The Money System—From Austerity and Devastation to Justice and Sustainability

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Our daily lives are dominated by a money system which is extremely damaging. We are well aware of far-reaching social injustices and environmental devastation which plague our common life. But very few of us have any idea of the major role our money system plays in contributing to our problems. Even among the many civil society organizations working valiantly for social justice and environmental protection, there is hardly any awareness of the damaging impact of our prevailing money system. Thus their efforts for needed change are often inappropriate and usually insufficient.

We deal constantly with money in our daily lives, and yet very few people understand the basic dynamics of our money system which operate below the level of our awareness. From much experience in Western capitalist nations, it is apparent that those, who make it their business to understand money systems in order to use them to their benefit, take advantage of our ignorance. Our ignorance makes us vulnerable to exploitation. So there is a lot of bad news. But there is also some remarkably good news! Knowledge and understanding could open possibilities for people to access extraordinary financial resources for creative social change.

It is my task here to attempt to explain clearly and concisely the workings of our money system which has incredibly powerful impact on our daily lives. Apart from the gross, not yet remedied abuses which brought on the present Great Recession, I will describe how the *routine functioning of our money system* works constantly to our detriment. But I will also indicate how our money system could be transformed to become a potent instrument for creative social and environmental change. I will also stress the relevance of monetary reform for enabling us to overcome the little-questioned universal commitment to unlimited, unsustainable economic growth in our finite global ecological system.

Let me note to begin with that I am indebted to many highly expert and committed monetary reformers for my remarks here, and recently especially to Ellen Brown, author of the mind-blowingly informative 2008 book on the dynamics of money systems, *The Web of Debt*, to the ever-increasing collection of her articles on her website; www.webofdebt.com , and to her leadership in the growing movement for state-owned banks. I am also indebted to John Cobb who, since I contacted him around 1995 to discuss the chapter on money systems added to the second (1994) edition of his extraordinary book co-authored with Herman Daly, *For the Common Good*, has encouraged me in my work on this issue.

The Current Austerity Agenda

Faced with disturbingly growing deficits and debts, governments all over the capitalist world are now imposing painful austerity measures. Millions of people have already lost their livelihoods and homes as a result of the Great Recession, and now such government support services as have been available—unemployment insurance, welfare payments, medical care, education, pensions, etc.—are under attack. Expenditures for environmental protection are also slated for reduction although increases are urgently needed. We are told cuts are unavoidable. There are only two possibilities: either cutting government spending, or raising taxes. And there is no serious consideration of raising taxes even on the obscenely rich, many of whom raked in vast wealth as a result of the financial meltdown which they helped to engineer. So governments are propagandizing conscientious citizens, with considerable success, to accept cuts to valued public services in order to rein in alleged excessive government spending.

We should, of course, be working insistently to have taxes on the rich raised promptly and substantially. Such action is needed not only to increase government income for maintaining and improving valuable public services, but also to reduce the ever-growing, disruptive disparity between the rich and poor. But we need to recognize that a more just tax system can only partially reduce the damaging impact of our money system.

Almost all discussion of public finance is confined to fiscal policy: the management of income and spending. We are all familiar with fiscal policy from our own experience with the economics of personal and family life. So this narrow, limited, public discussion appears to express eminent good sense. But, beyond our awareness, and almost entirely excluded from public discussion is the enormously powerful dynamic of monetary policy which goes far beyond mere fiscal policy. This is our primary concern here. But before I move into this crucial area, let me first mention that the economics of our public life, the economics of government, even in the limited area of fiscal policy, are radically different from family or business economics. When we run into our own personal economic difficulties, it is sensible and effective to cut spending. But not in our public life. When a government lays off public servants, it saves paying their salaries, but it loses the taxes they pay, and also the taxes of others who are no longer supported by their spending. The whole economy is driven down. Conversely if a government hires new employees, it receives their tax payments and the taxes of the others whom their spending supports. But even an enlightened and just government fiscal policy is woefully inadequate for meeting public needs. Even more crucial is monetary policy. So let us proceed to explore the dynamics of our little-understood money system.

What is Money?

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 and services. We are generally not sufficiently aware that modern money systems, with good reason, are no longer connected with gold or silver, or with any other specific commodity. Much past human 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 frequently to provide for a stable money supply, and can be too easily manipulated to our disadvantage by powerful banks and wealthy speculators. Moreover, with 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 transactions. The materials which governments use for manufacturing cash are worth much less than the money values that they represent. Cash, however, is only a small portion 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 checks, by which people assign to others money that they have deposited in banks. In recent years, the use of checks has been supplemented by the use of credit cards and debit cards, further reducing the need for cash.

