

THE MYSTERY OF MONEY AND BANKING

By Lloyd Churches

Many people like to complain about the banks but few understand why the banks are powerful, how they are privileged and what alternatives exist. I'm very interested in money and banking but I must admit it can be very confusing and very mysterious. Often I will read something and think I've understood but when I return to the subject a week later I've forgotten or I'll read something else which seems to contradict what I initially read and wonder if I really did 'get' it the first time.

It's vitally important that we understand the principles of money and banking so we can improve our world and tackle head on perhaps the biggest vested interest there is. After all, in a way, the banks are the biggest landlords of them all, they are collecting the rent of land through interest on mortgages.

What I want to give you are some ideas about money and banking and let you then google them and find out more.

Money as Debt

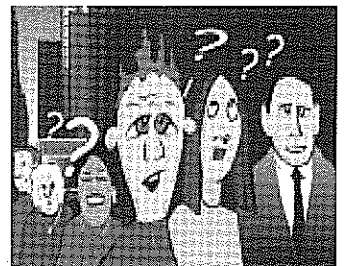
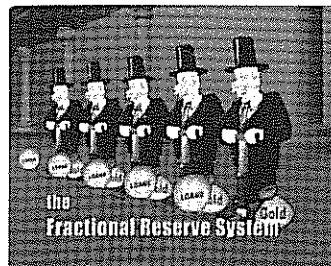
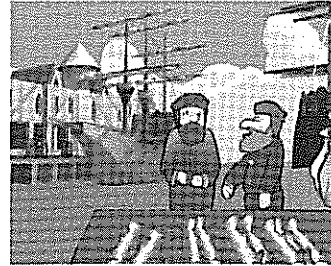
One of your first stops should be the 'Money as Debt' video. You can view this on video.google.com, search for Money as Debt and look for the 47 minute one. I probably found this one 3 years ago and today it is very popular. It's a narrator with cartoon type animations and plenty of interesting quotes like these:

"Some of the biggest men in the United States, in the field of commerce and manufacture, are afraid of something. They know that there is a power somewhere so organized, so subtle, so watchful, so interlocked, so complete, so pervasive that they had better not speak above their breath when they speak in condemnation of it."

-Woodrow Wilson, former President of the United States.

Permit me to issue and control the money of a nation, and I care not who makes its laws."

- Mayer Anselm Rothschild, Banker



This video will answer your questions about what money is, where it comes from, who creates it and who controls it. One of the most interesting things is where money comes from. The common usage of 'making money' through working on a job isn't what I mean. This is only exchanging money. I'm talking about issuing money or creating money. Most people probably think the government issues the money and lend it to banks who then lend it to us. The truth however is startling.

"The process by which banks create money is so simple that the mind is repelled"

- John Kenneth Galbraith, Economist

Money is created by banks out of thin air when someone agrees to go into debt. Amazing isn't it. Yes banks create money, not governments. Well, what's to stop them from making as much as they want? Well, first of all, they have to find someone willing to go into debt and well, when there's a land boom going on there are plenty of speculators who are willing to do that. The other limit is that they actually need to have some reserves of cash deposited with the central bank. This is known as the fractional reserve requirement and is

different from country to country being between 1 percent to 15 or 20. Surprisingly, and I may have misunderstood here, there seems to be no regulated requirement in Australia but our banks voluntarily have a 2 to 3 percent reserve.

