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Making the lira ‘as good as gold’
Currency board would protect Turkey from devastating inflation

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It is no secret that Turkish President Recep Tayyip Erdoğan aspires to become his country’s next sultan. But one substantial obstacle is blocking his path: the lira. Turkey’s coin of the realm is one of the world’s junk currencies, and it hangs like the sword of Damocles over Erdoğan.

For the decades of the 1970s, 80s, 90s and 2000s, Turkey recorded average annual inflation rates of 22.4%, 49.6%, 76.7%, and 22.3% respectively. Those horrendous numbers mask periodic lira routs. In 1994, 2000-01 and 2018-19, the lira has been devastated. But there is a way for Erdoğan to guard the currency from its downward spiral and suppress inflation. That path is paved with a currency board.

A currency board issues notes and coins convertible on demand into a foreign anchor currency at a fixed rate of exchange. The relevant monetary authority is required to hold anchor-currency reserves equal to 100% of its monetary liabilities. It generates profits from the difference between the interest it earns on its reserve assets and the expense of maintaining its liabilities.

By design, a currency board has no discretionary monetary powers and cannot issue money on its own credit. It has an exchange-rate policy – the exchange rate is fixed – but no monetary policy. Its operations are passive and automatic. The sole function of a currency board is to exchange at a fixed rate the domestic currency it issues for an anchor currency. Consequently, the quantity of domestic currency in circulation is determined entirely by market forces, namely demand for domestic currency. Since the domestic money is a clone of its anchor, a currency-board country is part of an anchor country’s unified currency area.

Currency boards require no preconditions, can be installed rapidly, and have existed in around 70 countries. Government finances, state-owned enterprises and trade need not be reformed before a currency board can issue money. The first was installed in 1849 in Mauritius, then part of the British Indian Ocean Territory. No currency board has failed. This perfect record includes the ‘National Emission Caisse’ established in northern Russia in 1918 during the country’s civil war. The caisse issued ‘British rouble’ notes, backed by sterling and convertible into pounds at a fixed rate. The father of the British rouble was none other than John Maynard Keynes, at the time a British treasury official.

Despite the civil war, the British rouble never deviated from its fixed exchange rate. In contrast to other Russian roubles, the British rouble was a reliable store of value. Naturally, the British rouble drove other roubles out of circulation. Its life was unfortunately brief: the caisse ceased operations in 1920 after allied troops withdrew from Russia. That said, it redeemed all the obligations presented to it before closing.

Looking to the yellow metal
One doesn’t need to reach far back in history to find a currency-board success story close to Turkey. Indeed, a relatively new currency board is located in Bulgaria, Turkey’s immediate neighbour to the northwest.

In 1997, hyperinflation gripped Bulgaria. The lev had collapsed, and the monthly inflation rate had soared to 242%. Then serving as an adviser to President Petar Stoyanov, I designed a currency board that was installed on 1 July. With that, the lev became a clone of the Deutsche Mark. Inflation was immediately defeated, lev interest rates plunged, a hard budget constraint was put on Bulgaria’s fiscal authorities, and the economy boomed. Since the installation of the currency board, fiscal deficits have been tightly controlled. Bulgaria’s fiscal discipline and debt reduction have made it a star performer in Europe.

In Turkey’s case, Erdoğan should install a gold-backed currency board. With a Turkish currency board, the lira would be tied to gold at a fixed exchange rate. Gold reserves would fully back the lira. The yellow metal is particularly attractive for countries like Turkey, since it is not issued by a sovereign and is highly revered. So, like gold, the lira would become an international currency that maintains its purchasing power over time. Indeed, the lira would be ‘as good as gold’.

Steve Hanke is a Professor of Applied Economics at the Johns Hopkins University and a Member of the OMFIF Advisory Board. He is the co-author of Gelişmişke Olan Ülkeler İçin Para Kurulları (Monetary Boards for Developing Countries), published in Turkey by Liberte Publishing Group.