

National Identity of the Banking System?

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Abstract: The article deals with the contradiction between the modern monetary system and the existing nature of the banking system. The monetary system is a whole, and banking system is its part. The whole and its parts should be organically linked to each other, however, in modern conditions they are not in conformity. The banking system is the object of the research described in the article. Conducting the study, the author applied the scientific methods of analysis and synthesis, deduction and induction, organic sequence and others. The result of the study gave rise to the conclusion that it is necessary to change the private-ownership nature of the banking system to the national one.

1. Radical Reforms in the Banking System as an Urgent Need

The present state of the banking system as well as the discussions on its sustainable development are in many ways reminiscent of the state of the Soviet economy, debates on the public ownership-based economy and its development. The content of those discussions was mainly focused on performing superficial analysis of the existing problems and formulating the same trivial proposals regarding the ways to overcome them. In those days only a very few dared to claim that no proposals for improving public ownership-based economy could make it more stable and competitive compared to the capitalist economy. [1] Accordingly, the only possible step towards developing domestic economy in the right direction was the fundamental transformation of the property relations. In fact, today the same can be said about the soundness of banking system: no cosmetic actions to improve the banking system, the monetary and credit policy of the central bank can radically change the banking system status. Some radical measures should be taken, and it is equally relevant for the banking systems of the countries with both advanced and developing economies.

2. The Problems of the Banking System Functioning in the Conditions of the Gold Standard Monetary System

It is common knowledge that the banking system in the countries of Western Europe, North America and several other countries of the world economy was shaped not according to verified economic science recommendations but empirically, primarily aiming at serving the interests of bank owners. The latter, being between the state and clients, always tried to reach a compromise and protect the interests of all the market agents. The establishment of a central bank proved to be

one of the most effective options for the implementation of a complex system of interests. The central bank was managed by the state, but in fact, it was privately owned, mainly by commercial banks. These banks primarily delegated those functions to the central bank, which were most burdensome to perform. It was currency issue function. Commercial banks carried out (were supposed to carry out) the issue of their banknotes according to the replenishing stocks of monetary gold. In the conditions of interbank competition, each commercial bank declared that the number of monetary units indicated on the issued banknotes, actually corresponded to their monetary gold reserves. In other words, each commercial bank declared that it strictly followed the historically existed scale of the national currency. Keeping the scale of the national currency unchanged was determined by the requirements of the money circulation law, immanent to the gold standard monetary system. However, since meeting this requirement was becoming more and more burdensome for the banks, and they did not want to risk their reputation of honest and diligent market relations contractors, they passed their gold reserves to the central bank without significant resistance and, accordingly, delegated the currency issue function to it. Thus, in case if this jointly formed institution could not cope with the function assigned to it, that would be its problem, not the problem of commercial banks reputation.

In the majority of the countries of Western Europe and North America, central banks began their currency issuing activities also quite enthusiastically, reassuring everyone that the banknotes they issued represented the real monetary gold reserves in accordance with the declared scale of the national currency. In particular, this was characteristic of the USA Federal Reserve, especially after the Second World War, when approximately 75% of the world's gold reserves were concentrated in the USA. However, as the post-war economy was restoring in Western Europe and Japan, maintaining the declared scale of the national monetary unit became not only burdensome, but also practically inexecutable. The volumes of currency issue were growing not due to the replenishment of monetary gold reserves, but simply because of the need to supply such funds in the market turnover. It resulted in the national currency declining, while declaratively the scale of the national currency remained constant. Moreover, as soon as the gap between the declarative and real scale of the monetary unit reached the critical level, the USA, and then the other economically advanced countries of the West, unilaterally refused to convert their banknotes to the declared amount of gold. Because of the common nature of such unilateral measures, they were demanded to be consolidated by the general agreement, which was adopted at the Jamaica International Monetary Conference in 1976.

At the conference, it was decided that the number of monetary units indicated on the banknotes of the central banks of the participating countries would not represent the monetary gold reserves and, accordingly, would not be converted to monetary gold. Thus, gold was no longer an element of the monetary system. In essence, for the monetary system this was a decision of historical importance. If over the course of history, by money or more precisely, by its qualitative determinacy, they meant gold, from that point on it was different. However, at the above-mentioned conference it was not defined what was supposed to be the new qualitative determinacy of money subsequently, or in other words, what instead of monetary gold, was to represent the amount of money indicated on banknotes.