Positive Money

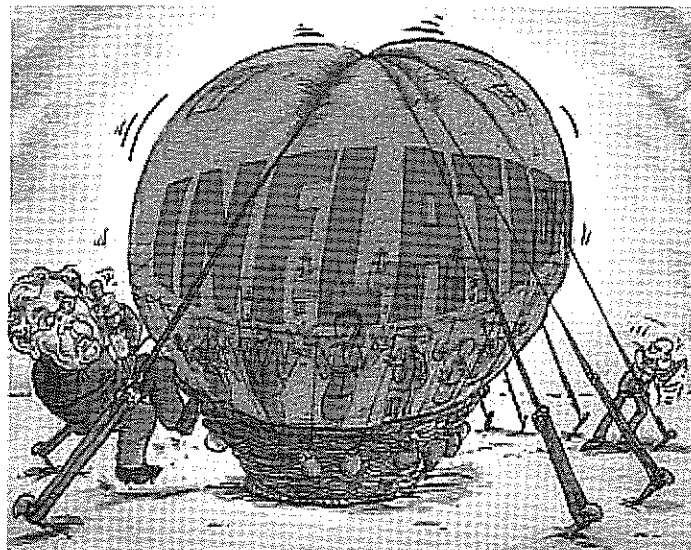
A website I've recently been reading is positivemoney.org.uk. This site will also explain the origins of money but will also go much deeper into the problems with the current system, the consequences, the solution and the benefits of the solution. So here you can learn that money is debt and the problem is that we can't get more money without going into debt and causing a boom and when we pay off the debt, money is destroyed and that causes a recession. So basically they are saying it's a catch22 situation, it causes the booms and busts instead of a stable situation. Their solution is to take away the bank's privilege of creating money and replace the 'money as debt' system with the alternative 'money as goods and services' system. In this solution, governments would spend money into existence by buying goods and services and paying your taxes would destroy the money.

	Money as Debt System	Money as Goods and Services
Money is created by...	Going into debt to banks	Governments spend on goods and services
Money is destroyed by...	Repaying debt to banks	Governments receiving taxes

They also want the banks to offer us risk free banking. When people deposit their money into transaction accounts the banks will not own this money, they will only hold it on trust in accounts with the central bank. The banks would not be allowed to loan out this money or invest it in risky ventures as they do now. In this way we can clearly separate the two main functions of money and of banking. One function of money is as a medium of exchange and money in these transaction accounts will be government guaranteed. The other function of money (store of value) is saving really. There will be no government guarantee for savings accounts, no bailouts. Transaction accounts are for short term debits and credits whereas savings account are for longer terms.

Inflation

We all know inflation occurs when we have too much money, right? But I find it really difficult to understand how inflation can be controlled. Being on a deadline, I'm not going to investigate it more now. All I know is that in Australia the Reserve Bank of Australia sets the cash rate and this somehow causes the banks to change the rate at which they lend. Ah, probably the higher cash rate is something the banks can pass on to savings accounts and so people would be encouraged to pay off their loans quicker and thereby reduce the money supply.



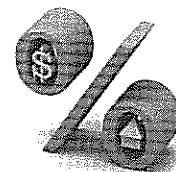
In the 'money as goods and services system' there could still be inflation. Government could cause inflation by paying too much salaries or not collecting enough taxes.

Michael Hudson

The reason I mention Michael Hudson in this money and banking article is because he's the guy in the know when it comes to what is happening in the big picture of global banking. Having worked in banking and researched so much economic history he seems to understand both the money issue and the land issue. He's not afraid to speak up and name the powerful vested interests and tell us what they are doing to your average poor worker. Read his articles and listen to his interviews if you are interested in current affairs to do with the GFC, bailouts, sovereign debt risk and the tricks the World Bank and IMF get up to. Although he's always promoting the collection of economic rent as a solution for indebted governments, I can't remember what his solution for money creation is although I wouldn't be surprised if he says to spend it into existence. Check out his website at www.michael-hudson.com and also the Institute of Creditary Economics www.credec.org of which he is involved.

Interest

Although banks create money out of thin air, that part isn't really a license to print money. After all they have to give the newly created money to the person who went into debt, otherwise they wouldn't go into debt. But what is like a license to print money is that they can demand interest from the debtor. This is how the banks make profit.



Now when money is created it is equal to the debt created and so there is money in circulation that can be taken out of circulation in order to repay the debt. But there is no such money in circulation to pay the interest? Isn't that crazy! So where does the money come from to pay the interest? The answer is that it can only come from new money, new debt. This means that the money as debt system actually requires



an ever expanding amount of debt to keep it going. There is actually much more debt in the system than there is money to repay it because when you don't pay your interest, it's added to your debt but without the corresponding money put into circulation.

