A KEY NEGLECTED TOOL FOR ECONOMIC RECOVERY:

A different and improved money system is urgently needed

By George H. Crowell

An improved money system could provide governments in Canada and elsewhere with abundant funding, not only to enable us to pull out of the current recession, but also to meet the whole range of social needs that confront us — from social justice and human welfare to environmental restoration and protection.

With careful management, these benefits could be achieved without inflation. Moreover, a changed money system could, over time, make it possible to bring under control and to reduce the huge debts that governments have incurred, while simultaneously continuing to improve human and environmental welfare.

We deal constantly with money in our daily lives, and yet very few people understand the basic dynamics of our money system, which operates outside our perception and awareness. This widespread ignorance, even among elected and appointed government officials, has opened the door to private commercial banking interests, enabling them to take over our money system, to operate it for their advantage, and to exploit the rest of us in the process.

"Widespread ignorance about how our money system works has enabled the private banks to take it over and operate it to their advantage, exploiting the rest of us in the process."

Over the past few decades, these private money interests, especially those based in the U.S., have been grossly abusing their power, and have brought on a devastating global recession. As they struggle desperately to hold onto their power, they are vulnerable to change. It is urgent for those who are concerned about social justice to gain an understanding of our money system so we can work at this strategic moment to turn its enormous powers to public advantage.

Let it be clear from the outset that monetary policy deals with matters that are radically different from fiscal policy, although the two interact in many ways. A nation's fiscal policy involves the management of its income and its spending. We readily understand the basic dynamics of fiscal policy because we have daily personal experience with managing our own income and spending. Almost all public discourse on government finance focuses on fiscal policy. But monetary policy has an entirely different dynamic, which is always present in our financial lives, public and private, but is almost always overlooked. Thus we tend to have a distorted picture of financial occurrences, which include both fiscal and monetary factors.

We are all well aware that money has always been a medium of exchange, a means for facilitating economic activity far more conveniently and efficiently than is possible through barter of goods or services. We are not quite as aware that modern money systems are no longer connected with gold or silver, or with any other specific commodity. Past experience has proven that attempts to connect money with some commodity, such as gold, whether directly through gold coins or indirectly by backing paper money with the promise to pay gold on demand, fail to provide a reliable medium of exchange. The value of gold or other commodities fluctuates too much to provide a stable supply of money. Moreover, with a rapidly growing global population and expanding economic activity, supplies of gold cannot keep pace with needs for new money.

We are all familiar with cash, the paper bills and metal coins that are printed or minted by governments, and that we can carry for use in small-scale, everyday economic transactions. The materials used for manufacturing cash are worth much less than the money values they represent. Cash, however, is only a small part of the total money stock — well under 5% in most nations.

We are also familiar with the fact that a far greater volume of economic activity, especially large-scale transactions, has long taken place through the use of cheques, by which people assign to others money that they have deposited in banks. In recent years, the use of cheques has been supplemented by the use of credit cards and debit cards, further reducing the need for hard cash.

Almost all the huge volume of money transactions around the world today takes place through banks. It is possible for people to carry on economic activity using only cash without ever making any use of banks, and this is undoubtedly the case with a vast number of desperately poor people, when they have access to any money at all. But even people of very modest means who receive or write cheques or who use credit or debit cards must necessarily work through banks. Their money is safer if deposited with banks, and banks allow clients to withdraw cash even from accounts whose deposits have been made in the form of cheques.

With recognition of the small proportion of our money supply represented by cash, and of the dominant role that banks play in our money system, a bit of reflection makes us aware that most of our money supply now consists of records in computers controlled by banks. As bank clients, we usually have access to duplicate records printed on paper, but it is the banks' records that really count. The question arises: *Where does all this non-cash money, this computer-entry money which can be exchanged through writing cheques and also through instructions conveyed by computers, come from?* This question is crucial. Its surprising answer is at the crux of what we need to know about our money system.

❊ ❊ ❊

There is a widespread belief that all or most of our money supply has somehow been created by governments. Our belief has been reinforced repeatedly by media images depicting large sheets of dollar bills of various denominations rolling off printing presses. Governments are certainly involved in producing cash, or, as we frequently hear, in "printing money." But this is only a small proportion of our money supply in circulation. While governments do exercise some influence over our money supply,

(Continued on Page 9)

Almost all money now created through private bank loans

(Continued from Page 8)

at present they directly create only a very small proportion of our money. Where, then, does nearly all our money supply come from?

