MANAGING THE NATIONAL MONEY SUPPLY

by

JAMES ROBERTSON

This is the draft of Chapter 3 of a book I am writing for publication by Green Books with the title *FUTURE MONEY: BREAKDOWN OR BREAKTHROUGH?*. I hope I may be able to complete the text of the book in time for its publication later this year.

Meanwhile Green Books have agreed to my circulating this draft chapter for possible interest now, before the expected publication in September of the final report of the UK Independent Commission on Banking.

Please feel free to forward this pdf to anyone you think might be interested in it. To be notified when the book is published, please subscribe to my occasional email newsletter here - http://www.jamesrobertson.com/subscribe.htm.

(Please forgive me if I don't have time to reply to comments in the next two or three months.)

James Robertson, July 2011
www.jamesrobertson.com

© James Robertson 2011

(v4 – Jul28-11)

CHAPTER 3. MANAGING THE NATIONAL MONEY SUPPLY

Draft July 2011

Start with the Right Questions

Impartial spectators visiting us from another planet would stand aghast at how we create and manage our national money supply. You can imagine them saying to one another: "These people must be absolutely crazy". To us they might say, more tactfully, "We wouldn't start from here if we were you".

We must start by asking the right questions. They include questions about facts and questions about what should be done.

The important factual questions are:

- who creates the money supply and puts it into circulation?
- in what form do they create it, as debt or free of debt?
- who gets first use of it?
- for what purposes?

The important practical questions are:

- who *should* create it and put it into circulation?
- in what form *should they create it*, as debt or free of debt?
- who *should* get first use of it?
- for what purposes?

If the way we now manage our national money supply had not grown up bit by bit, century by century; if it had not become thoughtlessly accepted as the status quo; and if we were now starting from scratch to arrange how money should be supplied to a democratic society - nobody in their right mind would dream of setting it up as it is now. Anyone with an inkling of how to manage anything would know that merging the two conflicting functions of

- providing the public money supply competently and fairly on behalf of society as a whole, and
- encouraging commercial banks to compete for profit in the market for lending and borrowing money,

would destroy the efficiency and reliability of both functions.

The root question is: what is the best way to create and manage the national money supply in a democracy? It is not primarily a question about banks, as politicians and experts take for granted, as they struggle to decide what should now be done.[1]

Nobody denies that reforming how the national money supply is provided and managed will, in today's circumstances, have very serious consequences for the banks. Those must be recognised. But, as with most practical problems, it will be sensible to put the horse before the cart.

The Present Arrangement

In the UK - and the same is true in other countries too - we allow our governments to make us dependent on commercial banks to create 97% of our national money supply as debt. Our governments don't have to do that; no law says they must; and, even if a law did say it, we could change it.

Most people don't yet recognise that the banks create the money by writing it out of nothing into our bank accounts as interest-bearing loans. The experts call it "creating credit", obscuring the fact that actually - as shown in the official statistics - the banks are being unnecessarily allowed to create almost all the national money supply as bank-account money for their own profit.

They do it under what is known as "fractional reserve banking". It requires commercial banks to keep in reserve only a fraction of the money that has been deposited with them. For example, if the required fraction is 10%, a deposit into the banking system of £1,000 would allow it to create an addition of £900 to the money supply by lending it to customers as "credit", and then a further 90% of £900, and then a further ... and so on.

Meanwhile the Bank of England and Royal Mint, as national agencies still providing national money as a public service in

[1] An example of present conventional thinking is that the terms of reference of the UK Independent Commission on Banking don't include "Who should create the national money supply, and in what form?" - http://bankingcommission.independent.gov.uk/bankingcommission/.

the public interest, are reduced to creating only about 3% of it as banknotes and coins. These bring in a correspondingly small contribution to public revenue.[2]

In striking contrast to the £multi-billion annual subsidy that our government gives to the bankers by allowing them to create almost all the money supply out of nothing as loans into customers' bank acounts, it severely punishes anyone other than the Bank of England or Royal Mint who creates and issues banknotes and coins. Anyone who fakes banknotes and coins and puts them into circulation as genuine money commits a crime - forgery or counterfeiting. If found guilty they go to prison while dozens of millionaire commercial bankers stay free, enjoying the profitable privileges that come from creating all the rest of the money supply.[3]

A Lesson from the History of Banknotes

For 160 years or so, our leaders have suppressed and ignored the important lesson to be learned from the history of banknotes.

Banknotes originated as credit notes issued by individual banks to their customers as receipts - that is to say, promises to repay the gold and silver coins and bullion which their customers had deposited with them for safe-keeping. Over the centuries, bank customers found that exchanging these paper notes was an easier way to make payments to one another than by physically transferring the bulky metal money held for them by their banks. In the course of time, banks developed their credit notes to meet that demand, and eventually the exchange of credit notes as a means of payment spread so widely that in practice they became money.

---

[2] In pre-democratic societies it was kings and rulers who provided all the currency. Their income from doing so was called "seignorage", and they spent it as they decided. No expert economic knowledge is needed to see that corresponding arrangements in today's democracies would treat all the income from creating new money as public revenue, and that normal democratic budgetary procedures would decide on its first use.