Almost all the huge volume of money transactions around the world 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 cash at all. But people even of very modest means who receive or write checks 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 deposits that have been made in the form of checks. With a recognition of the small proportion of our money supply represented by cash, and of the dominant role that banks play in our money systems, 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 out on paper. The question arises: Where does all this non-cash money, this computer-entry money, which can be exchanged through writing checks and also through instructions conveyed by computers, come from? What is the source of our money supply? This is a really crucial question. Its surprising answer is at the crux of what we need to know about our money systems.

Where Does Money Come From?

It is widely assumed that our money supply is provided by national governments. This is not the case. In Western capitalist societies at least, almost all our money supply—about 97%—is created by privately owned, profit-oriented, commercial banks in their process of making loans. It is widely assumed that banks lend the money of depositors, and, quite reasonably, profit from the spread between the interest they pay to depositors and the interest they charge borrowers. This also is not the case. When a commercial bank has determined that a borrower has provided satisfactory collateral—a home perhaps, or a car—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 in a computer of any desirable size, *creates new money out of nothing*! With their goal of gaining 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!

Is this not an obvious injustice? Banks do not lend the hard-earned money of depositors, or even their own hard-earned money. They are able to demand repayment with interest on money they have created out of nothing. When the economy is expanding the banks create and lend money freely, collecting interest, and when the economy is in decline they take over the collateral of borrowers as they have recently been doing quite ruthlessly in the U.S., as they seize the homes of millions of people. Unlike the rest of us, the banks are in a position to profit whether the economy is expanding or contracting.

Most of us are well aware, from much direct experience, that banks have the power to decide whether they will lend us money, and, in case we are unable to pay them on schedule, can foreclose on our property. When we recognize in addition, however, that banks create out of nothing the money they lend, the imbalance of power and its resulting injustices become shockingly obvious! But this is not the whole story. There are major additional problems arising from our money system with vast implications that remain overlooked and little understood.

The Far-Reaching Central Problem of Our Current Money System

Here is the fundamental reality, the key dynamic which makes our money system so extremely damaging. *When the banks, in their normal process of making loans, create money out of nothing, they create the principal for their loans, but they do nothing to create the interest they require to be paid.* Nearly all our money supply, the life-blood of our economy, the money we all depend upon for our daily economic transactions, has been created as principal for loans carrying with it the requirement that non-existent money for interest be paid on it. Almost our entire money supply is, therefore, debt-money. This perverse debt-money system has little-recognized, ruinous consequences.

(1) **Competition**. Each borrower is forced into competition with all other borrowers, including powerful corporations and governments, to gain control over enough money, which has been created only as principal, in order to make regular loan repayments of both principal and interest. Borrowers must compete not only with each other for this money, but also with lots of other participants in the economy who owe nothing, and who also depend upon this very same limited money supply. Where can borrowers obtain money to pay the interest? Ultimately from further borrowing at further interest—a process that obviously cannot possibly be sustained indefinitely. Without our full awareness, this competition for limited funds can become quite intense, subtly undermining impulses toward community, charity, and cooperation. Increasingly apparent now, however, are growing pressures by powerful corporations and governments to cut the wages of workers, who are now losing ground in this highly competitive power struggle.

(2) **Inflation**. Businesses are often heavily dependent upon borrowing. In order to meet their many expenses, including interest payments as well as pressure to gain profits, they do all they can to push up prices. With money for interest payments non-existent, this inflationary pressure is driven not by excessive money in the economy, but largely by the scarcity of money. In so far as they can, workers push back for higher wages. The more inflation occurs, the more all participants in the economy strive to increase their share of income. The lack of money for interest payments is not the only factor here, but it plays a highly significant role.

(3) **Recession**. The lack of money available for interest payments inevitably drives some borrowers to default on their loans. As growing numbers of defaults reenforce each other, increasingly cascading downward, recession looms. The banks further reenforce this trend. They decrease their lending, and concentrate on taking over the collateral of borrowers. When better situated borrowers nevertheless succeed in paying off their loans, the banks take the repaid principal out of existence, and reduce new loans, thus diminishing the amount of money in circulation, and increasing the difficulties of borrowers. Money they receive in interest payments the banks get to keep as their own. But even this money remains part of the debt-money supply for which all money-users compete. Economists frequently refer to the "business cycle," which they see as the normal expansion and contraction of capitalist economies. But they fail to explain that it is our debt-money system which makes this "cycle" inevitable.

