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Article Topic: Reforming Money and Banking: How a Full-Reserve Banking System Can Eliminate Government Debt

Modern financial systems are constructed on the decades-old framework of a model of a fractional-reserve banking system, i.e. a system where the commercial banks only keep a fraction of their depositors reserves on their books, and lend the rest out. Despite its primary role in the development of the economy and the creation of credit, this system has been demonstrated multiple times to be susceptible to bank runs, economic crises and boom and bust cycles. Since the past few years, economists, policymakers, and reformers have revived an influential alternative, full-reserve banking, also called **100%** reserve banking or sovereign money creation. In addition to the possible stabilization of banking systems, one of the strongest points in favor of it is the argument that the system can get rid of government debt by radically reorganizing the money creation and circulation mechanisms. To gain proper insight on this suggestion, one has to examine the current methods of money creation, the very existence of government debt and how full-reserve banking might help redefine the monetary and fiscal environments.

In the modern world, governments or central banks create money, most of it, up to **90% or 95** percent, in most countries, but the governments do not create most of the money within countries but rather through the credit creation process, by commercial banks. With the bank giving a loan, it is also establishing a deposit in the account of the borrower in effect raising the supply of money. This system helps in the economic growth as there is constant supply of loans to the business, households and investors. Nonetheless, there are systemic risks associated with it. Since banks loan much more than the amount of money in their physical cash reserves, they are susceptible to liquidity and solvency crisis. A good example of this is the **2008** financial crisis, where over lending, lack of reserves, etc. In the full-reserve banking, the banks associated with commerce would be obligated to keep reserves to the value of 100 percent of deposits. This implied that banks were no longer allowed to make money by lending. In its place, they would just lend money which has been expressly deposited in time-deposit savings accounts or loanable funds accounts. Consequently, money-making would be centralized to the central bank or the state, and the commercial institutions would not have the right to print money anymore. In essence the creation of money would be a civic activity as opposed to an activity of privately generating money. The result of this structural change is that the supporters state that governments would not have to borrow money into being, since they, or their central banks, are able to create debt-free money without any intermediary.

This paradox is inverted by a full-reserve system. Through removing the control of money creation by the commercial banks and placing it under the control of the government, the governments were able to fund the state expenditure without a need to borrow money, but instead by issuing new money. This type of creation of money by the state has been termed as sovereign money and there are those who believe that this model has the potential of eliminating the necessity of national debt almost completely. The state would not sell bonds to raise money, but would simply issue new money and introduce it into the economy through either public spending, tax credits or transfers to citizens. Since such money would be created without the interest payments, the government would not have to service debt and this would remove one of the most significant factors of fiscal pressure. The other strong force through which full-reserve banking can reduce or else eradicate government debt is on the conversion process itself. Switching to full-reserve banking instead of the current fractional-reserve banking would entail having commercial banks fully reserve existing deposits. In order to do this, the central banks would be required to issue new money and make this money available to banks to cover 100% of their current deposit liabilities. This new central bank money would be taking the place of the deposits money issued by the commercial banks. What is more important to note is that this new money would be created to facilitate the transition and this money could be used to retire government debt as well. Rather than inflating all the newly created central bank money into the reserves of commercial banks, some part might be used to purchase and put out the existing government bonds. The plan would decrease the government debt with neither increasing taxes nor decreasing government expenditure. Notably, since it would be the governments that possessed the authority to issue money, they would not have any liability or interest attached to them.

The criticism of the creation of money without the debt is that it would lead to inflation. Nevertheless, those who support full-reserve banking argue that the existing system already produces money by means of private debt creation, which in most cases causes inflation of assets, credit bubbles, and unstable economy. Full-reserve Money supply would only increase in a transparent and democratically administered process through the central bank or independent monetary authority. New money would be issued on quantifiable economic indicators like the GDP growth, inflation goal and productive capacity. Provided the creation of money is in tandem with the output of the economy, chances of runaway inflation are low. Also, the transition to the issuing of the money by the government instead of privately could in fact lower the probability of speculative bubbles with which the recent economic crises have been marked.

More than having an ability to eliminate government debt, full-reserve banking has a number of systemic advantages. To one, it significantly lowers the possibility of bank runs. Since the banks would not be allowed to lend out the demand deposits, customers would be in a position to withdraw their money any time without the risk to the solvency of the bank. This greater stability may result in no longer needing government-sponsored deposit insurance schemes, which save government funds and create less moral hazard. In addition to that, decoupling payments system and risk-based lending would make the financial environment more secure and transparent. The payment accounts would be used as digitalized versions of safes; they would store the money safely, as the lending processes would be more similar to investment funds; risks are clear, and the investors will take them instead of ordinary citizens.

Advocates also believe that full-reserve banking brings about sustainable credit dispensation. Within the existing system, banks are also highly motivated to channel their loans into highly lucrative speculative investments, like housing bubbles or stock market leverage. These activities tend to overrate the cost of assets without adding to the actual economic productivity. With a full-reserve system, the banks would not lend out any money except money deposited by the savers or investors and this would result in the banks making more prudent and productive lending decisions. The flow of credit would be to those activities that create real economic value and not the speculative value. The removal of government debt by establishing a sovereign money might also transform the public policy. The absence of debt servicing costs would enable governments to allocate fiscal resources to the long term development plans including infrastructure, education, health and environmental sustainability. The things that appear now like financial strains such as high interest rates on borrowing would be possible. Also, in the absence of the burden of huge national debts, governments would be able to react to economic recessions through more effective counter-cyclical policies involving spending. The governments would not have to rely on the central banks to stimulate the economy indirectly by reducing interest rates or through quantitative easing, but they would have direct instruments when it comes to putting money back into the real economy.

In conclusion, the idea of reforming money and banking through a full-reserve banking system represents a radical yet intellectually grounded approach to stabilizing financial systems and transforming public finance. By transferring the power of money creation entirely to the state or its central bank, full-reserve banking could, in theory, eliminate government debt and replace debt-based money with sovereign money. This transformation promises numerous advantages, including increased financial stability, reduced risk of crises, more transparent credit allocation, and enhanced fiscal capacity. While the challenges of implementing such a transition are substantial, the potential to break the perpetual cycle of government borrowing and debt accumulation makes full-reserve banking an attractive and visionary reform for the future of economic governance. Furthermore, a full-reserve framework promises a more secure and resilient financial environment by stabilising the payments system, decreasing the incentive for speculative lending, and coordinating credit creation with actual economic productivity. The long-term advantages—economic stability, decreased crisis risk. and the empowerment of sovereign monetary policy and structure.

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