

Currency boards: traditional, modern and virtual

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*All opinions expressed are those of the author.



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What is a currency board?

- A currency board is an arrangement whereby, at a minimum, all currency (meaning notes and coin) is guaranteed to be fully backed by foreign assets at a fixed rate and the issuer is obliged to redeem currency (and any other monetary liabilities) at this rate, which is often embedded in legislation.
- Currency boards should remove any incentive for a 'run' from the currency by guaranteeing that the last person in the queue to present a domestic banknote is still able to exchange it at the promised rate for the anchor currency.

Why adopt a currency board?

- (perceived) advantages of fixed exchange rates
confidence in currency; increased
international trade
- But dangers from 'pegs'
- Adopting a foreign currency avoids exchange
rate risks but involves loss of identity and
seigniorage

Traditional currency boards

- 19th century in Mauritius, Ceylon and Falkland Islands.
- West African Currency Board 1912
- Having currencies backed by sterling was like sterling being backed by gold.

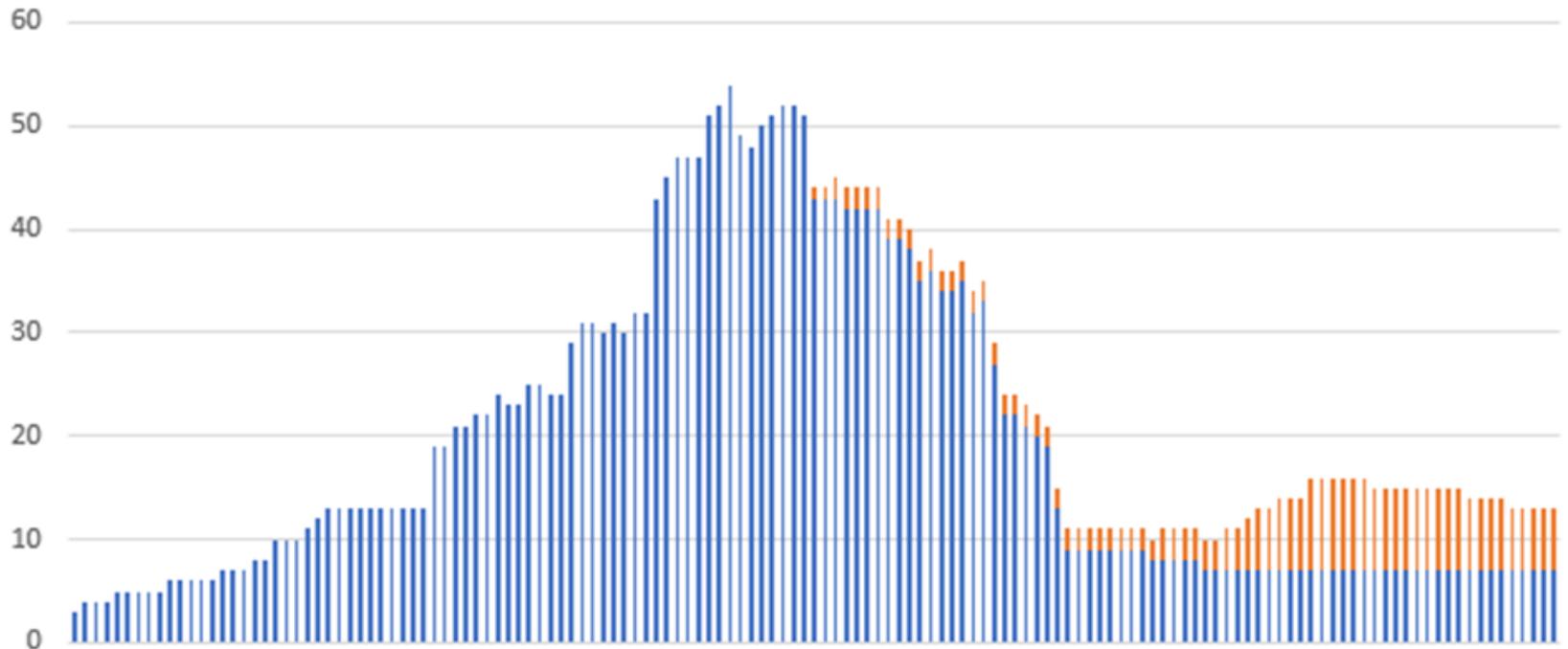
Mr Keynes and the currency boards

Keynes (as junior treasury official) involved in North Russian currency board (1918-1920).

