NEGATIVE: 100% Reserve Requirement

By “Coach Vance” Trefethen

Affirmative plan abolishes “fractional reserve banking” (FRB) by setting a 100% reserve requirement. In the Status Quo, FRB is the system used by all banks in the normal course of their operations. Banks take in depositors’ money, but that money does not simply sit in the bank as digital assets or cash in the vault. Most of it (except for the reserve, which could be only 10%) is lent out to borrowers to earn money for the bank. It could go to car loans, home mortgages, business loans, or other investments that will earn a return that will pay the expenses and profits of the bank and pay for the (meager) interest the bank pays its depositors for the use of their money. They will keep in reserve (either cash in the vault or digitally deposited in another bank, a reserve bank) the remainder that is not loaned out or invested elsewhere. The reserve is held to supply the needs of depositors who might be expected to withdraw some of their money (or write checks on it), but who are not expected to demand all of their money at once. If the Status Quo has a reserve requirement of 10%, it would mean a bank could lend out 90% of its depositors’ money, and only keep 10% available for the depositors’ immediate use. What happens if a lot of depositors suddenly show up (or write big checks) and their demand exceeds the 10% liquidity that the bank has available? In the old days, there would be a “run on the bank,” as word would get out that the bank doesn’t have enough money, panic would ensue, and the bank would collapse. They might try to salvage the situation by quickly selling their assets (all those outstanding loans) at discount prices (and huge losses). They could also try to borrow money overnight from other banks. If all else fails, they could turn to the federal government for a bailout, either gifts or loans from the taxpayers to satisfy the depositors until the situation calms down.   
 Historically, some have called FRB a “fraud,” since it appears depositors are promised access to all of their money but in fact the bank only has 10% of it. If banks promised to put all depositors’ money into a safety deposit box, and then lent it out, that would indeed be a fraud. But that promise was never made. Depositors are entering into a contract whereby they get low-cost or free banking services and interest on their deposits, in exchange for the bank having the right to use their money and earn a return on it.  
 The AFF plan tries to solve for the alleged “fraud” and the panics/bailouts by setting the reserve requirement at 100%. All the money of all depositors would always be available at all times. It may sound good in theory, but ask yourself this: How would a bank make money to pay for its branches, employees, equipment, etc. if it cannot use depositors’ money for investments and lending? They would have to simply charge depositors fees for the privilege of storing their money at the bank; essentially, depositors would get a negative interest rate on their money. And all that lending, which drives big segments of the economy, would never happen, reducing economic activity and losing jobs. Huge amounts of money would be taken out of the money supply, leading to deflation and probably another Depression.

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Negative: 100% Reserve

MINOR REPAIRS

Solve bailouts – not with 100% reserve – but change from Federal Reserve to private lenders of last resort

John Tamny 2012 (speech and op-ed writer, Director of the Center for Economic Freedom at FreedomWorks, editor of RealClearMarkets, and a senior economic adviser to Toreador Research & Trading ) FORBES 29 July 2012 “Ron Paul, Fractional Reserve Banking, and the Money Multiplier Myth” <https://www.forbes.com/sites/johntamny/2012/07/29/ron-paul-fractional-reserve-banking-and-the-money-multiplier-myth/#3b73852179b7>

There is, however, one area of agreement between this writer and the fractional reserve skeptics, and it has to do with bailouts. Those who decry the bank lending of deposits dislike the government backstops in the form of the Fed as lender, and they also dislike federal deposit insurance. They have a point there, but the logical conclusion from this should not be that banks should have 100% reserve requirements. Instead, the Fed’s role as lender of last resort should be abolished (and while we’re at it let’s abolish the Fed, but that’s for a different article). If so, private market actors would quickly take over the Fed’s role with ease, and they would do so far more effectively for only lending to banks with good balance sheets that are merely experiencing near-term cash shortfalls.