[3] For the offical statistics see Section 3.1D at http://www.statistics.gov.uk/statbase/Product.asp?vlnk=376
For more on the penalties for counterfeiting and forgery see Darius Guppy at http://www.jamesrobertson.com/news-apr10.htm#monetaryreform - Section 3(5).

Meanwhile, the banks had been learning that, when all went well, comparatively few of their customers would redeem their credit notes; most would leave their gold and silver money untouched in the bank. So the banks found they could profit by issuing credit notes worth more than the value of the gold and silver money they held for their customers. And that is what they did.

From time to time this resulted in "a run on the bank". The customers of a bank would realise that it had issued more paper money than it would be able to repay from the gold and silver money it was holding in its vaults. Fearing that they might lose their precious-metal money that was in the bank, their customers would rush to it to take their money out before other customers took out theirs. Their "run" would bring about the disaster they all feared. The bank would go bust.

By the middle of the 19th century it had become clear in England that what had originated as the credit notes of private banks were now almost universally used as actual money, and that failure to control their issue was damaging the economy as a whole. So the Bank Charter Act of 1844 was passed, which led to the present Bank of England monopoly of the banknote issue in England and Wales, and to the requirement that the value of banknotes still issued by commercial banks in Scotland and Northern Ireland should be backed by Bank of England notes.

British banknotes still say "I promise to pay... ", but we know that that is a historic survival, and that they are no longer simple credit notes. A joker trying to redeem them from the Bank of England will be sent with a flea in the ear or, at best, with other banknotes to the same value as those presented for redemption - or even the same ones - minus commission maybe!

So what is the lesson the managers of the money system have failed to learn from that history of banknotes? It is fairly simple.

Since 1844 commercial banks have been allowed to develop exactly the same trick with bank-account credit as they had previously done with credit notes. Credit notes had developed into paper money conveying value created out of nothing.

They had circulated *outside the banking system* in person-to-person transactions between bank customers, as banknotes still do. When the issue of banknotes was transferred to the Bank of England - later nationalised as an agency of the state in 1946 - other commercial banks were deprived of that source of profit.

So, having been deprived of that source of profit in 1844, how have the banks nonetheless achieved the astonishing further growth in the proportion of the national money supply that they now create as interest-bearing, profit-making loans?

They have done it by writing it as credit lent into their customers' bank accounts inside the banking system instead of, as previously, into banknotes circulating in the outside world. They have enabled their customers to spend it into circulation by paying it directly from their bank accounts into the bank accounts of other bank customers, and it continues to circulate that way *within the banking system* until the loan is repaid. Then it is written off, the money goes back into the nothing from which it originated, and new bank loans replace it in the money supply.

That development has helped the bankers and their associates to obscure how our money is created and put into circulation; and the dematerialisation of bank-account money into electronic form has mystified it further in the past half century.

So today, everyone with a current bank account knows that we can spend the money in it immediately, just like the coins in our pockets and the banknotes in our wallets. But few of us realise that the money in our bank accounts originated as profit-making loans from banks and that, as we circulate it through the economy, we are paying them interest on it.

Interconnected Effects of The Present Arrangement

(1) We Now Pay a Hidden Subsidy to the Banks[4]
This follows directly from the last paragraph. As debt-created money circulates through the economy, it pays interest to the banks that created it. It is the original borrowers who actually pay it. But the prices charged by borrowers who have borrowed it to finance the production and provision of goods and services for sale must include in their prices the cost of paying interest on it and eventually repaying it. So almost everyone who buys anything will indirectly be paying a fee to the banks for using money the banks had created as debt.

This is a kind of "stealth tax". But it's not a tax we pay to the government as public revenue. Under the present way of providing the money supply, everyone pays it as a subsidy to the banks almost every time we use money in the course of our daily lives. That includes the government's use of money on behalf of society as a whole.

Conveniently for the banks and those who share significantly in bank profits, the statistics don't show how much this present annual subsidy is worth to the banks. Nor do they show how much public revenue will be gained - for the benefit of taxpayers and other citizens - when an agency of the state takes over the function of creating the money supply debt-free and giving it to the government to spend on public purposes. Creating the money supply free of debt will relieve everyone of the need to pay that money to the banks.

It will still be true, of course, that business borrowers will have to pay bank interest on loans needed to cover the production costs of the goods and services they sell to us, and their prices to us will have to include those loan costs. But for two reasons the total amounts we now pay the banks for using money will fall.

a) First, those loan costs will tend to fall, because the rates of interest the banks can charge will be based on a more competitive money market than today's, which protects the existing banks from competition. This is discussed later in this chapter under the heading "Lending,

[4] This is only one of the many ways governments now make taxpayers subsidise the banks. Some others are discussed in http://www.neweconomics.org/publications/feather-bedding-financial-services

Borrowing and Saving after Monetary Reform".

b) Second, the money supply will no longer have to grow, as it does now.