In Keynes (1913) he wrote 'local currency maintained at par with the international currency...is the ideal currency of the future'.

Rise and fall of currency boards

Number of currency boards: 1880 - 2019



Move away from traditional currency boards

- Currency boards seen as ‘financial hallmark of colonialism’.
- Central bank seen as symbol of national identity.
- International reports (e.g. League of Nations International Financial Conference of 1920) advocated central banks.

(Misplaced) Criticisms of currency boards

- Involves 'lending to UK' rather than investing in local economy.
- Causes deflation and/or restricts economic growth.
- Prevents independent monetary policy 'fine tuning' which can prevent recessions.
- Hinders development of financial markets.

Remaining traditional currency boards

Table 1: Traditional currency boards

	Currency	Anchor currency	Date established	Population ('000)
Bermuda	Dollar	US dollar	1915	64
Cayman Islands	Dollar	US dollar	1972	60
Falkland Islands	Pound	UK pound	1899	3
Faroe Islands	<u>Króna</u>	Danish krone	1940	49
Gibraltar	Pound	UK pound	1927	34
Guernsey	Pound	UK pound	1945	63
Isle of Man	Pound	UK pound	1961	84
Jersey	Pound	UK pound	1963	103
St Helena	Pound	UK pound	1975	4

Modern currency boards

- Hong Kong (1983)
- Modern currency boards offend purists who call them 'unorthodox' or 'currency board-like'.
- Have bank settlement accounts
- May be lender to last resort to banks (with excess reserves)
- May hold some government securities or issue their own paper
- May manage funds for governments

Currency board balance sheets

Table 3: Currency board balance sheets (% to total assets)

	Traditional Currency Boards				Modern Currency Boards				
	Bermuda	Cayman Islands	St Helena		Bosnia-Herzegovina	Brunei	Eastern Caribbean	Hong Kong	Macao
	Bermuda Monetary Authority	Cayman Islands Monetary Authority	St Helena Government Currency Fund		Central Bank of Bosnia-Herzegovina	Monetary Authority of Brunei Darussalam	Eastern Caribbean Central Bank	Hong Kong Monetary Authority	Monetary Authority of Macao
	(Dec 2018)	(Dec 2017)	(Mar 2018)		(Dec 2018)	(Dec 2018)	(Mar 2019)	(Dec 2018)	(Dec 2017)
Currency	75	73	85		41	26	22	12	7
Deposits of domestic banks	0	0	0		47	38	62	3	12
Deposits of domestic government	0	0	0		6	2	8	35	24
Securities issued by currency board	0	0	0		0	0	0	27	15
<u>Other liabilities</u>	<u>4</u>	<u>7</u>	<u>0</u>		<u>0</u>	<u>9</u>	<u>2</u>	<u>6</u>	<u>29</u>
Total liabilities	79	80	85		94	76	94	83	87
Capital & reserves	21	20	15		6	24	6	18	14
Foreign assets*	80	76	96		97	93	94	80	71
Gold	0	0	0		2	5	0	0	0
Claims on domestic government	0	0	0		0	0	2	0	0
Currency inventory	3	1	4		0	0	0	0	0
Claims on domestic banks	0	0	0		0	0	0	0	0
<u>Other assets</u>	<u>17</u>	<u>23</u>	<u>0</u>		<u>1</u>	<u>1</u>	<u>4</u>	<u>20</u>	<u>29</u>
Total assets	100	100	100		100	100	100	100	100

*securities of foreign governments, deposits with foreign banks and IMF, foreign currency.