Herein lays the seeds of destruction. There is scarcity of money built into this system. Eventually the amount of debt is so big and people realize that it can't be repaid. So there is a financial system crisis and banks must eventually write off the bad debts in order for the economy to start again.

Interest-Free banking

Before I found out about Georgism I was very interested in interest free banking. There is a bank in Sweden (JAK Medlemsbank) that offers interest free loans. However, they do require that you first save with them to earn savings points which I suspect is the same as earning interest before you can spend it. But their bank, ran by members for members believes interest is the number one economic problem and they try to educate society on how to change to interest free banking. I'd like to think that the 'money as goods and services' system would be an interest free system but I don't know if it's that simple.

LETS

I've been aware of LETS systems (local exchange trading systems) for many years. The potential here is to create an interest free currency. There's one in my local area and I often see the group promoting themselves at fairs and festivals but I have as yet not become a member. They let people trade between themselves in a local area. They use a bookkeeping system to record transactions, no cash required. Even though these have been around for 20 years they have not really taken off. I think the biggest hinder is that the two biggest costs in people's lives are taxes and rent (including mortgage repayments and interest) and it's not possible to use LETS credits to pay those.

How Are Banks Privileged?

We all seem to agree that banks are privileged but I'm interested in what the source of this privilege is. I'm always looking for principles. Banks have a monopoly on the creation of money which seems to give them the power

to decide which ventures get funded, the power to collect interest and to hold debt against a person, not just against collateral. On reflection though, don't we all have this power. The only difference is that we need to have money before we can lend or invest it.

Perhaps the real privilege is again in the land. Banks hold mortgages over land and the interest payments from those mortgages represent the rent of land. Ah yes private property in land, the mother of all monopolies.

Using Money to Store Value

Our current monetary system money has two functions: a medium of exchange and a store of value. One of the biggest hinders to monetary reform is that it's confusing to have two functions. Unfortunately the majority's perception of money is that it is a store of value. The proper perception should be that it's a tool to facilitate and measure exchanges. It's a time and labour saving device, making possible exchanges of goods and services at different times and different places compared to barter where both sides of the exchange must coexist in the same time and place. When you sell something and receive money, that's only one side of the exchange. The other side of the exchange (which can be at a different time and place) is that you buy something and give the money back. The problem is that in our current monetary system we don't need to think about the other side. We think that the money has value in itself and we can store that value for long periods of time. We are even encouraged to store it because banks offer us interest. So with all this money in store there are all these goods and services that don't get purchased which leads to waste and unemployment.

If you want to save for your retirement then money is a good place to store it. Money, because its abstract and not physical, will not depreciate like other goods. You can't buy all the food now that you'll need in retirement but if you hold your money at least its nominal value will not decrease and with compound interest it could even grow. All other assets depreciate or require maintenance fees to keep their value. Money doesn't.

In Austria, in the depression, some cities designed a type of money that depreciated. At the end of each month people had to attach stamps to the money notes in order for the notes to continue being valid. The speed of circulation was incredible. People strived to spend their money as soon as possible so they wouldn't have to pay the stamps. This allowed the local town economies to flourish.

The Georgist View

The general view of Georgists on the money problem is that it's not so important and a bit of a distraction from the land problem. They think if we solve the land problem, land will have little or no price and the bank's assets, its mortgages will be much smaller, only reflecting the values of houses and capital and not the land value.

The development of plans to implement Georgist reforms

is always hampered by the debts people have to the banks. The banks have captured the future rental stream of land and turned it into a financial asset and severed the connection to land making it exempt from land tax. If we understand money and banking well, it could assist us in creating a workable implementation plan.

Other views emerging are that the land issue and money issue are both intertwined and the only way to find solutions is to fix them together. An example of such a solution can be seen in the article in the previous issue of Progress called Location Value Covenants.

Lastly, don't forget that Henry George did have some things to say on money and banking. See the quote below and. I suggest you read the article 'Henry George's Concept of Money and Its Application to 21st Century Monetary Reform' which you can find at www.progress.org/2003/moneyz04.htm.

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