(2) Why the Money Supply Is Now Forced to Grow

When customers now repay loans to their banks, the banks write off the money and return it to the nothing from which they had originally created it. But the money that has been paid on it as interest remains in existence as the property of the banks.

This makes it continually necessary for enough new money to be lent into existence to replace *both* what was originally lent but has now been written off *plus* what has gone to the banks as interest on it. Otherwise there will not be enough money in circulation to support the non-financial activities of the economy.

The present arrangement for providing the money supply thus requires the money supply to grow continually. That is one reason why governments in normal times instruct the Bank of England to maintain a continuing inflation rate[5] of between 1% and 3% a year, rather than money values that stay stable.

Whether economic growth can any longer be accepted as an overriding purpose of the money system in the 21st century has been questioned in Chapter 2, concluding that it should not be, partly because:

(a) the volume of economic activity, dependent on the total value of money circulating through the economy, cannot grow ad infinitum, and

(b) the continually growing volume of money transactions it involves benefits banks and other financial businesses at the expense of everyone else.

(3) Indebtedness in Society is Forced to Grow

As the present arrangement for creating the money supply necessitates its continual increase and depends on people and businesses taking out loans from the banks, it automatically causes rising indebtedness in society. Bank of England statistics confirm that the growth of the "Broad Money Supply" and the "Debt Owed by the Public in the UK" each year totalled

[5] The rate at which money loses its value for what it can buy.

roughly £2,500bn between 1969 and 2009, and closely matched each other's growth year-by-year.[6] This inevitably has a further undesirable consequence.

(4) National Poverty Must Increase

You don't have to be the proverbial rocket scientist - or even a professional economist or statistician - to figure out who, apart from the banks themselves, will benefit most from increasing indebtedness in society and who will suffer most.

Got it? Yes? In general, those who benefit most will be people and businesses with enough spare money to lend or invest it and get back more money from doing so. Those who suffer most will be those who have to borrow money at interest, and so pay more in order to meet the needs of themselves and their families. In short, the present way of providing the money supply systematically works to increase poverty and widen the gap between rich and poor.

(5) Ecologically Damaging Human Activity Must Grow

Because the present way of providing the money supply necessitates continual growth of debt and of conventionally measured economic production, it has the general effect of making us earn our living by extracting and wasting more of the earth's resources than would otherwise be needed. Although it may be argued theoretically that the need for continually increasing economic growth and debt repayment could be met by a shift to "green" and "weightless" financial growth, we know that in practice things don't work out like that.

That is partly because providing a money supply based on debt widens the gap between rich and poor (4 above). But it is also because it encourages many rich people to behave like masters of the universe, enjoying unecological lifestyles with yachts, expensive houses and other lavish back-up all over the world, supported by the luxury of tax havens; and because at the same time it compels millions of the world's poor to work

[6] Source: Bank of England Interactive Statistical Database figures for "M4 and M4 Lending". See p19 of Submission to the Independent Commission on Banking, November 2010 - http://www.positivemoney.org.uk/wp-content/uploads/2010/11/NEF-Southampton-Positive-Money-ICB-Submission.pdf

in unecological and often slavish occupations as the only available way of gaining a living for themselves and their families.

(6) Economic Efficiency will Continue to Suffer

Banking efficiency is central to the flow of money through the economy. Subsidising banks as highly as we now do allows banks to co-exist comfortably with their existing competitors and to discourage potentially more innovative and competitive new entrants from coming into the banking industry.

Providing the national money supply is a service that needs to be managed efficiently in the public interest with a wholehearted sense of public service. The market for borrowing and lending money is one of a country's internal markets that needs to operate freely and efficiently in the interests of its customers. The present way of creating and managing both the supply of money and the market for money already in circulation fails on both counts. The efficiency of the national economy suffers seriously from both failures.

(7) Economic Distortions

Damaging consequences follow from allowing banks to decide, in their own commercial interest, how the national money they create will be used on its first entry into circulation. We need not blame them for it. If they are given the chance, it is natural for them to distort the initial flows of money through the economy in favour of activities likely to be profitable to them.

Take, for example, lending for speculative purposes. Banks often find it more profitable to create money to lend to people and businesses to buy already existing assets - like land and houses, and stocks and shares - for speculative purposes, than to finance the production of goods and provision of services by lending to support productive work in progress or the development of productive new facilities.

However, house-price booms and slumps are only partly due to how the money supply is now managed. Another cause is the failure to tax land values and so recapture, as public revenue, the public money spent on local infrastructure and facilities. Without a tax on land values, that public money

automatically finds its way into windfall profits to local property owners.

So monetary reform by itself would not completely solve that particular problem. Although banks would then have to borrow all the money they lend, they might still find it more attractive to borrow it to lend to speculative buyers of already existing properties than to borrow it to lend for productive purposes. This and other combinations of faulty monetary and tax policies are further discussed in Chapter 4.

Another example concerns the *development of more self-reliant local economies* - a matter of increasing urgency and importance as discussed in Chapter 6.