3. The Structure of the Banking System in the Conditions of the Jamaica Monetary System

However, as if by default it was meant that in the new conditions the number of monetary units indicated on the central bank notes will represent the “impeccable” reputation of the bank. Consequently, it was presumed that cash issue would be carried out simply in a credible manner towards the reputation of the central bank as an honest and competent market processes regulator.

Hence, the new monetary system was called “fiduciary”. [3] It was, of course, curious, bearing in mind that throughout the history of their activities, the central banks in the vast majority of Western countries shamelessly deceived the holders of banknotes, which were issued by them, in terms of maintaining the unchanged scale of the national currency; and finally, they completely went back on their obligations. The “impeccable reputation” of the central bank became one of its assets. Government debt obligations turned out to be another important asset of the central bank in the countries where it was privately owned and the national funds had the foreign currency status.

Due to this the central banks of Western countries, which were experiencing severe systemic crisis, not only almost painlessly recovered from it and turned from administrators into rightful owners of the remaining monetary gold reserves, but also got their hands on the instrument of influence on the state in the form of its debt obligations. The state budgeted with a deficit, implementing its various programs and plans, while the deficit was made up by borrowing the issuing funds from the central bank. All the above-mentioned participants of credit relations were comfortable with this state of affairs. The only “minor” problem was that because of the constant state budget deficit, the state debt was steadily growing. Political parties at the helm succeeded each other, but the national debt continued growing. It is important to note that despite all the bias towards the neoliberal school of economic thought, it made one interesting conclusion that the amount of public debt should not exceed 100% of the gross domestic product, but there was no decisive evidence provided to prove this point [4, p. 365-377]. However, the most significant thing is that this provision was formulated; and in one way or another, government officials were guided by it in their economic policies.

Started with a relatively insignificant amount, the state debt of the economically advanced countries of the West within a comparatively short period exceeded the established limit continuing to grow and threatening these countries by the risk of collapsing. Rejecting the issue of state debt obligations is a way to prevent state debt increase. However, this way means the impossibility of further central bank asset building, which acts as the basis for its issue function implementation. Meanwhile, it has practically no other (equivalent) asset forms. The need to replenish the amount of cash in the market turnover will inevitably lead to these funds issue just for the “impeccable reputation” of the central bank. Actually, this is what is happening now, both in the United States and in some other economically developed countries of the West. Hence, new cash issued by the central bank, and the USA Federal Reserve in particular, in fact, started to represent not only the issuer's specified reputation, but also the production capacity of the printing plant where they were issued every day all year round.

However, it should be noted that previously the cash money issued by the USA Federal Reserve also represented production capacities of the factory rather than government debt obligations. Debt obligations of the American state were purchased by the factory simply for the products. Accordingly, cash in circulation in the USA represented issue funds allocated to purchase government securities. As a result, it turns out that US dollars basically represent US dollars. This is a curious vicious circle with no easy way out. Consequently, this cycle, like the entire modern banking system, does not need superficial improvement, but a fundamental reforming; just like once the Soviet economy needed significant transformation. The Soviet system has already been transformed, while the modern banking system has not. Its vulnerability is conditioned not as much by a relatively large proportion of “toxic” assets, overdue receivables, etc., as by the fact that it “is in fundamental contradiction with the essence of the modern monetary system” [5].

4. Conclusion

At the Jamaica Conference, a decision was made to change the type of the monetary system, but the important fact that the banking system is a part of the monetary system was not taken into account. As changes happen to a more general monetary system, then the banking system as a part has to be inevitably reformed. The monetary system is such a general thing that belongs to the market on the whole, while the banking system is the part of the monetary system, which is privately owned. The obstacle in banking system reforming is to transform the private ownership into the national one, owned by the entire market. Thus, if the problem in reforming the Soviet economy was to transform public property into private, then in modern banking system reformation the problem is the opposite — to change the privately owned nature of the banking system to the national, to make this system the national identity.

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