In Western capitalist societies, almost all our money supply is created by privately owned, profit-oriented commercial banks in their process of making loans. When a commercial bank has determined that a borrower has provided satisfactory collateral, it issues a loan by providing the borrower with a deposit in the amount of the loan. The private bank, through the simple act of making an entry of any desirable size in a computer, *creates new money out of nothing.*

With their goal of making profit, the banks, of course, charge interest on the loans they make. Governments have authorized commercial banks to exercise this extraordinary power: lending at interest money they have created out of nothing, and giving them the right to take over the collateral, the property of the borrower, in case the loan is not repaid.

There is another widespread belief that banks lend out the money of depositors, that they serve as "intermediaries" between depositors and borrowers. It is generally thought that banks gain their profits from the spread between the low interest they pay to depositors and the higher interest they collect from borrowers. While we may well resent the high rates of interest the banks often demand for their loans, we grant as basically legitimate the banking practice of charging higher interest for their loans than the rates they pay to depositors. But our assumption that in this process they are lending out the money of depositors is mistaken. If they did, they would have to inform us that the money we deposited with them would not be available to us until it had been repaid by the borrowers. But our deposits in fact remain in our control, and readily available to us to withdraw at any time. Awareness that the private commercial banks *create money out of nothing* whenever they make loans is the beginning of an accurate understanding of our money system.

The power to create money out of nothing is awesome. Whoever gets to benefit from the first use of newly-created money gets something for nothing. The process is essentially the same as when counterfeiters print and successfully pass off cash. Counterfeiters, however, have to cope with disadvantages that the banks avoid. It is not easy for them to make convincing facsimiles of modern cash, and they run the risk of being caught and severely punished. Commercial banks can, entirely legally, with quick and easy computer entries, create any desired quantity of money, for which they demand interest while holding collateral in case of default on the loans.

"Almost all our money is created by privately owned commercial banks in the process of making loans on which they charge interest, and with the right to seize the borrower's collateral if the loan is not repaid."

People frequently say "there is no such thing as a free lunch." Few have any idea what vast, endless "free lunches" are available to commercial banks.

From an ethical perspective, it is clear who *should* benefit from the creation of new money. Money is needed by all of us in order to facilitate economic activity. The need for money arises from the entire community. Shouldn't we all, therefore, share in the benefit of newly created money? The problem is not the fact that money is created out of nothing. The problem is that our present money system is arranged overwhelmingly for the benefit of private commercial banks.

So accustomed are we to this system whose dynamics escape our notice that we fail to recognize how we are victimized by it. The system's most basic problem — rarely mentioned by professional economists, and perhaps neither recognized nor understood by most of them — arises from the fact that almost all the money in circulation in our society has come into existence through loans made by the commercial banks, which invariably require that interest be paid on these loans. *The banks create the principal for the loans they make, but they do not create the interest they require to be paid.* Almost all the money in circulation — the money upon which society is dependent for economic activity, carrying with it the requirement that interest be paid — is therefore debt-money.

This leaves us collectively, as a society, legally obligated to meet an impossible condition: paying off debt with money that does not exist. This extremely unjust situation, of which hardly anyone is aware, has devastating consequences, such as these:

1. **Inflation.** As businesses attempt to expand, they take on debt, and in addition to their expenses for wages and materials, must meet interest-payment requirements — for which money has not been created. One obvious solution for them, if possible, is to raise prices. Higher prices spread from many businesses through the economy and can thus lead to inflation. It is frequently emphasized that inflation can be caused by the creation of too much money. But little discussed is that inflation pressures arise from the *scarcity* of money which routinely occurs in debt-money systems where money has not been made available to cover interest payments.

2. **Growth.** Not only through higher prices, but also through unlimited exponential growth, corporations seek to gain profit while meeting their expenses, including interest charges. The drive for unlimited economic growth, long known to be unsustainable, has been destroying our ecological life-supports. Our debt-money system is a key factor in this destructive process.

3. **Competition.** Vying for scarce money is a key factor driving people to strive for their own success at the expense of others, and it hardens them to the difficulties and failures of others. Businesses not only raise prices and pursue growth, but also oppose unionization, lay off workers, and seek to cut their wages, pensions, and medical coverage. We are so accustomed to this state of affairs that we hardly notice that a more enriching,

(Continued on Page 10)

Money was created debt-free in the past, and could be again

(Continued from Page 9)

cooperative lifestyle is possible and desirable. And we are certainly not aware that our money system, which we do not understand, contributes to such a problem.