Allowing commercial banks to create virtually all the national currency as profit-making debt obliges the borrowers who have spent it into circulation to earn national currency to service their loans and eventually repay them. The need to repay it perpetuates the need to acquire and use the national currency, and so stifles the spread of parallel community currencies and other aspects of local financial self-reliance.

When the money supply has been converted into a circulating fund of debt-free money created by the central bank and given to the government to spend into circulation, governments will find it easier than the banks to spend it debt-free. That will enable them to support a growing number of people - as individuals, or households or neighbourhoods - to develop the ability to become more economically self-reliant and less dependent on getting and spending national currency. Governments would then no longer be discouraging the spread of local currencies and local economic self-reliance. They discourage it now by allowing the commercial banks to issue the national money supply as debt that has to be paid interest and eventually repaid in the national currency.[7]

The broader point at issue here is important. Projects of high long-term value to society as a whole, but of less or no short-term profit to banks or other commercial businesses, are unlikely to qualify as first users of money created by

[7] UK Prime Minister David Cameron does not yet seem to understand that his idea of the "Big Society" is unlikely to be very effective unless the privileges that now allow Big Money to dominate our lives are withdrawn.

commercial banks on which interest has be paid and which eventually has to be repaid itself. It is much more likely to be targeted on projects of that kind if the money has been created by a public agency and issued into circulation debt-free by a democratic government in the public interest. Health care is a good example: sophisticated new drugs from pharmaceutical corporations to treat sickness are more likely to attract banks to create loan money to invest in them, than are new programmes of health creation to prevent sickness occurring in the first place. More generally, dealing with bad things after they have occurred - crime is another, and war another - tends to attract higher investment of money than in preventing them happening at all.

A Constant Cause of Financial Instability and Crises

Crises of financial instability are the inevitable result of mixing together the two conflicting functions of

- providing the public money supply in the interest of society as a whole, and
- competing for profit in the commercial market for lending and borrowing money.

Bernard Lietaer and his colleagues have recorded that, worldwide, there have been almost a hundred major financial crises over the past twenty years.[8] We are now, we hope, just beginning to work our way through the consequences of what may turn out to be the most damaging financial breakdown humanity has ever seen. As Lietaer reminds us, the last one on anything like this scale was followed by the Great Depression of the 1930s, an international wave of fascism, and the Second World War.

The present worldwide financial boom and bust has developed in three stages - boom, bust, and sovereign debt out of control. At the time of writing, the second and third are still happening.

There is either ignorance or deliberate concealment by the managers of the money system about the flows of money in those three stages: where did the money come from, where

---

8 http://www.lietaer.com/images/White_Paper_on_Systemic_Banking_Crises_final.pdf

has it gone to, and where is it still continuing to go to? In all three stages huge windfalls - at the cost of the rest of society - appear to have been enjoyed by a limited number of bankers, other financial managers, their associates in connected walks of life like accountancy and financial law, and their families and friends. We should press our elected representatives, executive government and professionals in charge of the money system to admit that that correctly reflects what has been happening.

Stage 1: Boom-time - in a time of boom it is in the public interest to limit the supply of money going into the economy. But it's obvious that, if naturally profit-seeking commercial bankers are entrusted with creating the national money supply as profit-making loans, they won't be able to resist competing with one another to create and lend as much as they can for as long as the boom goes on. By doing that they can make themselves very rich - Windfall Number 1. They are bound to stoke up the boom - and so speed up the onset of the bust that will end it.

In 2007 the Chief Executive Officer of Citibank graphically described the bankers' situation. Shortly before he got his multi-million-dollar 'golden parachute' to compensate him for being 'chucked out' of his crisis-stricken bank, Chuck Prince explained: "As long as the music is playing, you've got to get up and dance". I recalled having seen, as director of the Inter-Bank Research Organisation during the (much smaller) secondary banking crisis of the early 1970s, bankers stampeding toward the abyss into which many of them knew they would probably fall. I understood very well what Chuck Prince meant.

Stage 2: Bust-time - when booms go bust as they always do, the public need becomes the opposite of what it was in the boom. We need more money put into circulation, not less. At this point our self-inflicted dependence on commercial banks to provide the money supply again works in the wrong direction - the opposite direction to the one that was wrong in the boom. Banks now can't or won't provide enough money.

They have lost so much that many are in danger of going bust and out of business altogether. Because our governments unnecessarily require us to depend on the banks to provide

the national money supply, the bankers are now able to hold us to ransom. Our governments have to bail out the banks with billions of our public money - trillions worldwide - Windfall Number 2.

However, at this stage the bailed-out banks can't or won't concentrate on the task of creating and lending the amount of money the economy needs in order to revive. They must use most of the bail-out money for themselves.

First, they must use it to strengthen their balance sheets, to protect them from going bust in the future; to do that they have to set aside money as reserves with the central bank. Second, they need to spend much of the rest of the bail-out money on competing with one another to give big enough bonuses to their managers to persuade them not to go to other more generous banks. In November 2009, for example, a few months after paying back the US bail-out money it had received[9], the Chairman and CEO of Goldman Sachs was preparing to hand out more than $20billion in year-end bonuses to his managers - claiming that his bank had only been doing "God's work"!

