Currency vs Banking. Arguments and counterarguments

Synopsis compiled by Joseph Huber

Currency School	**Banking School**
Criticism of fractional reserve banking … which is seen both as illegitimate in that it grants monetary privileges to banks, and as dysfunctional in that it causes major problems of instability and crises beyond the single banks involved.	Credit creation on a fractional reserve base is neither fraudulent nor dysfunctional, but a necessity of industrial growth in order to overcome material restrictions of traditional metal currencies.
Banking School On the grounds of the *law of large numbers*, fractional reserve banking involves no more risk than lending on a full reserve base. Bankers know from experience how large a reserve they actually need.	**Currency School** In practice, *banks tend to overshoot and get overexposed* to various risks, whereby the central factor underlying all of this is unrestrained credit and debt creation on a basis of fractional reserves.
Currency School *Banking and financial crises are of monetary origin.* Unrestrained, overshooting issuance of banknotes and credit creation result in inflation, asset inflation, currency depreciation, recurrent boom-and-bust cycles, and banking crises. In the process, bank money (deposits) proves to be unsafe.	**Banking School** *Crises do not have monetary causes.* Boom-and-bust cycles and other malfunctions do not have monetary causes. There must be other economic and financial reasons.
Banking School *Fullarton's Law of Reflux* Inflation and currency depreciation do not occur for monetary reasons. If such phenomena occurred, customers would immediately convert banknotes into coin, or withdraw deposits.	**Currency School** Orderly conversion or withdrawal is not reported to have ever happened. Rather, vain attempts to do so have resulted in bank runs. Fullarton's Law refers to traditional coin currencies. With modern fiat currencies it has become irrelevant. One cannot escape inflation by converting deposits into cash, or banknotes into coin.

Currency School *Control of the money supply* Because any amount of money can be created at discretion, there must be some institutional arrangement and rules in order to keep the money supply in a commensurate relation to real economic growth. Without an anchor of relative scarcity– then gold, today the productive potential of an economy at full capacity – money and capital markets will not reach a stage of 'equilibrium' and self-limitation.	**Banking School** *The money supply takes care of itself*. Like any market, money and capital markets are self-regulating and stabilizing at a point of equilibrium of supply and demand. Trust in free markets. – Efficient financial markets are supposed to price in all relevant information (EMH by Fama). – Markets are supposed to have superior crowd intelligence (Hayek).
Banking School *Real bills doctrine* It all depends on observing the real bills doctrine: as long as bankers accept as collateral only good and short-term IOUs, the money supply will be commensurate with real demand, the money will be put to productive use, and no overshooting money supply will occur.	**Currency School** *Thesis of real bills fallacy* In actual fact, bankers do not observe the real bills doctrine, and probably cannot because one never knows whether respective collateral will prove to be 'real' or fictitious.
Currency School *Chartalism. State theory of money* Money is part of a state's sovereign prerogatives and a question of monetary sovereignty. A state's monetary prerogative includes 1. determining the currency, i.e. the official unit of account 2. issuing the money, i.e. the means of payment denominated in that currency as legal tender 3. benefitting from the seigniorage thereof.	**Banking School** *Commodity theory of money* Money is a commodity like any other, thus an endogenous creation of market participants, in particular of banks. Banknotes and demand deposits are a private affair, based on private contracts. Trust in free banking.

Currency School	**Banking School**
Separation of money and bank credit Separation of powers between the creation of money and the use of money in banking and the economy in general. Banks should be free enterprises, but must not have the privilege to create themselves the money on which they operate. Control of the quantity of money is the responsibility of a state authority (e.g. central bank, treasury, currency commission).	*Money and credit are identical and thus cannot be separate.* (... which is certainly true if asserting a banking perspective of loaning money into circulation).
Currency School	**Banking School**
Debt-free money Money does not need to be loaned into circulation, but can equally be spent into circulation free of interest and redemption, i.e. debt-free.	*All money is debt* The creation of money includes the creation of interest-bearing debt, and extinction of the money upon redemption.