## What is debt free money? [work in progress]

In the literature on monetary reform two concepts of debt free money circulate. The first regards money 'debt free' whenever it is spent (or given away) into circulation. The second regards money 'debt free' because it embodies the currency, without being a claim on anyone.

### The first concept

The first concept considers the position of the receiver of money. If he receives money without any obligation to pay it back, this money is regarded 'debt free'. This is not a property of the money he received. It is a property of the title on which the money is transferred. The same money can transform in 'debt money' whenever the receiver lends it out. In a bank money system, it is rather common that he will do so. If he puts it in the bank, he lends it out to that bank, converting its 'debt free money' into a claim to money.

The receiver of that money (the bank) does not receive the money free of debt, because it must pay it back in the future. Adherents to the first concept of 'debt free money' will see most 'debt free money' quickly disappear after it enters circulation.

### Second concept

The second concept provides a more stable basis to debt free money. It does not focus on the title by which money transfers. It looks at what money represents. Does it represent a claim on anyone or not? Deposits and promissory notes for example represent a claim on the issuer. They are therefore considered 'debt money'. Notes and coins on the other hand, do not represent a claim on the issuer. They are 'debt free money'.

### Notes and coins

To some it might seem strange that notes and coins are 'debt free'. After all, they are recorded as a liability on the balance sheet of the central bank. Doesn't that imply that they represent a claim to money? The answer is 'no'. Notes and coins don't give recourse to the estates of the central bank. If a central bank goes bankrupt the holder of its notes has no claim, just notes. That is not necessarily a bad thing because these notes might still embody the currency and retain their purchasing power, after the issuer disappeared.

### Cash as a liability

Why then does the central bank record cash as a liability ('notes in circulation')? Cash can be withdrawn from the bank. It can also be returned to the bank. When it returns the bank credits the account of the person that 'deposits' it at the bank.[1] The account 'notes in circulation' is a reservation for such 'depositing' of the notes in circulation. This reservation does not compete with the other creditors of the central bank. In that regard 'notes in circulation' can be regarded as bank equity. This equity converts to liability whenever notes return from circulation for depositing.

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[1] ECB/2010/29 "NCBs shall accept all euro banknotes on the request of the holder for exchange against euro banknotes of the same value or, in the case of account holders, to be credited to accounts held at the recipient NCB."

## Banknotes are chattels

Today, bank notes are chattels. This is a recent development though. In the past, when notes where convertible in gold and specie, bank notes were 'promissory notes'. They thus represented a debt: the obligation to pay 'real money' on demand to the holder of the note. This obligation ('convertibility') was abandoned in the Netherlands in 1948. At the time, the change in the character of bank notes was not recognized, and only acknowledged decades later. In the 1980-ies the subject was still debated. Only in 1998 the Netherlands lawmaker officially declared that bank notes were chattels that embody asset value and purchasing power (Tweede Kamer, vergaderjaar 1997–1998, 25 719, nr. 3 p. 15.). In Germany the 'debt free' character of bank notes was acknowledged by the Bundelverwaltungsgericht in 1993 (Bundesverwaltungsgericht 23 november 1993, 1 C 21/92, JurionRS, 13249). Today it is universally accepted that bank notes are monetary objects (chattels) and no claims.

## Purchased into circulation

Interestingly, the status of bank notes improved upon abolition of convertibility. Bank notes transformed from being claims to money (monetary value) into MONEY (monetary objects). These objects are sold into circulation, in a demand driven process.[2] The supply of bank notes is only limited by the credit the central bank extends to its account holders (typically banks). Note purchases are settled in central bank balances. Only banks with sufficient credit at the central bank can purchase banknotes at the central bank.

## The financial asset backed monetary credit system

One might assume that accounting for bank notes changed after bank notes transformed into debt free money. After all, returning notes can be recorded as assets, instead of liabilities. The ECB doesn't allow that though. It explicitly requires that all national central banks (NBCs) record them as liabilities.[3] This is consistent with the character of the present money system. This system is not based on the monetary objects that embody the currency (notes and coins). It is based on the credit issued by financial institutions, and increasingly on debt instruments backed by financial assets (such as repos and other money-market instruments). Notes and coins are a mere extension of this credit system. Thus, characterization of the present monetary system as a *fiat money system* is rather misleading. The fiat money in this system is not used for monetary policy, and issued fully elastic with demand from the banks. It is more instructive to describe the present system as a '*financial asset backed monetary credit system*'.[4] If we truly had a fiat money system, notes and coins would be treated as assets, if returned to the central bank.

The foregoing demonstrates that the 2$^{nd}$ concept of 'debt free money' corresponds with the legal nature of money. Money in a strict sense is always debt free. Coins have been debt free from the onset. Notes only became debt free quite recently. But the present money system is not based on notes and coins. It is based on credit that exchanges at par with the currency, as embodied in these notes and coins.

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[2] ECB/2010/29 "The issue of euro banknotes need not be subject to quantitative or other limits, since putting banknotes into circulation is a demand driven process."

[3] ECB/2010/29 "NCBs shall treat all euro banknotes accepted by them as liabilities and process them in an identical manner."

[4] https://onsgeld.nu/onsgeld/2016/wortmann_radical_monetary_reform.pdf