Careful monitoring and regulation of existing banks would be far better than full-reserve requirement

Prof. Sheila Dow, Prof. Guðrún Johnsen and Prof. Alberto Montagnoli 2015 (Dow – Dept of Economics, University of Stirling and Univ. of Victoria. Johnsen – asst. prof. of finance, Univ. of Iceland. Montagnoli – Dept of Economics, Univ. of Sheffield) A critique of full reserve banking January 2015 <https://www.sheffield.ac.uk/polopoly_fs/1.448817!/file/paper_2015008.pdf>

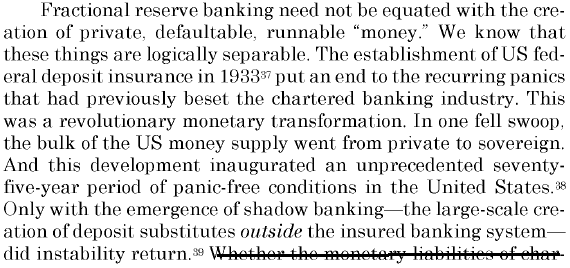
What we would favour would be an attempt to recapture the socially-useful form of banking which prevailed until the mid-twentieth century – itself a tall order given the way in which financial development has occurred since then. We therefore suggest a more moderate change in financial structure, whereby public support is provided to traditionally-regulated banks performing traditional functions, offering chequing and savings deposits, as well as loans designed to be held to maturity. But close attention would need to be paid to behaviour in the rest of the financial sector, and the way in which it was evolving, in order to curb excesses where possible and to discourage the build-up of asset bubbles. This is easier said than done, but the lesson of financial history is that there are no simple solutions and that the search for solutions needs to take account of the evolution of the financial sector. In our view the solution to the banking crisis is not to eliminate banking.

INHERENCY

1. Federal deposit insurance solves bank panics

Bank panics/instability solved since 1933 by federal deposit insurance. Only remaining instabilities are outside the system

Prof. Morgan Ricks 2016 (assoc. professor at Vanderbilt Univ. Law School) Safety First? The Deceptive Allure of Full Reserve Banking, UNIVERSITY OF CHICAGO LAW REVIEW <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1058&context=uclrev_online>



2. Bank crashes are prevented by Status Quo mechanisms

Fractional reserve isn’t a problem because even if they don’t have enough cash on hand, they can borrow it

John Tamny 2012 (speech and op-ed writer, Director of the Center for Economic Freedom at FreedomWorks, editor of RealClearMarkets, and a senior economic adviser to Toreador Research & Trading ) FORBES 29 July 2012 “Ron Paul, Fractional Reserve Banking, and the Money Multiplier Myth” <https://www.forbes.com/sites/johntamny/2012/07/29/ron-paul-fractional-reserve-banking-and-the-money-multiplier-myth/#3b73852179b7>

It’s certainly the case that sometimes banks fail to keep enough cash on hand necessary to meet depositor desires for cash, but far from a problem, banks or any financial institution can simply borrow from other institutions not presently experiencing a cash shortfall. If the assets on their books are sound, this is no problem. If it is a problem, they, in a normal world, can be acquired. And while this is unfortunate, the Federal Reserve also exists as lender of last resort when banks are short cash, and they theoretically lend to them at a penalty rate of interest so that the banks can meet all depositor requests.

HARMS / SIGNIFICANCE

The real problem is bailouts, not fractional reserve, and we can solve that if we focus on it as the real problem

John Tamny 2012 (speech and op-ed writer, Director of the Center for Economic Freedom at FreedomWorks, editor of RealClearMarkets, and a senior economic adviser to Toreador Research & Trading ) FORBES 29 July 2012 “Ron Paul, Fractional Reserve Banking, and the Money Multiplier Myth” <https://www.forbes.com/sites/johntamny/2012/07/29/ron-paul-fractional-reserve-banking-and-the-money-multiplier-myth/#3b73852179b7>

As for fractional reserve banking, its detractors need to be serious. Businesses are in the business of profits, and the path to banking profits is to lend out as much money as possible as prudently as possible. The highly confused detractors don’t hate fractional reserve banking; instead they dislike bailouts of banks that don’t lend monies entrusted to them effectively. That’s fine, but they would be wise to train their eyes on what’s actually the problem over essentially yelling at the scoreboard.