Modern currency boards

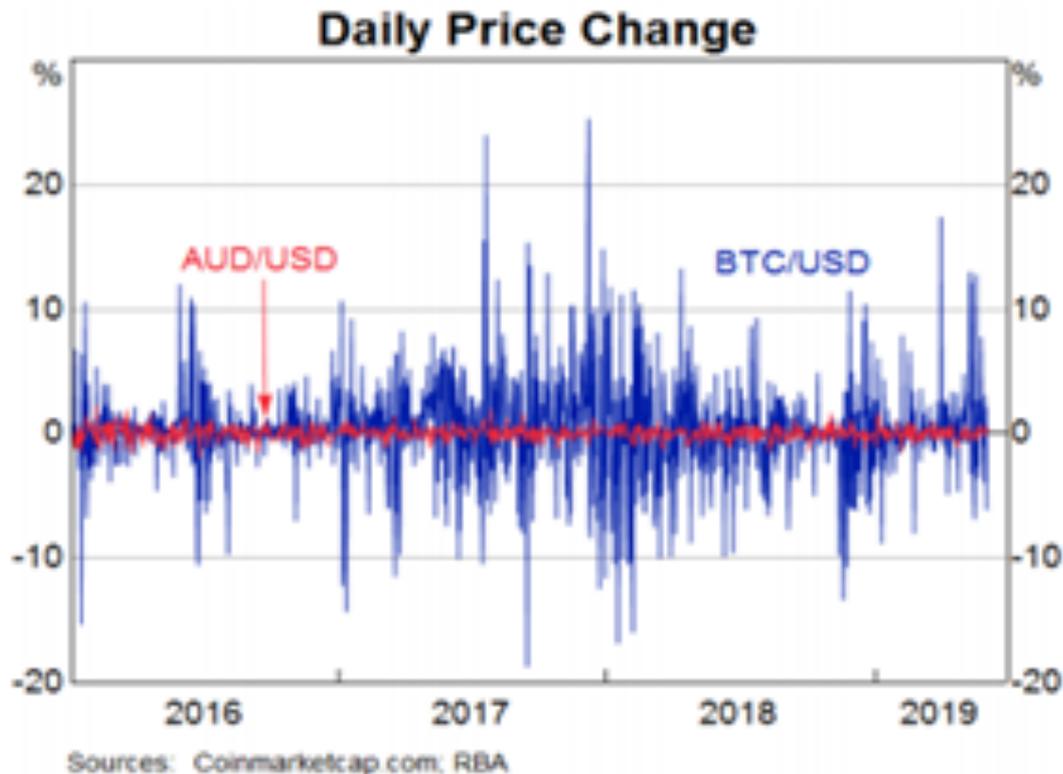
	currency	Linked to	Inception	Population (million)	Inflation (end-2018)
Bosnia-H.	Marka	euro	1997	3.9	1.6
Brunei	Brunei dollar	Singapore \$	1952	0.4	0
Bulgaria	Lev	Euro	1997	7.0	2.3
Djibouti	Djibouti franc	US dollar	1949	0.9	0.6
Eastern Caribbean	EC dollar	US dollar	1950	0.6	2.0
Hong Kong	HK dollar	US dollar	1983	7.5	2.4
Macau	Pataca	HK dollar	1989	0.6	2.9

Modern currency boards in crisis

- Hong Kong attacked in 1997 by speculators using 'double play'; shorting equities to take advantage of high interest rates. Currency board held.
- Argentina attacked in 2001 as speculators expected devaluation. Currency board abandoned.

Cryptocurrencies

Cryptocurrencies – best known Bitcoin is so volatile it is not really even a currency as used for very few transactions.



