of borrowing, which suppresses supply as well as demand. Businesses that can't afford the higher cost of borrowing may have to cut hours, lay off employees, or close outlets. To fight inflation, we need more supply, not less. Lower income people generally have the most debt, so they get hit the hardest when the cost of borrowing goes up. If the economy slows because of the rate increase, it is the lower income people who are most likely to be unable to make their mortgage payments and lose their homes to foreclosure. Inflation is already causing some people to spend money more quickly. The more everyone spends, the faster prices rise. People need a safe place to put their money where it will not be eaten up by inflation. The government needs to absorb excess demand by offering people savings accounts with an interest rate on savings that significantly exceeds the rate of inflation. Getting people to save more and spend less is exactly what is needed to slow or stop inflation. Having more savings not only helps individuals deal with unexpected emergencies, but in the aggregate serves as an automatic stabilizer for the economy. Only accounts of persons certified to be living within the country would earn a high positive interest rate during an inflation and that positive interest rate would only apply to a base amount of no more than $10,000 to avoid large private bank transfers. If $12,000 were deposited, only the first $10,000-US would earn the high positive interest rate, while the remaining $2,000 would be subject to a negative interest rate. To make these accounts as attractive as possible to lower-income people, any interest earned in a government savings account should be tax free. Tax refunds could be placed in these accounts. Every newborn baby should be assigned a savings account at birth with $1,000 put in it, which could not be withdrawn until age 70. However, any interest earned in the account and any additional money put into the account could be withdrawn at any time. Finally, when an economic downturn comes, the government could put stimulus money directly into these accounts. This new tool would allow the government to control the economy more efficiently and more effectively in avoiding both recessions and excessive inflation.