Now in 2011 nobody in the whole wide world with responsibility for managing national money supplies seems able to suggest a practical way to solve the puzzle. So, if the banks cannot or will not create enough money by lending it, what might be a better way to create it and put it into circulation?

Some, like Niall Ferguson and Laurence Kotlikoff, opt for *limited purpose banking* as the answer to the question "How to take the moral hazard out of banking". They are coming near to the only sensible solution of the puzzle.[10] More importantly, Bank of England Governor Mervyn King appears to be almost prepared to accept that a different way of creating and managing the money supply is what is needed. In a public lecture in New York on 25 October 2010[11], he drew attention

[9] From the $700 billion Troubled Asset Relief Program (TARP), launched under President Bush's Emergency Economic Stabilization Act of 2008.
[10] http://www.ft.com/cms/s/0/34cd41e4-df77-11de-98ca-00144feab49a.html#axzz1Mu0nJRDx
[11] See, http://www.bankofengland.co.uk/publications/speeches/2010/speech455.pdf

to the possibility of "eliminating fractional reserve banking".[12] He recognised that "the pretence that risk-free deposits can be supported by risky assets is alchemy". He concluded that "of all the many ways of organising banking, the worst is the one we have today".

However - to bring in a couple of animal metaphors - as the mountains have laboured expensively at successive international meetings of the Group of Twenty countries (G20), hardly even a ridiculous mouse has been born; and almost everyone still fails to notice, or pretends not to notice, the elephant in the room. We will come back to the elephant shortly.

Stage 3: Sovereign debt out of control - this third stage in the present financial breakdown is now overlapping the second.

When governments have to borrow the money to bail out the banks, the national debt (or sovereign debt) grows.[13] Then governments have to raise enough money from their taxpayers and other citizens (by increasing taxes and cutting public spending) to service the debt until it has been paid back and reduced to an acceptable level. When countries themselves - not just their banks - reach a level of debt higher than potential lenders trust them to service and pay back, they have to be bailed out.

That has already happened to the governments of Greece, Ireland and Portugal; and it threatens other Eurozone countries and the future of the Eurozone itself. It also results in the need for Emergency Budgets elsewhere, including the UK, which can cause widespread hardship and serious social unrest.

---

[12] As noted earlier, fractional reserve banking is what we have now. It requires commercial banks to keep in reserve only a fraction of the money deposited with them. For example, if the required fraction is 10%, a deposit into the banking system of £1,000 would allow it to create an addition of £900 to the money supply by lending it to customers as "credit", and then a further 90% of £900, and then a further ... and so on.

[13] "Government debt", "national debt", "sovereign debt", and "public debt" all mean much the same thing. It should not be confused with the "total debt" of a country, which includes the debt of financial institutions, non-financial businesses and households in addition to government debt.

Taking the UK as an example, the UK Total Government Debt in 2001 was £300bn; in 2009 it had doubled to £600bn and in 2011 it is expected to rise by another nearly £400bn to £0.932 trillion. At present the annual interest the government is paying on the debt is £42bn. It was expected to rise to at least £70bn by 2015, before the UK Emergency Budget was introduced in June 2010; and the impact of that Budget on the eventual figure is as uncertain as is its impact on everything else by 2015.[14]

The growth of government debt has been part of a wider growth of indebtedness across the whole economy. In 1987 the UK's total debt for households, the City, non-financial companies and the government stood at 200% of gross domestic product; by 2009 it had reached £7.5 trillion, 540% of GDP.[15]

This massive growth of indebtedness has been hugely profitable for bankers already. As interest continues to be paid on the debts, and more of the outstanding capital gets paid off, more profit will continue to flow in their direction - Windfall Number 3.

Even if some experts may qualify or dispute some technical details of that brief summary, the elephant in the room can be clearly seen. Two things appear to be certain.

1) If the conventional thinking of governments and their expert advisers had recognised how much public spending could be saved and how much public revenue could be raised by monetary reform, measures like the UK Emergency Budget of June 2010 would have meant much less unnecessary hardship for most UK citizens than they are now causing.
2) The sooner the necessary monetary reform can be introduced and implemented, the better it will be for the people of every country that decides to adopt it.

[14] http://www.ukpublicspending.co.uk/uk_national_debt_chart.html
[15] http://www.guardian.co.uk/business/2010/nov/09/debt-timebomb-harm-economy-decades

Monetary Reform: Separating The Two Functions

A simple basic reform is all that is needed to separate the two functions now confused. It has two complementary parts.

> (1) It will transfer to nationalised central banks like the Bank of England the responsibility for creating, not just banknotes and coins as now, but also the overwhelmingly large component of the supply of public money consisting of bank-account money mainly held and transmitted electronically. Having created the money, the central bank will give it to the government to spend it into circulation on public purposes under standard democratic budgetary procedures.
>
> (2) It will prohibit anyone else, including commercial banks, from creating bank-account money out of thin air, just as forging metal coins and counterfeiting paper banknotes are criminal offences.