No harm to depositors: Fractional Reserve Banking (FRB) benefits them. They earn interest and get lower fees for services

Lawrence White 2012 (Distinguished Senior Fellow, F.A. Hayek Program for Advanced Study in Philosophy, Politics & Economics) 28 July 2012 testimony before the House Subcommittee on Domestic Monetary Policy & Technology <https://www.mercatus.org/publications/monetary-policy/fractional-reserve-banking>

The advantage to the bank from keeping fractional reserves is clear: It earns interest on the lent-out funds. A few commentators have declared that FRB must be a fraud: The gain is all on the bank’s side, and no customer would agree to it if she realized what the bank was up to. But this claim assumes that there are no advantages to the bank’s customers. In fact there are clear advantages to the bank’s customers, at least under competition. To compete for customers, all experience shows, banks offering fractional-reserve accounts charge zero storage fees and even pay interest on deposits, up to point where the interest they pay falls short of the interest they earn only by just enough to cover the bank’s operating costs for safekeeping and payment services. In this way FRB creates a synergy between payments services (checkable deposits, banknotes) and intermediation (pooling savers’ funds for lending to selected borrowers). When the deposited funds that are not needed as reserves can be lent out, depositors enjoy lower (or zero) storage fees and interest on checking deposit balances.

Benefits to consumers outweighs the risks of fractional reserve banking – based on consumers’ own behavioral preferences

Lawrence White 2012 (Distinguished Senior Fellow, F.A. Hayek Program for Advanced Study in Philosophy, Politics & Economics) 28 July 2012 testimony before the House Subcommittee on Domestic Monetary Policy & Technology <https://www.mercatus.org/publications/monetary-policy/fractional-reserve-banking>

By contrast to money warehousing, the savings of fractional-reserve banking do carry a disadvantage in the form of greater default risk. If the bank’s investments go sour, the depositor may not be repaid in full. The warehouse, by contrast, makes no investments. So the customer choosing between a bank account contract and a warehousing contract needs to consider: Is the saving in storage fees and the interest paid on deposits high enough (relative to the increased risk of not being paid promptly)? Historically, in competitive systems where banks were free to diversify and capitalize themselves well, the answer was yes for most people. Thus well informed consumers who want economical payment services typically prefer a fractional-reserve bank to a warehouse. In sound banking systems historically, before deposit insurance, the risk of loss was a small fraction of one percent, while the interest was more than one percent, and the sum of interest and storage fee savings was even higher. Thus FRB can arise and survive without fraud.

FRB doesn’t cause bank runs/panics

Lawrence White 2012 (Distinguished Senior Fellow, F.A. Hayek Program for Advanced Study in Philosophy, Politics & Economics) 28 July 2012 testimony before the House Subcommittee on Domestic Monetary Policy & Technology <https://www.mercatus.org/publications/monetary-policy/fractional-reserve-banking>

A run is always possible against fractionally backed bank deposits that are unconditionally redeemable on demand. Against such deposits, a run can even, in theory, be self justifying: If a run forces the bank to conduct a hasty sale of illiquid assets, the bank may receive such a reduced value for its assets that it becomes insolvent (liabilities exceed assets), so that all depositors can no longer be paid in full. From this theoretical possibility, some economic theorists have jumped to the conclusion that fractional-reserve banks are in practice inherently run-prone. (The best known statement is a 1983 article by Douglas Diamond and Phillip Dybvig.) According to this view, a run can happen at any time, in any place, on any bank, triggered by nothing more than random fears or events that have no basis in the target bank’s solidity. But are real-world deposit contracts so fragile? Historical evidence says no. Please consider: If real-world deposit contracts really were as fragile as the self-justifying-run theory supposes, it would be a mystery how they survived centuries of Darwinian banking competition before the first government deposit insurance schemes began. Wouldn’t a more robust arrangement have come to dominate the field?

