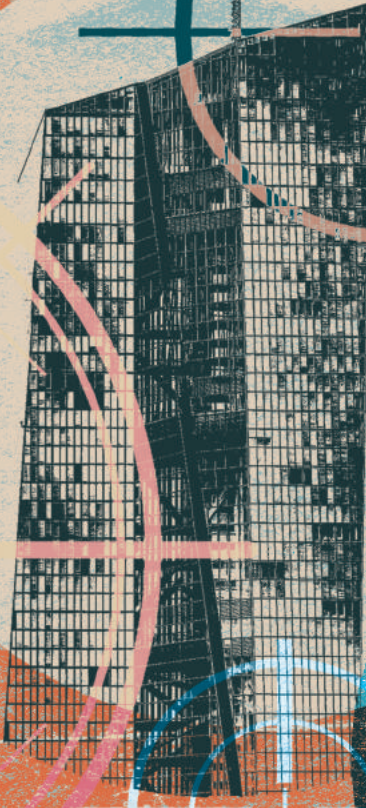


The Bulletin

 OMFIF

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IN THE LINE OF FIRE

THE THREATS TO CENTRAL
BANK INDEPENDENCE

The Bulletin

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10



17



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- 4 ABOUT OMFIF LEADER**
- 5 LEADER**
- 6 REVIEW**

- COVER STORY**
- 10 IN THE LINE OF FIRE**
David Marsh
- 15 ECB MAIN TASK IS TO FOLLOW RIGHT POLICIES**
Danae Kyriakopoulou
- 16 SCEPTICISM OPENS DOOR FOR CRYPTOCURRENCIES**
Steve Hanke

- OUTLOOK 2021**
- 18 WHAT NEXT FOR RESERVE MANAGERS?**
Massimiliano Castelli
- 19 DIGITAL DYNAMISM WILL FUEL ASIA'S OUTPERFORMANCE**
Taimur Baig
- 20 BIDEN MUST ADOPT MULTILATERAL TACTICS FOR CHINA POLICY**
Nathan Sheets
- 21 AFTER COVID-19, WE REQUIRE A NEW FORM OF FINANCE**
Joseph Ding
- 22 MAKING DIVERSITY COUNT**
Hani Kablawi
- 23 MAKING CBDCS A TRUE AND TRUSTED CURRENCY**
Wolfram Seidemann
- 24 BEWARE RISING NEUTRAL RATES**
James Sweeney
- 25 SOVEREIGN DEBT CAN BOOST EURO'S RESERVE CURRENCY STATUS**
Frank Scheidig

- 26 WHY RISING PUBLIC DEBT WON'T DRIVE COUNTRIES INTO DIFFICULTIES**
Christian Kopf

- WORLDVIEW**
- 28 10 REASONS WHY RENMINBI WILL KEEP ON RISING**
David Marsh
- 30 DON'T OVERPLAY THE DOLLAR'S DECLINE IN 2021**
Mark Sobel
- 31 ERA OF LOW INFLATION COULD LAST FOR 50 YEARS**
Meghnad Desai
- 32 WHY BROWN SHOULD BE THE NEW GREEN**
Danae Kyriakopoulou
- 33 THE CASE FOR A EUROPEAN BANKING CHARTER**
Ignazio Angeloni
- 34 A SURGE IN INFLATION IS ON THE HORIZON**
Juan Castañeda and Tim Congdon
- 35 SHEDDING LIGHT ON CHINA'S CAPITAL INFLOWS**
Herbert Poenisch

- INQUIRY**
- 38 OMFIF ADVISERS NETWORK POLL**
Ensuring policy harmony



30

38



SCEPTICISM OPENS DOOR FOR CRYPTOCURRENCIES

CENTRAL BANKS COULD BE OVERTAKEN BY PRIVATE SUBSTITUTES



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When delivering the BBC's 'A Question of Trust' Reith lectures in 2002, Baroness Onara O'Neill recounted advice given by Confucius to his disciple, Tzu-kung. He revealed that a government needed three things to survive: weapons, food and trust. If a ruler cannot hold onto all three, which one should be given up first? For Confucius, weapons were the most expendable, and then came food. But a ruler should attempt to hold onto trust at all costs, for 'without trust we cannot stand.'

This is widely understood by central bankers. But few have been able to implement policies that have garnered much

trust, particularly in the modern era of fiat money—and for good reason. Over the past 120 years, central banks have produced a great deal of inflation, which has been accompanied by a loss in the purchasing power of their currencies. At times, bouts of hyperinflation have reared their ugly heads. Currencies have been rendered worthless overnight.

Consider what has happened in Venezuela, Zimbabwe and Lebanon during the past year. On 31 December, I measured the annual inflation rates in those top three inflators to be 1,945%, 395% and 274% respectively. Inevitably, the bolivar lost 94.5% of its value against the dollar last year, the Zimbabwean dollar lost 79.5% and the Lebanese pound lost 72.6%. It is difficult to trust central banks that issue currencies such as these.

There are exceptions, but very few. The

most notable is the Swiss National Bank. In the last 120 years, Switzerland has experienced the world's lowest average annual rate of inflation. Unsurprisingly, the Swiss franc has appreciated against all other currencies over that period. In consequence, unlike most central banks, the SNB commands a great deal of trust.

CREATING ORDER

The public is always in search of alternative institutions and reliable arrangements that work. Carl Menger, founder of the Austrian school of economics, formulated the process by which institutions are created and evolve. This has come to be known as spontaneous order, an order that is not consciously designed by anyone. For example, a V formation of migrating geese does not exist because one goose ordered it. Menger demonstrated that it was spontaneous order that gave rise to money. No one invented money. Instead, money emerged unplanned out of people's attempts to improve their condition by moving away from bartering and by engaging in indirect exchange via money.

This brings us to the rise of cryptocurrencies. Lack of trust in central banks and national currencies set the stage for the spontaneous arrival of private substitutes. While technology played its part in making cryptocurrencies feasible, it is the lack of trust in central banking that has paved the way for what might be a new spontaneous order. ●

Steve Hanke is Professor of Applied Economics at Johns Hopkins University and a member of the OMFIF Advisory Board.



'MONEY EMERGED UNPLANNED OUT OF PEOPLE'S ATTEMPTS TO IMPROVE THEIR CONDITION BY MOVING AWAY FROM BARTERING AND BY ENGAGING IN INDIRECT EXCHANGE VIA MONEY.'

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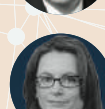
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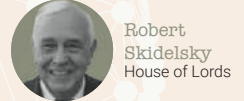
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