(4) **Inequality**. As the banks collect interest payments on money originally created only as principal, and as they foreclose on the property of delinquent borrowers, wealth becomes increasingly concentrated in the hands of a privileged few, while many people, those who are more economically vulnerable, are increasingly impoverished. The Occupy Movement has brilliantly highlighted the socially debilitating growth of disparities between the obscenely rich and the tragically poor. It would be helpful now if Occupy would identify and publicize the extent to which this disparity is rooted in our destructive debt-money system.

(5) **No Money Without Debt**. In our money system, we cannot pay off our debts without reducing our money supply. Unless borrowing occurs—whether by individuals, or businesses, or governments—money does not even come into existence. If we all exercised the virtue of thrift and paid off our debts, there would be no money. If the U.S. government paid off its $15.7 trillion debt, it would devastate the U.S. economy and much of the global economy as well. No debt, no money at all!

How can austerity be anything but unjust in a system like this?

(6) **Unsustainable Growth**. In efforts to meet the relentless, impossibly out-of-reach, interest-payment demands of our money system—which include *compounding* interest, exponentially growing interest demands, rising to impossible heights—both businesses and governments constantly press for unlimited economic growth largely through ever-increasing exploitation of our environment, essentially ignoring the depredations imposed on our planet's finite environmental life-support systems. While our money system is not the only factor promoting unlimited economic growth, this overwhelming, ignored problem of endless growth cannot be overcome as long as our present money system prevails, and we are kept in the dark about how it functions. Economic growth will invariably be presented as a key solution to economic difficulties that arise from our debt-money system. Moreover, wealthy economic interests, including the most powerful banks, will continue to invest huge sums in highly destructive exploitation of environmental resources, as for example, in the Alberta tar sands, in ever more devastating weapons for war, and in the most ruthless form of environmental destruction of all—war itself.

(7) **Government borrowing.** We come now to one of the most shocking, but most readily understandable consequences of our money system. Without having mastered other complexities of our money system, anyone can readily understand this aspect. Governments in capitalist nations are running huge and growing deficits and debts, and are forcing austerity down our throats, because they borrow from private banks and other money-lenders, and pay them interest! In Canada, governments at all levels put out more than $60 billion each year for interest payments. The U.S., at the federal government level alone in fiscal year 2011, made interest payments of $454,393,280,417.03. In fiscal years 1988 through 2011, the government spent more than $7.9 trillion on interest payments. (See www.treasurydirect.gov). At present interest rates are unusually low. When or if Western economies start to expand, our central banks will surely push interest rates up, allegedly to fight inflation, and even without higher debts, interest payments could rise rapidly. Here is the startling reality. *These immense interest payments are not necessary!* Just as private banks, with authorization from the very governments which are paying them interest, can create money out of nothing for lending, so governments themselves can create interest-free money out of nothing for public benefit! This urgently needed change is an essential, potent source of hope for the human future!

From Bank-Created Money to Government-Created Money

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 have to cope with disadvantages, however, that the banks avoid. They face difficult challenges in preparing convincing facsimiles of modern cash, and they run the risk of being caught and severely punished. Commercial banks can, entirely legally, with quick, easy computer entries, create any desired quantity of money. They can access money even more easily than it could be picked off trees! 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!

Who *should* benefit from the creation of new money? From an ethical perspective it is clear who *should* benefit, is it not? Money is needed by all of us in order to facilitate economic activity. The need for money arises from the entire community. Therefore ought we not *all* to share in the free benefit available from newly created money? The problem is not the fact that money is created out of nothing. The problem arises from who benefits. It is entirely possible for governments to take over at least in part if not in full the power to create money, and to use it for public benefit. Indeed it has been said that this is the most powerful of all the economic tools available to governments!

Strategic, progressive tax policy is also powerful, and is especially needed now to reduce the disparities between rich and poor. But even high taxes on the rich do not compensate adequately for the destructive impact of our debt-money system which functions largely beyond the tax system. We still urgently need the remedy of government-created money. Not only could the destructive dynamics or our present money system be overcome, but also enormous transformative opportunities would be available. Through creating their own interest-free money, governments could avoid austerity measures, could rebuild decaying infrastructure, could maintain and improve valuable social programs, could create lots of good full-time jobs, could eliminate poverty, and could invest in restoring our environment, while at the same time steadily reducing government debts!

In the case of infrastructure, it would be especially appropriate for interest-free money to be lent to all levels of government as needed. At present, governments borrow at interest for such projects, and pay for them two or three times over. Interest-free loans would make it possible for them to pay for the projects just once out of tax income over the lifetime of each project—perhaps 30 to 50 years. This would free large amounts of tax funds for current program spending.

There is another astonishing possibility. When additional new money is needed in the economy, as in our present Recession, governments could simply spend money into existence as a f*ree benefit for public use*. Whether government-created money is spent or lent into existence, these measures put debt-free money into the economy, making possible great reductions of the far-reaching problems resulting from our present destructive debt-money system.