FRB not responsible for U.S. bank runs: They were caused by bad regulations. Other countries with FRB have no problem

Lawrence White 2012 (Distinguished Senior Fellow, F.A. Hayek Program for Advanced Study in Philosophy, Politics & Economics) 28 July 2012 testimony before the House Subcommittee on Domestic Monetary Policy & Technology <https://www.mercatus.org/publications/monetary-policy/fractional-reserve-banking>

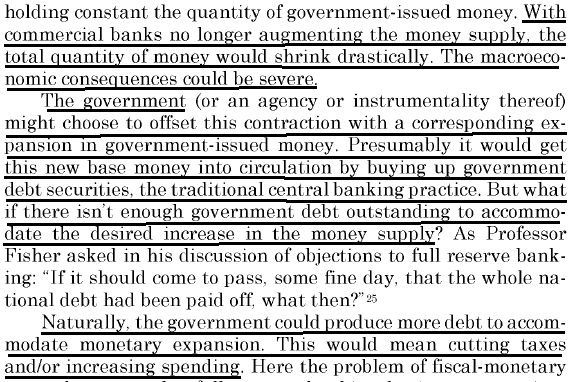
The historical record does of course indicate that runs and banking panics were a problem in United States during the pre-Fed or “National Banking” era (1863 1913), and also under the Fed’s watch during the early years of the Great Depression. But few other countries have had similar experiences. It is therefore clear that run-proneness and panics are not inherent to fractional-reserve banking. If we look for a pattern across countries, this is what we find: Countries like Canada, Scotland, Sweden, and Switzerland, where the banking systems had no more than minimal restrictions on entry, note-issue, branching, and capitalization, had virtually no problem from runs and none from panics, in contrast to the more restricted and hence weaker banking systems of the United States and England.

SOLVENCY

1. Won't solve federal deficit / national debt

Government would have to borrow more to offset the money supply reduction created by 100% reserve banking

Prof. Morgan Ricks 2016 (assoc. professor at Vanderbilt Univ. Law School) Safety First? The Deceptive Allure of Full Reserve Banking, UNIVERSITY OF CHICAGO LAW REVIEW <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1058&context=uclrev_online>



2. Non-bank institutions

Link: 100% reserve means banks would charge depositors interest for holding their money

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It’s certainly true that banks could maintain 100% of funds deposited, but if so, they wouldn’t be banks. Instead, they’d be warehouses for money, and those warehouses would charge depositors a fee for the right to deposit with them. Basically money saved would decline day after day and year after year; essentially compound interest in the reverse.

Plan doesn't solve long-term because non-bank institutions (not subject to 100% reserve) replace banks for lending, to keep the economy working – and still rely on government central banking to function

Prof. Bill Mitchell 2010 (Professor of Economics at the University of Newcastle, Australia) 12 Jan 2010 100-percent reserve banking and state banks <http://bilbo.economicoutlook.net/blog/?p=7299>

The more reasonable advocates of full-reserve banking recognise that you need separate institutions that will take risk and provide credit. So banks would still lend but only for each dollar of currency they hold (can raise). Depositers could formally forego their right to withdraw their funds for some fixed-term and in return they would receive interest. This would stop bank runs and allegedly ensure that at the end of the period the funds would be available to the depositer. They claim also that with a controlled money supply, productivity growth would see prices fall and wealth increase. They allege that there would be no shortage of money to feed growth because less money would have to be used (given lower prices). It is a crazy argument. There might even be a two-tier banking sector (this is similar to Tobin’s idea). Some banks would become deposit-taking institutions who hold government debt and manage the clearing house system (for the daily reconciliation of cheques between commercial banks). But then the credit creation becomes the domain of other institutions to ensure that the real economy has access to working capital to facilitate production. To ensure financial stability, these institutions will either still need access to central bank discount facilities (overdrafts) to ensure the clearing house system doesn’t fail or they would be required to issue their own liabilities that were attractive to prospective lenders.

Bypasses MUST occur – because sane people won’t leave their money at negative interest. They’ll put it somewhere else that gets a return

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Of course if banks were warehouses, thus not banks, they would quickly be put out of business given the desire of individuals to be compensated for monies they don’t have an immediate need to consume. Banks pay them for the right to lend out cash they don’t immediately need, and they’re able to compensate them through loans made to others who have an immediate need for credit; thus fractional reserve banking. In the above sense if fractional reserve banking did not exist, wise minds would soon invent it given the desire among most individuals to be compensated for their savings. If this is doubted, one would have to believe that absent banks people would be happy simply storing their money under a mattress or in a safe. Not very likely, which explains why fractional reserve banking is the commercial rule. It is because consumers want banks, and banks are able to open their doors precisely because they lend out money deposited with an eye toward profits.

