The paper by Alistair Milne on 'Register, Issue, Cap and Trade' must have been the most enormous fun to write. The 'cap and trade' part reminds me strongly of a similar paper some 34 years ago by Nigel Duck and David Shepherd, 'A proposal for the UK money supply', which was published in the Economic Journal in March 1978. In an internal memo at the Bank of England, I remember savaging that paper then. Its idea was that the Bank of England should auction off permits for financial intermediation to the banks, which would only be allowed to expand financial intermediation up to the limit of the permit that they bought.

In effect, that idea and Alistair's 'cap and trade' are simply another version of a direct control on bank lending and deposit expansion, made somewhat more flexible through an auction system. Having been partly responsible for the details, form and introduction of such a control myself in earlier years, i.e. the British 'corset' in the UK in the 1970s, I know all too well how porous these are. This is so especially when there are no exchange controls and intermediation can simply go offshore. But even if financial intermediation could be restricted to one country by exchange controls, Alistair's system would still be full of holes. He attempts to plug disintermediation into off-balance sheet entities by requiring all financial intermediaries, including shadow banks, to register their liabilities, but there is one hole that he cannot plug, which is currency. Operating via currency, rather than through deposits, would have significant extra transactions costs, but if the cost of buying access to intermediation rights was high enough, it could be easily done, and could, and would, be streamlined over time. Thus, if a borrower wanted additional loans, the ultimate lender could transfer her deposit into cash and pass it to the borrower, which could keep the funds in cash form. The intermediary could make the arrangements and gather in a fee, but nothing would show up on the books of any intermediary. It would transform banking at the margin into a managed version of peer-to-peer lending, but that could be done easily enough. So even with a full set of exchange controls, Alistair's direct controls could be avoided, admittedly at some cost, but that is the fate of all direct controls, even including my own 'corset'. And, without a complete set of tight exchange controls, the whole idea is doomed from the start.

Alistair is also worried about an insufficient expansion of money and credit, and argues for a helicopter drop of additional currency in such circumstances. This could not, of course, be done by the Bank of England, whose balance sheet has to balance. But currency can be emitted by the Treasury, as with Bradburies in World War I. With such currency being acceptable in payment in taxes, the issue of helicopter money is akin to a reduction of taxation, (or increase in public sector expenditure). It would therefore go directly to increase the public sector's deficit and debt, and quite rightly so. As a taxpayer, one might hope that the Treasury (or Bank of England) would at least buy some valuable assets in return for the extra currency; so Alistair's helicopter money should actually be transmuted into the more acceptable form of 'credit easing'.

Alistair also suggests that such additional monetary expansion continue until a higher level of inflation, than the current target, is achieved. Although this proposal of temporarily raising the target for inflation has been advocated by several other , often quite eminent, economists, it would worry me greatly, and I could not advocate it. If the new inflation target were not published, but inflation did rise above the retained lower inflation target level, then at some point the Bank of England's credibility would get shattered. Assume, then, that the new higher inflation target would be published, then why would one not expect nominal interest rates and nominal wages and prices to rise in line, leaving real conditions unchanged, except for the fact that the government would have decided to expropriate certain sectors of the population, i.e. the savers and creditors, and equivalently to benefit other sectors, i.e. the borrowers and debtors. I cannot see that being politically acceptable. Moreover, if the government should consciously aim to debauch the currency through intentional inflation, there could be a steep slippery slope towards a complete loss of confidence in the value of the government's money, with a rapid drift towards hyperinflation. The idea that we can safely embark on a planned inflation now, in order to reduce the current level of debt, but revert to price stability at some future date, strikes me as dangerously wishful.

Still, it must have been great fun to write!

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