

IMF: The Chicago Plan Revisited: Conclusion

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WP/12/202

IMF Working Paper

Research Department

The Chicago Plan Revisited

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August 2012

VIII. Conclusion

This paper revisits the Chicago Plan, a proposal for fundamental monetary reform that was put forward by many leading U.S. economists at the height of the Great Depression.

Fisher (1936), in his brilliant summary of the Chicago Plan, claimed that it had four major advantages, ranging from greater macroeconomic stability to much lower debt levels throughout the economy. In this paper we are able to rigorously evaluate his claims, by applying the recommendations of the Chicago Plan to a state-of-the-art monetary DSGE model that contains a fully microfounded and carefully calibrated model of the current U.S. financial system. The critical feature of this model is that the economy's money supply is created by banks, through debt, rather than being created debt-free by the government.

Our analytical and simulation results fully validate Fisher's (1936) claims. The Chicago Plan could significantly reduce business cycle volatility caused by rapid changes in banks' attitudes towards credit risk, it would eliminate bank runs, and it would lead to an instantaneous and large reduction in the levels of both government and private debt. It would accomplish the latter by making government-issued money, which represents equity in the commonwealth rather than debt, the central liquid asset of the economy, while banks concentrate on

their strength, the extension of credit to investment projects that require monitoring and risk management expertise. We find that the advantages of the 56 Chicago Plan go even beyond those claimed by Fisher. One additional advantage is large steady state output gains due to the removal or reduction of multiple distortions, including interest rate risk spreads, distortionary taxes, and costly monitoring of macroeconomically unnecessary credit risks. Another advantage is the ability to drive steady state inflation to zero in an environment where liquidity traps do not exist, and where monetarism becomes feasible and desirable because the government does in fact control broad monetary aggregates. This ability to generate and live with zero steady state inflation is an important result, because it answers the somewhat confused claim of opponents of an exclusive government monopoly on money issuance, namely that such a monetary system would be highly inflationary. There is nothing in our theoretical framework to support this claim. And as discussed in Section II, there is very little in the monetary history of ancient societies and Western nations to support it either.