Non-bank / “shadow” institutions were a big part of the financial crash and would still be a problem under 100% reserve

Prof. Sheila Dow, Prof. Guðrún Johnsen and Prof. Alberto Montagnoli 2015 (Dow – Dept of Economics, University of Stirling and Univ. of Victoria. Johnsen – asst. prof. of finance, Univ. of Iceland. Montagnoli – Dept of Economics, Univ. of Sheffield) A cr15 <https://www.sheffield.ac.uk/polopoly_fs/1.448817!/file/paper_2015008.pdf>

In the run-up to the crisis, the risk posed to bank deposits and therefore to the public purse arose from banks engaging in non-traditional activities, fuelling a much wider dysfunctional expansion in financial asset markets. Arguably the banks played a crucial role in expanding credit as rapidly as they did, financing the escalating levels of financial churning which drove up asset prices, in a vicious circle. However an increasing proportion of total credit was being provided by shadow banking. If we think of the financial sector as an inverted pyramid, shadow banking at the top expanded on a base of commercial bank deposits which expanded on a base of reserves. In each case the general overconfidence with respect to default risk encouraged a significant increase in balance sheets as a multiple of the respective bases. As far as shadow banking is concerned with respect to their bank deposits, this would carry over even where the amount of bank deposits was restricted by 100% reserve requirements. Now even shadow banks are being overtaken in the credit market by technology groups; of particular relevance to the full reserve banking proposals is the emergence of new payments systems.

Credit expansion outside of traditional banking defeats the risk solvency of 100% bank reserves

Prof. Sheila Dow, Prof. Guðrún Johnsen and Prof. Alberto Montagnoli 2015 (Dow – Dept of Economics, University of Stirling and Univ. of Victoria. Johnsen – asst. prof. of finance, Univ. of Iceland. Montagnoli – Dept of Economics, Univ. of Sheffield) A cr15 <https://www.sheffield.ac.uk/polopoly_fs/1.448817!/file/paper_2015008.pdf>

Banks certainly fuelled asset markets with credit, but the ultimate problem was asset markets themselves. Nevertheless it could be argued that full reserve banking, by constraining credit growth, would constrain the capacity for markets to become so fragile that they collapse, causing a financial crisis. But the international financial system has shown itself capable of massive expansion outside national regulatory restrictions which in turn has impacted on asset markets, and particularly markets in speculative assets. The credit restrictions therefore might be felt more by SMEs rather than financial markets. Macroprudential regulation would still be required for the entire financial system, based on close attention to the way in which it was evolving and to trends in asset markets.

3. Already tried and failed

Kaupthing bank had 95% reserve requirement [way more than 10% we have today] and still failed

Prof. Sheila Dow, Prof. Guðrún Johnsen and Prof. Alberto Montagnoli 2015 (Dow – Dept of Economics, University of Stirling and Univ. of Victoria. Johnsen – asst. prof. of finance, Univ. of Iceland. Montagnoli – Dept of Economics, Univ. of Sheffield) A cr15 <https://www.sheffield.ac.uk/polopoly_fs/1.448817!/file/paper_2015008.pdf>

To further support our argument that full-reserve banking would not make the financial system less prone to bank runs and financial crises, we look at the case of a British bank, Kaupthing, Singer and Friedlander (KSF), where a 95% liquidity requirements did not prevent the bank collapse, but rather it pulled the trigger on a subsequent failure of its parent company, the Icelandic Bank, Kaupthing.