Those two measures together will nationalise the national money supply and make it possible to denationalise any commercial banks that have had to be nationalised. They will then be able to compete freely with all the other commercial banks in a profit-based market for borrowing and lending money that is already in circulation after being created by the central bank.

The first of those two measures will make a public agency responsible for directly creating and managing the public money supply in the public interest.

The second will create a more competitive market than now for facilitating loans between lenders and borrowers. The loss of the commercial banks' privilege of creating the money they lend will bring them into line with ordinary private-sector businesses that don't get given their main materials as a free gift. It will encourage them to provide better services more efficiently than now to their customers, and make it easier for new entrants to join the payment services industry. Anyone who genuinely accepts the virtues of a free-market economy, subject to rules fairly laid down and enforced by democratic governments in the public interest, will support it.

Most taxpayers and other citizens will benefit from:

1) getting rid of the hidden tax that we all now pay to commercial banks every day as interest on all the bank-account money in circulation; and
2) profiting from the one-off increase in public revenue resulting from the process of converting the money supply created by commercial banks as debt into money created free of debt by the Bank of England; this will be an addition to public revenue for use according to normal democratic budgetary procedures - either to reduce otherwise necessary taxes or to be spent into circulation on public purposes.

The published national and bank statistics do not provide financial estimates for what those those two benefits would amount to.[16] But conservative assumptions of 5% annual interest payments and an existing total money supply of £1,500 billion to be replaced would provide

1) an annual total saving to all citizens of, say, £75 billion, and
2) a one-off benefit to the public purse totalling some £1,500 billion over a 3-year period of transition from the existing commercial-bank-created money supply to the new debt-free money supply created to serve the public interest.[17]

The hardships imposed by the continuing financial crisis on the majority of citizens who were not directly responsible for it, and the continuing public unrest resulting from them, bring an added a sense of emergency to the overwhelming long-term arguments for monetary reform.

Controlling the Money Supply after Monetary Reform

Transferring responsibility for creating all new bank-account money to the central bank will catch up with what happened to banknotes under the Bank Charter Act of 1844 in the UK.[18] It will be the natural next step in the historical evolution of the Bank of England, following the operational independence given

[16] The Treasury and Bank of England should be asked to publish their best estimates.
[17] The estimate of £200 billion at http://www.bendyson.com/statistics therefore seems very moderate.
[18] See page 4 above.

to it in 1997. The private bank established in 1694 to serve the needs of the monarch will step by step have turned into a national agency responsible for providing a money supply that serves the common interests of all the citizens of a democratic society.

After the reform, operationally independent central banks like the Bank of England will continue to be given published monetary policy objectives by their governments. But they will no longer be expected to achieve them indirectly by managing interest rates to influence the demand for new money created by banks as loans under the system of fractional reserve banking. They will themselves decide at regular intervals how much new money needs to be added to the money supply, and then create it and pass it as debt-free public revenue to the government.

Then the government will either use it to reduce taxation or put it into circulation by spending it on public purposes along with other public revenue, in accordance with normal budgeting procedures. Normally the central bank will play no part in deciding how the money will be spent which it creates to meet monetary policy objectives.

The money supply will change its character when it all consists of money created by the central bank. As new debt-free money comes into circulation, and as the repayment of existing bank loans extinguishes the money created by the commercial banks, the money supply will become a clearly defined fund of officially created and recognised money.

This will consist of three categories of money:

(1) banknotes and coins;

(2) sight deposits in the current accounts of customers of banks and other agencies licensed by the central bank to manage bank accounts for customers; and

(3) the money in the current accounts of those banks and agencies with the central bank.

Those will constitute a supply of actual money in circulation which is immediately available for spending, and the total of which will be precisely identifiable in the official statistics.

One particular point about this new arrangement should be noted. If ever the central bank decided that the money supply

should be reduced by withdrawing money from it, it could ask the government to pay back the required reduction out of public revenue from taxes and other sources. The central bank would then destroy it.

As long as the need for continual growth of the money supply as an aspect of continual economic growth has been taken for granted, the question of how to reduce the money supply has been irrelevant. But it will become more relevant, if unending economic growth comes to be recognised as undesirable and impossible as discussed in Chapter 2.

Lending, Borrowing and Saving after Monetary Reform

The fund of money constituting the money supply will be quite distinct from financial claims, such as savings in savings accounts. Those will not contain money. They will be claims for money to be paid to their holders at certain times in certain circumstances. They will have been bought by their holders paying money for them to their sellers, as other forms of saving like investments, securities, insurance policies etc are bought now. Some claims like insurance policies pay back sums of money on specified dates or events; others, like share certificates, are exchangeable for money at their market prices at pay-back time.