Virtual currency boards

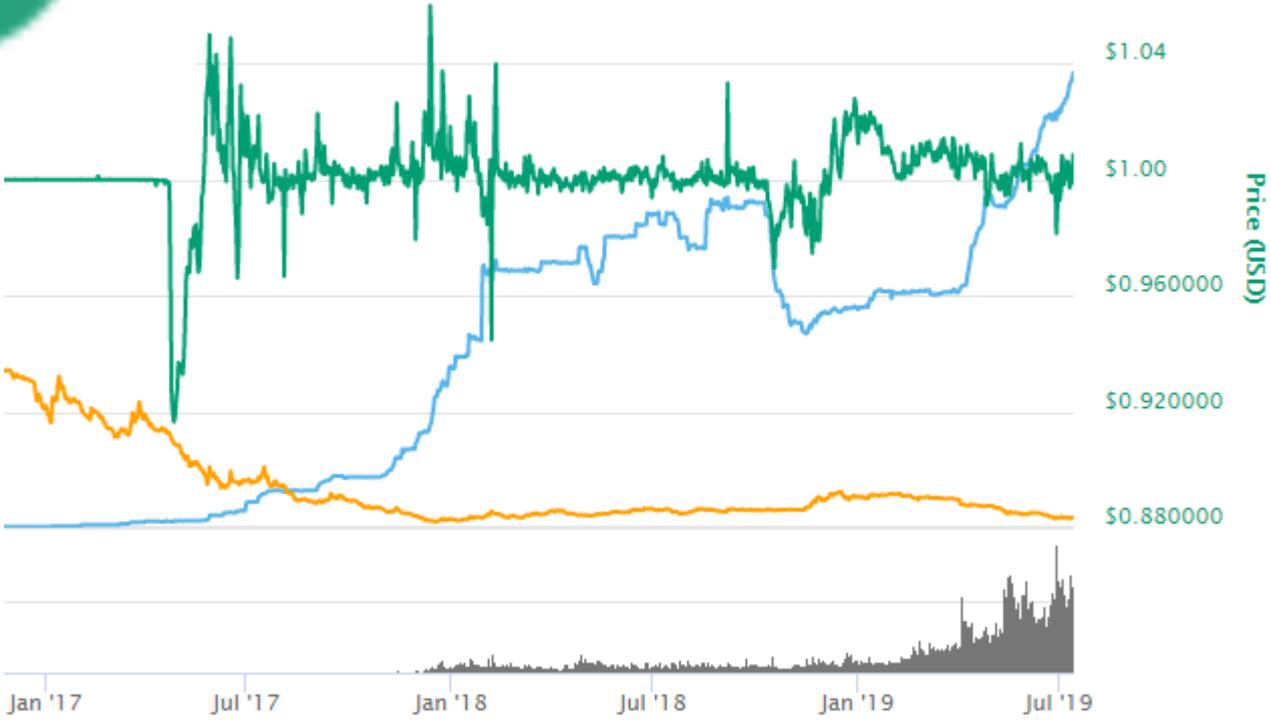
Asset-backed stablecoin: “cryptocurrencies that seek to gain and maintain a stable value through being – or purporting to be – a claim on real or financial assets” such as US dollars.