Full-reserve banking is a dangerous experiment. It’s only been tried once, and it failed

Prof. Sheila Dow, Prof. Guðrún Johnsen and Prof. Alberto Montagnoli 2015 (Dow – Dept of Economics, University of Stirling and Univ. of Victoria. Johnsen – asst. prof. of finance, Univ. of Iceland. Montagnoli – Dept of Economics, Univ. of Sheffield) A cr15 <https://www.sheffield.ac.uk/polopoly_fs/1.448817!/file/paper_2015008.pdf>

The authors of the full-reserve banking plans are to be congratulated for seeking a radical solution to the undoubted problems with the current banking system. No possibility is without problems. But we have identified some serious problems with these plans which stem, we believe, from a misunderstanding of the nature and role of money and the history of the development of money and banking. We are not aware of any experience with such a system, so what is proposed is an experiment. The closest experience is the crisis-induced 95% reserve requirement on Iceland’s Kaupthing, Singer and Friedlander, which only illustrates the capacity of banks to subvert controls.

4. Can’t get the right money supply

100% reserve banking means total money supply is controlled 100% by the government, not by markets creating money through lending. But there aren’t valid indicators to tell them what is the correct money supply (which they would have to know to make the plan work and keep the economy stable)

Prof. Sheila Dow, Prof. Guðrún Johnsen and Prof. Alberto Montagnoli 2015 (Dow – Dept of Economics, University of Stirling and Univ. of Victoria. Johnsen – asst. prof. of finance, Univ. of Iceland. Montagnoli – Dept of Economics, Univ. of Sheffield) A cr15 (brackets and ellipses in original) <https://www.sheffield.ac.uk/polopoly_fs/1.448817!/file/paper_2015008.pdf>

Supporting the 100% reserve proposals, Martin Wolf (2014) writes ‘the central bank would create new money as needed to promote non-inflationary growth’. This assertion assumes that the central bank has a correct model of the economy and this can be used to make correct decisions about the level of money injected in the economy. However, from a Keynesian perspective there cannot be a ‘correct’ model or ‘true’ risk measures because of fundamental uncertainty (see Dow 2014), hence macroeconomic models which generate monetary policy recommendations can only be seen as a guide rather than a rule. As highlighted in Dow (2014) ‘central banks have become explicit about the various forms of uncertainty they face. The most fundamental of these is model uncertainty: uncertainty as to the best model to use as the basis for policy-making. […] The theoretical literature generally presumes that there is such a thing as a correct model, but that policy-makers face stochastic errors in identifying it (see for example Hansen and Sargent 2004). This follows from the mainstream literature’s inattention to fundamental uncertainty (unquantifiable risk) as opposed to quantifiable risk’ (see further Dow 2004, Lawson 2009). Finally, the central bank’s task is complicated further by the fact that realtime data on GDP are subject to heavy revision. Orphanides and van Norden (2002) find that the revisions of US GDP are quite sizable and are of the same order of magnitude as the estimated output gap. In the same spirit, Edge and Meisenzahl (2011) find similar results for the debt-to-GDP ratio, casting doubts on this indicator and its ability to be used as a key indicator for macroprudential policy. Unsurprisingly therefore the central banks’ record on producing accurate forecasts of the economy is rather poor, supporting indeed the view that a true model, good to understand the economy and forecast future events, does not exist.

Not knowing the correct money supply means the government couldn’t stabilize the economy, and could guess wrong and make things worse

Prof. Sheila Dow, Prof. Guðrún Johnsen and Prof. Alberto Montagnoli 2015 (Dow – Dept of Economics, University of Stirling and Univ. of Victoria. Johnsen – asst. prof. of finance, Univ. of Iceland. Montagnoli – Dept of Economics, Univ. of Sheffield) A cr15 (brackets and ellipses in original) <https://www.sheffield.ac.uk/polopoly_fs/1.448817!/file/paper_2015008.pdf>

Even if the state could control the quantity of money, and even if there were a clear correlation with the rate of inflation, it is not clear what would be the basis for settling on any particular cap on the money supply. It is highly uncertain how the committee would be able to create the amount of reserves required by the economy in order to remain on a certain economic trajectory. The particular PM/NEF proposals for countercyclical money creation are designed to promote financial and economic stability by leaning against the wind on credit creation. But success would hinge on being able to orchestrate the extension of credit on the basis of that money supply, which requires that money would indeed consist only of state money and that the path of credit growth would follow that of money growth. If the restrictions on what performed money functions and on credit expansion were indeed successful, the danger would be an end result of an inelastic economic system which would be slow to react to domestic and international economic shocks, hence exacerbating rather than dampening the negative consequences of any shocks.