4. **Recession.** Forced into competition with one another for money that does not exist, borrowers must resort to the only significant source of additional money — further borrowing from the banks, which adds to interest expenses and exacerbates the debt problem. Inevitably, some borrowers are driven to default and bankruptcy, eventually driving the economy into recession. Central banks perversely hasten the collapse by raising interest rates to fight the inflation brought on by the debt-money system.

5. **Inequality.** While some people are inevitably impoverished by this system, the banks are in a position to gain while the economy is expanding by collecting interest from their loans, and while the economy is receding by foreclosing on the collateral of defaulting borrowers. The rich get richer and the poor get poorer. The debt-money system plays a key role in our society's present growing inequality.

"Our federal government, through the Bank of Canada, can create debt-free money today, just as it did in the past to get out of the Great Depression, finance its participation in World War II, and establish Medicare and other social programs."

There are, of course, many people who are fortunate enough to have no debts. They own money outright. But nearly all the money they own exists only because *somebody else* owes interest on it. Those who improvidently borrow excessively, and are ridiculed for doing so, are in effect the unsung heroes of our economy. They help to provide the lifeblood of our economic system, the circulating currency which keeps the economy running.

Meanwhile, the banks keep making things difficult for us. When borrowers repay the money they have borrowed, the amount that made up the principal of their loans goes out of existence. The creators of money become its destroyers. As for the money paid to cover interest, the banks get to keep that as their own — although it remains debt-money to which they have clear title. In an expanding economy, banks are happy to make new loans, creating new money to replace that which has been destroyed. But when the economy is in decline, the banks become reluctant to lend, and may extract more money from the economy through repaid loans than they put in through new lending. This is a key factor contributing to recessions, including the one currently wreaking havoc for many around the world.

We live in thrall to a destructive money system which dominates the global economy, and plays a key role in the entire range of social and environmental problems that threaten our very survival.

Things do not have to remain this way. Governments give legitimacy to the private banking system, and they could take this privilege away. The very same governments which have given authority to private commercial banks to create money are entirely capable of creating money, fully legitimately, themselves. They can create *debt-free* money — money that is interest-free — and they can use it for public welfare. A national government can reduce or eliminate money creation by private banks, and, through its central bank can create a debt-free money supply. It can do this by making interest-free loans to any level of government in the nation, or it can simply create and spend money into existence in delivering services to the public. The debt-free money would continue circulating in the economy and facilitating other economic activities.

It is especially appropriate for governments to provide interest-free loans for infrastructure projects that ordinarily have been financed through borrowing from banks and other money-lenders at current rates of interest. Instead of having such projects paid for several times over, as can happen with interest-payment requirements, they could be paid for just once, with enormous savings of tax money for other programs. And when money in circulation needs to be expanded, the government could spend the amount needed into existence without creating inflationary pressure.

These suggestions are not just theoretical. Canada, for example, used its central bank, the Bank of Canada, founded in 1935 and fully nationalized in 1938, to create money to get out of the Great Depression, to finance its participation in World War II, and in three post-war decades to build its enviable social programs, including public medical care. But, yielding to pressure from the private banking system, Canada gradually abandoned its use of debt-free money created by the Bank of Canada. In the 1970s, more than 20% of federal government borrowing was from the Bank of Canada, but today even that inadequate amount has been sharply reduced, to an estimated paltry 6% or less. Small wonder, with all other government borrowing made from the private banks at substantial interest rates, that the national debt has soared into the multi-billion-dollar stratosphere.

There is a long global history of private banking interests effectively working to oppose government involvement in money creation — unless vitally needed, as today in the U.S., to bail them out of their speculative excesses. The U.S., in its colonial period and during the Civil War, made impressive and promising use of government-created money. You can check this out in Ellen Hodgson Brown's extraordinarily powerful recent book on monetary issues, *The Web of Debt*, and on her website: www.webofdebt.com .

There is great danger, of course, that governments can terribly abuse their power to create money. But at least governments can be subjected to democratic control, as private banks cannot. We need a government-operated money system, fully transparent and under the democratic control of a well-informed public.

(George Crowell retired in 1996 as a teacher of social ethics in the Department of Religious Studies at the University of Windsor. He has been a member of the Committee on Monetary and Economic Reform since 1994 when he started working on monetary issues. He now lives in London, Ontario.)