In the transition after monetary reform, as borrowers repay bank loans borrowed before the reform comes into force, money to replace that money in the money supply will have been created by the central bank, and given to the government to spend into circulation. When it has reached some people and organisations they will decide to save it, not spend it. Their banks may then borrow it from them and lend it to borrowers, no longer creating new money in the process but as plain intermediaries borrowing existing money from lenders and then lending it at a profit to borrowers - as most people mistakenly suppose they do now.

Customers saving money with a bank will pay it to the bank as the purchase price of a claim to receive money later at a specified date with a specified rate of interest paid at specified intervals. The principle will be that money in the circulating fund of national money cannot be simultaneously available for spending to more than one holder at a time. The fund of

money in circulation will remain unchanged in size, except for increases or withdrawals made by the central bank in accordance with the government's monetary policy objectives.

The commercial banks, having hitherto been able to create money as soon as their customers ask to borrow it, will face the need for efficient stock control - just as all other businesses need to make their ranges of products and services available to meet customer demand as quickly as possible, without the cost of having too much on hand for too long. The only difference is that for banks, being single-product (money) businesses, this will be a much simpler challenge than for others like supermarkets.

Moreover, the need to find existing money quickly to lend to retail banks so that they can lend it quickly to their customers will encourage money markets to develop ways to find it quickly. Even if it does lead to some loss of flexibility for banks and their customers, and slightly slow down the velocity of money circulation, the central bank will be able to compensate for that by increasing the money supply. So there is no reason why it should damage the public interest if that does happen.

Regulation, Supervision and Guarantees

The monetary reform proposed in this chapter reflects "the attraction of the more radical solutions ... that they offer the hope of avoiding the seemingly inevitable drift to ever more complex and costly regulation" - Governor of the Bank of England Mervyn King's words in his New York lecture of 25 October 2010.[19] For contrast with the expected regulatory aftermath of less radical solutions see the jungle of proposals being discussed by the Bank and other UK financial organisations in May 2011.[20]

Monetary reform will make it possible to clarify responsibilities for regulation, supervision and guarantees on the following lines. They will be based on the differences between three

---

[19] http://www.bankofengland.co.uk/publications/speeches/2010/speech455.pdf

[20] http://www.thetimes.co.uk/tto/business/industries/banking/article3025878.ece

separate sets of functions:

1) the central bank's responsibility for providing and managing the national supply of money as a distinct, well defined circulating fund, the value of which is guaranteed by the state,
2) the responsibilities of government agencies and departments for raising public revenue and spending it on public purposes, and
3) private-sector, profit-making activities of buying and selling the very wide range of claims to money which, while being bought and sold for money, do not themselves contain money immediately available for spending by their purchasers.

The first of these three areas of regulation and supervision will be the responsibility of the central bank. It will include:

- licensing banks (and other organisations) to provide payments services in the national currency,
- regulating and supervising the administration and activities of those organisations,
- ensuring by audit trails that they do not create new money, and
- guaranteeing all deposits in their current accounts.

The central bank will continue to be accountable to the elected government and parliament for how it carries out these functions.

The second area - public revenue raising and public spending - will remain as now a responsibility of executive government democratically controlled by elected ministers and accountable to parliament. It will include guaranteeing the value of financial claims sold by agencies of the government like National Savings.

In the third area of regulation and supervision - private sector financial services - monetary reform will abolish the "seemingly inevitable drift to ever more complex and costly regulation" of commercial banks creating money under the fractional reserve system; the banks will be prohibited from creating money altogether.[21]

[21] [The "Overview" in the book will have compared the need for radical reform of the money system as a whole with the change made in the 16th century by the Copernican revolution in our understanding of the solar system. The complex corrective regulations needed by the present unreformed money system are

This area of regulation will then be limited to the buying and selling of financial claims. They will in themselves contain no money available for immediate use, just claims to be paid money in the future. They will include the savings and lending services provided by banks to their customers, all kinds of insurance policies, stock exchanges, commodity markets, pension funds and many others. They tend to shade into activities that have been called "casino banking" - hedge funds, trading in derivatives, options, futures etc. It is difficult to make a clear distinction between those and other forms of gambling, such as those controlled by the Gambling Commission, or betting on horse-racing and other sports. Even making a living from trading on the stock market, or in gold, or the fine art and antiques market, involve a measure of gambling too.

After monetary reform this area of regulation will deal with businesses handling money in much the same way as other businesses do when buying and selling other things. They will receive money or pay money in exchange for what they sell or buy. What they will not do is to create new money and affect the stability of the money supply. Therefore no guarantees from public funds need be given for the contractual or estimated values of the claims they buy and sell, any more than guarantees from public funds need be given for the reliability of other goods and services bought or sold by other types of business. Buyers and sellers should buy and sell them at their own risk, subject to the criminal and civil law, and laws on consumer protection.

International Competition and the National Economy

Commercial banks and their supporters in the UK and other countries claim that withdrawing the present subsidy they get from creating the national money supply would put them at a disadvantage against competitors from other countries; for example, it "would lead to the migration from the City of London of the largest collection of banks in the world, and be a disaster for the British economy".[22] They say that UK banks

---

paralleled by the epicycles piled on epicycles needed then to correct the conclusions of pre-Copernican, Ptolemaic astronomy.]