Making use of government-created money could provide enormous financial resources for environmental protection and restoration—including reversing global warming, saving endangered species, promoting locally supported organic agriculture, enabling reforestation, conserving soil, deploying environmentally benign energy systems, cleaning up pollution, and much more. Ambitious initiatives never considered before could be made financially possible. Both social and environmental welfare measures could be funded abundantly. It should be noted that social justice and environmental improvement need to go together. Situations where people are desperately poor, while the rich focus attention on repressive measures to keep them under control, are far from conducive to devoted concern for our stunningly beautiful, incredibly complex, life-supporting, planetary ecological system.

But how about the fact, the problem, that the sort of economy visualized here, with abundant government-created money stimulating new economic activity, would bring economic growth in our finite ecological system? Let us be clear that shifting from a debt-money system to a debt-free money system would by no means automatically guarantee that government spending would be designated for social or environmental welfare. Monetary policy change is a *necessary* condition for most of the entire range of social problems we face. But it is not a *sufficient* condition. Far-reaching changes would be made possible, but a profound public commitment to benevolent social and environmental ends would be required for them to be implemented. There is already available from the work of many civil society organizations and universities rich information about the work that needs to be done. Monetary reform could finance this work. But the spending must be wisely allocated, and the commitment to do so must be strongly mandated by a committed and aroused public.

Having money-creation under government control is not a panacea. Government-created money could become grossly misused—perhaps for environmental exploitation or for war. Monetary reform must be brought under democratic control. This requires development of a high degree of public awareness regarding how our money system works, and mechanisms to assure that full, accurate, transparent information on the functioning of the system is publicly available, and widespread commitment to assuring that the system is benevolently used—conditions very difficult to achieve.

The obstacles against monetary change are enormous. Intense and even ferocious resistance would certainly come from the global banking system which understands full well that its enormous power is concentrated in its monopoly over the creation of money out of nothing. There is a centuries-long, sordid history of struggle by bankers against any government attempts to control money-creation for public benefit. The banks have it easy right now. They can present themselves as kindly and helpful, despite all their recent crimes, because we, the people, have so little understanding of how they really operate. These days, all they have to do in response to any suggestion for the sort of monetary reform we call for is to say that it would be inflationary. They remind us of the hyperinflation in Germany during the 1920s, and speak contemptuously of governments' madly “printing” huge quantities of inflationary money. Almost everybody falls for this. End of argument. We money reformers—hopefully all of us—need to become prepared to refute these claims.

The Inflation Issue

So just a few final comments along this line. We need to recognize that it is indeed possible for governments creating their own money to produce too much, thus causing inflation. We need to be fully aware of this. But first we need to emphasize how damaging our current bank-created debt-money itself is. It has its own long record of promoting steady, ongoing inflation. Inflationary pressures are built into its very genes. It is a startling fact about our current system that on average about 40% of the prices of all the goods in our society is the result of accumulating interest expenses! This is a potent inflationary pressure that can be reduced as interest-free money becomes available. (See Margrit Kennedy, “A Changing Money System,” www.converge.org.nz/evenz/money.pdf , as recommended by Ellen Brown in “Time for an Economic Bill of Rights,” Nov. 9, 2011 on her website.)

There is lots of evidence to indicate that when governments have controlled their own money-creation they have managed their economies with very little inflation, as Canada did between 1938 and 1974. The record shows that hyperinflations, including that of Germany, were not driven by government irresponsibility, but by wealthy speculators, including banks, manipulating national currencies to their own great advantage (see Ellen Brown, *The Web of Debt*).

The task of monetary reform must include arrangements for managing the money system to prevent either inflation of deflation. The National Emergency Employment Defense Act (NEEDACT) introduced into the U.S. Congress by Representative Dennis Kucinich in 2011 (based on the work of the American Monetary Institute headed by Stephen Zarlenga) proposes a Monetary Authority, charged with responsible management of the money supply. Public-spirited experts are needed to bear this responsibility. But we can fully expect that banking interests would inevitably strive mightily to gain control of such an agency. In order to prevent such a travesty, we need a public extremely well informed about the issues at stake, not only to bring about monetary reform, but also to remain constantly on guard to protect a democratically controlled money system. And we need our trusted civil society organizations, who have long been working devotedly across the entire range of social and environmental issues, to recognize the urgent need for monetary reform, and to include, as a key part of their mandate, the promotion and maintenance of a benevolent, government-operated money system. So let us all get **in**formed, so we can get and keep our money system **re**formed!