-Dark et al , *RBA Bulletin*, June 2019

Virtual currency board - Tether



Largest one – worth \$4 billion



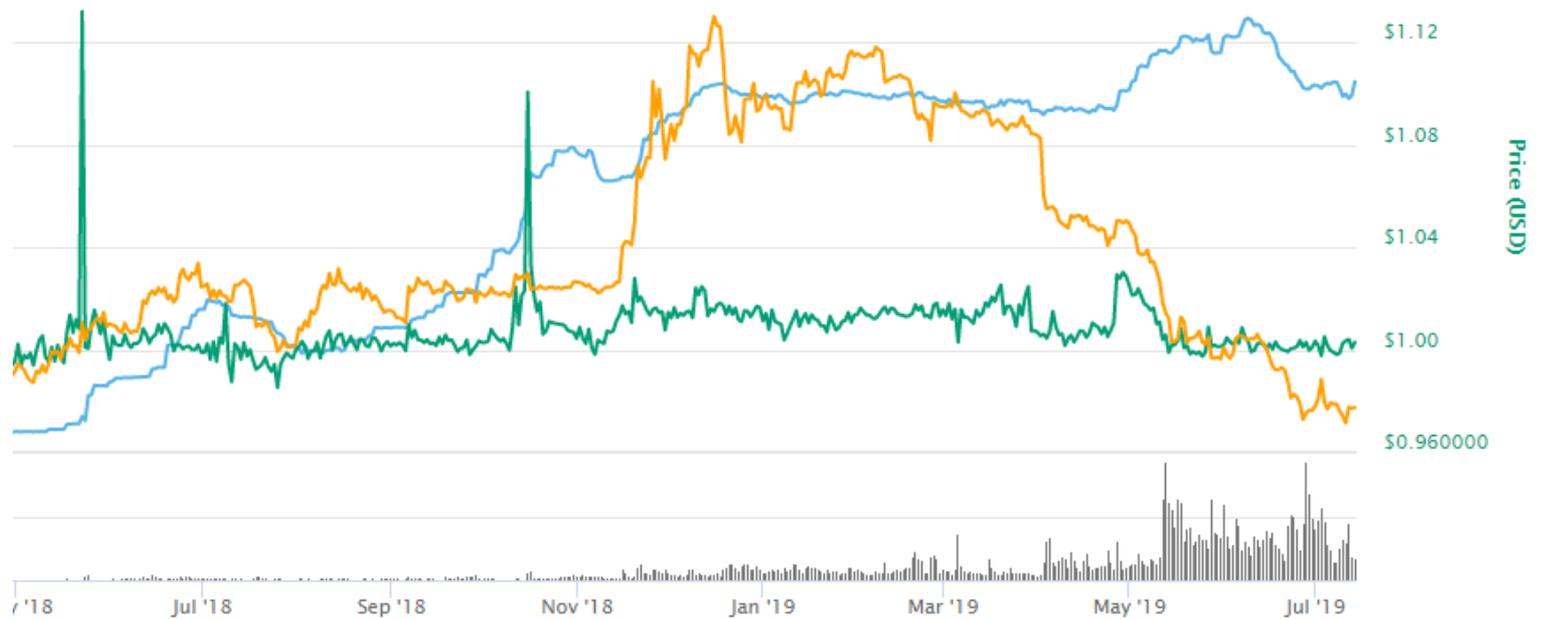
Virtual currency board - Tether

- Initially claimed to be 100% backed by US dollar at unidentified bank.
- Feb 2019 court proceedings revealed only 76% backed.
- Some reserves invested in bitcoins.
- Legal domicile: British Virgin Islands