DISADVANTAGES

1. Deflation from reduced money supply

100% reserve = harsh deflationary forces

Prof. Bill Mitchell 2010 (Professor of Economics at the University of Newcastle, Australia) 12 Jan 2010 100-percent reserve banking and state banks <http://bilbo.economicoutlook.net/blog/?p=7299>

Note that the current practice is that loans create deposits. Clearly, under a 100-percent reserve system, all credit granting institutions would have to acquire the funds in advance of their lending. There would be the equivalent of a gold standard imposed on private banking which could invoke harsh deflationary forces.

Drastic shrinkage in the money supply, leading to severe economic consequences

Prof. Morgan Ricks 2016 (assoc. professor at Vanderbilt Univ. Law School) Safety First? The Deceptive Allure of Full Reserve Banking, UNIVERSITY OF CHICAGO LAW REVIEW <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1058&context=uclrev_online>

Suppose the government outlawed fractional reserve banking-thereby transitioning to a full reserve system of the type Professor Levitin contemplates-while holding constant the quantity of government-issued money. With commercial banks no longer augmenting the money supply, the total quantity of money would shrink drastically. The macroeconomic consequences could be severe.

Impact: Jobs lost. Deflation reduces consumer demand, contracting the labor force, leading to recession / Depression

Mike Patton 2013 (independent registered investment advisor serving affluent and high net worth clients. Certified Financial Planner (CFP); Accredited Estate Planner (AEP), Board Certified in Estate Planning (BCE); Certified Tax Specialist (CTS); and Chartered Mutual Fund Counselor (CMFC) ) 1 July 2013 FORBES “Inflation Or Deflation: Which Is The Greater Risk?” <https://www.forbes.com/sites/mikepatton/2013/07/01/the-truth-behind-the-feds-monetary-expansion/#2565c6e37236>

Deflation can be defined as the decrease in the general price level of goods and services. During the Great Depression deflation was present most of the time. Deflation results in an "increase" in the value of a currency, and as a result, it encourages individuals and corporations to "hoard" their money. After all, why spend money now if prices will be lower in the future? During deflationary periods demand falls as individuals and businesses wait for lower prices. This translates into a reduction in corporate profits, a contraction in the labor force, and lower wages. The end result is a further decline in demand. Lower prices are not necessarily bad in the short term. But if deflation persists, as it has in Japan, it can create a deflationary spiral that can cause or aggravate a recession. And, if deflation persists long enough, a depression may ensue.

2. Government spending crowds out private sector

Link: Big incentive for government spending to increase. Cross-apply Solvency-1 card

Link: 100% reserve would divert money to the government for public spending and suppress private investment

Lawrence White 2012 (Distinguished Senior Fellow, F.A. Hayek Program for Advanced Study in Philosophy, Politics & Economics) 28 July 2012 testimony before the House Subcommittee on Domestic Monetary Policy & Technology <https://www.mercatus.org/publications/monetary-policy/fractional-reserve-banking>

Under a fiat money standard, as we have today with the Federal Reserve dollar, things are different. There are no mining or minting costs saved by holding fractional rather than 100 percent reserves in the form of fiat money. For commercial banks to hold 100 percent reserves in the form of fiat money issued by the federal government would, however, change drastically the function of the banks. Instead of funding productive enterprises, the banks would instead only fund the federal government. Fewer loanable funds would be available to the private economy, and more to the government. Private investment would be suppressed, and public spending enlarged.