[22] Michael Portillo: see *Monetary Reform - Making it Happen*, p 41, http://www.jamesrobertson.com/books.htm#monetary

and the wider financial services industry create exceptionally large shares of wealth (GDP), tax revenue, and employment for our economy, without which we would all suffer.[23]

But it is high time for the government to examine those claims thoroughly and publish the answers to these questions:

- how much does having such a dominant and highly subsidised financial sector benefit most UK citizens compared with what it costs us - economically, socially and ecologically?[24]
- how many UK citizens positively benefit from it, and how many of us suffer?
- who benefits from it and who suffers?
- how realistic is it to claim that top bankers and other financial people and businesses will decide to leave the country and go elsewhere if monetary reform is introduced in Britain before other countries catch up?
- would they be welcome elsewhere if they went?
- how much would it matter to our own economy and society if they went? and
- should we wait to reform the way our money supply is created and managed until other economically important countries agree to reform theirs simultaneously?

The right answer for most UK citizens, and most citizens of other countries too, seems clear. We should get our governments to reform the way the money supply is created as soon as possible. We should not wait for other countries to catch up.[25]

[23] "Economic Contribution of UK Financial Services 2010" - http://www.thecityuk.com

[24] Research by the New Economics Foundation in 2009 found that "While collecting salaries of between £500,000 and £10 million, leading City bankers destroy £7 of social value for every pound in value they generate". See *"A Bit Rich: Calculating the real value to society of different professions".* http://www.neweconomics.org/publications/bit-rich

[25] What we should do about international monetary reform is discussed in Chapter 5.

Conclusion

This chapter began by asking the right questions. Having now reached the chapter's end, we find that answering them gives us the answer to other questions that have attracted public and expert concern in recent months. One of these is what to do about bankers' bonuses; another is whether to break up the banks so that they will no longer be "too big to fail".

The answers are: the bankers' bonuses affair shows top bankers badly out of touch with the values and demands of modern democratic societies; and today's banking system, dominated by a small number of world-scale banks, highly subsidised and protected by the privilege of creating money out of nothing as profit-making debt, should give way to a worldwide system of smaller banks competing with one another to serve the needs of their customers.

The effective practical course for people who share that view is to go to the root of the problem. Reforming how the money supply is now created and managed will remove our self-inflicted dependence on big banks that means we cannot let them fail. It will generate competitive pressures on them to decentralise. It will remove the huge subsidies which now protect them from those pressures, and which they channel into absurdly high salaries and bonuses.

In short, we have to accept that there is no possibility of correcting the present misconceived arrangement for creating the money supply. Monetary reform will avoid further costly and fruitless, national and international consultations on how to square that circle. It will liberate us to develop a more democratic, decentralised money system serving the needs of the majority of citizens, not just a favoured minority.

James Robertson
July 2011

Selected Notes and References on Reforming the Money Supply

(In the book these will be in a consolidated note toward the end.)

Joseph Huber and James Robertson, *Creating New Money: A Monetary Reform for the Information Age*, New Economics Foundation, 2000 – http://www.jamesrobertson.com/books.htm#creating

Monetative: A Mission Statement: Taking Money Creation back into Public Hands (Joseph Huber) http://www.monetative.de/?page_id=71

Positive Money (Ben Dyson) http://www.positivemoney.org.uk/ a leading UK campaign for monetary reform.

Prosperity (Alistair McConnachie) http://prosperityuk.com/ pioneer of monetary reform in UK - see their important list of Links.

New Economics Foundation (with Ben Dyson and Prof Richard Werner), submission to UK Independent Commission on Banking, January 2011 http://www.neweconomics.org/publications/towards-a-21st-century-banking-and-monetary-system.

Charles Bazlinton's Blogspot http://www.the-free-lunch.blogspot.com/ regular comments on UK monetary reform, land value taxation and citizen's income. "Fairness with freedom".

Mary Mellor, *The Future of Money: From Financial Crisis to Public Resource, 2010.* Essential reading on the money system and its future from an anti-capitalist viewpoint.

In *"Honest Money and the Future of Banking"* the Cobden Centre for Honest Money and Social Progress (Steve Baker, MP) takes a more "right-wing" point of view.

The American Monetary Institute (Stephen Zarlenga) is the outstanding force for US monetary reform. http://www.monetary.org/

The Moneymasters and *The Secret of Oz* (Bill Still, USA). http://www.themoneymasters.com/mm/. Influential films and text supporting monetary reform.

*The Web of Debt: The Shocking Truth About Our Money System And How We Can Break Free, 2009 (*Ellen Hodgson Brown, USA), acclaimed as "an absolute must read and relevant to people of all

political stripes" - book and follow-up blog http://www.webofdebt.com/

John Lanchester, *Whoops! Why everyone owes everyone and no one can pay*, Penguin, 2010, paperback, 239 pp, £9.99. "A devastating and devastatingly funny analysis of the credit crunch and subsequent global financial meltdown" (*London Review of Books*).