Virtual currency board - TrueUSD



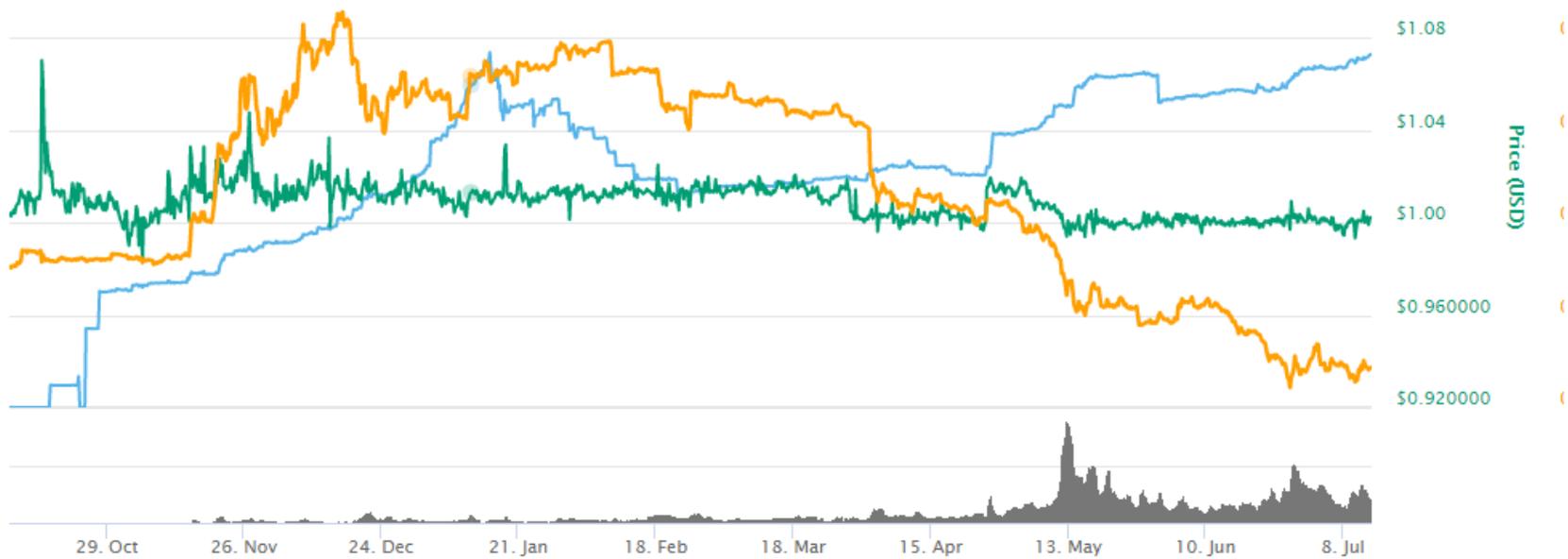
worth \$200 million



Virtual currency board - USDCoin



worth \$380 million



Libra

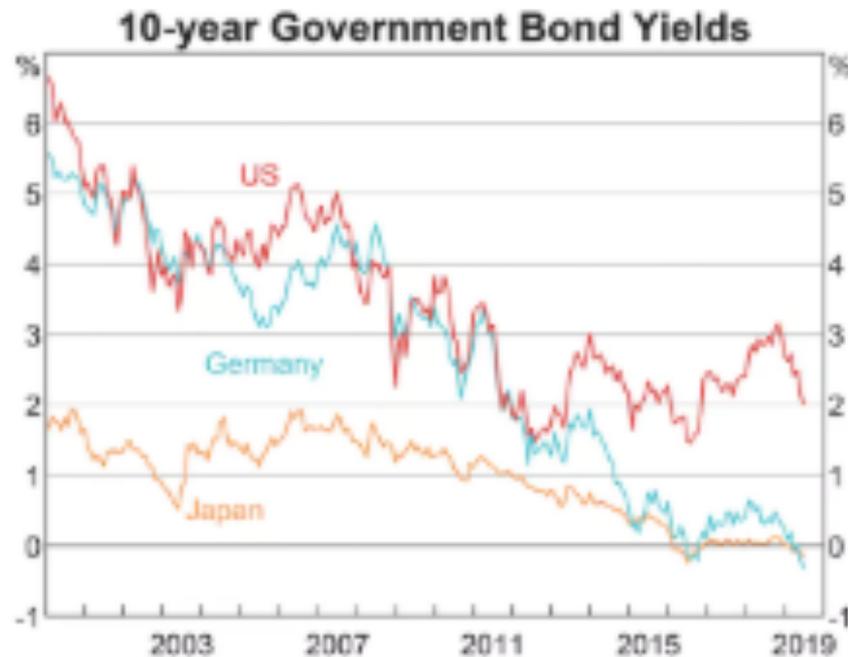
- Facebook, Mastercard, Visa, Paypal, eBay, Uber, Spotify and Vodafone (but notably no banks) have contributed at least \$10 million each to become founder members of the Swiss-based Libra Association.
- Libra payments will be able to be made using a digital wallet, named Calibra, integrated into Facebook's Messenger and WhatsApp applications.
- Focus on the billion adults with a mobile phone but no access to a traditional bank.
- to be fully backed by a reserve of bank deposits and short-term government securities held by a geographically distributed network of custodians.



Source: Jerry Siegel, 'Bizarro, private detective!', *Adventure Comics*, no 286, July 1961, p. 3.

Bizarro bonds a reality

Now the governments of Austria, Denmark, Finland, France, Germany, Japan, Netherlands, Sweden and Switzerland are selling ten-year bonds with negative interest yields.



Risk to seigniorage

- All three currency boards work on the basis that they earn interest on assets (bonds) but pay no interest on liabilities (currency).
- This model now at risk.