Impact: Long-term economic harm. Government spending crowds out private sector investment, harming the economy in the long-term

Matthew Mitchell and Prof. Jakina Debnam 2010 (Mitchell –Senior Research Fellow at Mercatus center, George Mason Univ. Debnam - assistant professor of economics at Amherst College. PhD in Economics at Cornell Univ.) <https://www.mercatus.org/publications/regulation/long-run-we%E2%80%99re-all-crowded-out>

When government borrows to finance its spending, it competes with private entrepreneurs who are borrowing to finance their own activities. Capital used by the government is capital that cannot be used by private businesses. Moreover, when government borrows, competition in the market for loanable funds increases, raising the price of borrowing, or the interest rate, for private investors. For firms, this means an increase in the cost of doing business. Companies and projects that would have otherwise been profitable are no longer able to be so at the higher interest rate.Lastly, borrowing may have longer-term effects on the nation’s capital stock, and through that, on its future national income. This can happen when increased borrowing is financed in part or in whole by international capital inflows (foreign lending). In this case, domestic production may not decline in the short run and interest rates may not increase in the short run. But because the nation must eventually repay its foreign debts, future national income is less than it otherwise would be.

3. Increased risk

Link: 100% reserve would defeat the purpose of banking and drive consumers and markets toward non-bank “shadow” alternatives – outside of bank regulations and far riskier

Prof. Sheila Dow, Prof. Guðrún Johnsen and Prof. Alberto Montagnoli 2015 (Dow – Dept of Economics, University of Stirling and Univ. of Victoria. Johnsen – asst. prof. of finance, Univ. of Iceland. Montagnoli – Dept of Economics, Univ. of Sheffield) A cr15 <https://www.sheffield.ac.uk/polopoly_fs/1.448817!/file/paper_2015008.pdf>

It seems to be assumed that the new fully-backed bank accounts are held for transactions purposes only (for both real and financial activity), something which is reasonably stable. But the demand for money arises also from increases in liquidity preference at times when price volatility is high and expectations are unclear (precautionary demand) or when volatility in asset prices declines and markets are more confident in upward or downward trends in asset prices (speculative demand). The authorities would need to be sensitive to these fluctuating sources of money demand when setting their target. Demand for money other than for transactions purposes reflects a reasonable response to fundamental uncertainty. But the build-up to the crisis demonstrated the widespread capacity for conventional expectations to be unreasonable and, in particular, to underestimate risk. As a result high expected returns on market assets could entice society into treating assets as safe which are in fact much less safe than current bank assets. The demand for liquidity could be satisfied by assets other than the fully-backed stock of bank deposits. It is therefore conceivable that 100% reserve requirements on depository institutions would ‘just drive even more finance into shadow banking, and make the system even riskier’ (Krugman (2014).17 Goodhart (2008) explores the ways in which regulation affects institutions inside and outside the regulatory net as the ‘boundary problem’. In the case of full reserve banking, the problem of low profit opportunities in retail banking may be so severe that the end of fractional reserve banking would mean the end of banking, leaving financial activity to institutions outside both the regulation and protection of the authorities.

Impact: Turn the Affirmative harms

Risk gets worse, not better – and that was what 100% reserve was supposed to solve!

4. Masking DA. AFF distracts us from the real solutions

Focus on Fractional Reserve distracts us from the real problems that are jeopardizing the US banking system

Lawrence White 2012 (Distinguished Senior Fellow, F.A. Hayek Program for Advanced Study in Philosophy, Politics & Economics) 28 July 2012 testimony before the House Subcommittee on Domestic Monetary Policy & Technology <https://www.mercatus.org/publications/monetary-policy/fractional-reserve-banking>

The evidence shows that a fractional-reserve banking system is not unstable when the banking system is free of hobbling legal restrictions and free of privileges. The U.S. banking system in the 19th century was weakened by legal restrictions. In response to that weakness, rather than let the banking system become robust by repealing its restrictions, Congress in the 20th century patched over the problem by creating the Federal Reserve system (to act a “lender of last resort”) and federal deposit insurance. As a result, the U.S. banking system in the 21st century is chronically weakened by government privileges (especially taxpayer-backed deposit insurance and taxpayer- backed “too big to fail” bailouts) that generate moral hazard. Banks take advantage of these guarantees by holding asset portfolios too full of default risk and interest-rate risk. They finance their portfolios with excess leverage (too much debt, not enough equity). Rather than trying to come up with another patch, Congress should seek to dismantle the restrictions and the privileges that have left the American people saddled with an unhealthy banking system.

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