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For a just and sustainable society

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Members and subscribers might like to consider renewing their subscription for 2013 early. This will avoid the problem of forgetting to do so during the busy end-of-year and new year periods.

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ECONOMIC REFORM AUSTRALIA (ERA)

ERA is a non-party-political organization, formed in 1993 as a union of the Economics Review Association and other economic reform groups. Its long-term goal is to achieve a socially, environmentally and financially sustainable economic system. ERA's commitment to economic sovereignty seeks to return control of the economic and financial system to the people. This requires full public scrutiny and accountability for all economic processes and a recognition that economic systems must serve the people for the global good.

Membership of ERA is open to all who agree with its objectives and overall philosophy, and may be effected by forwarding A$20.00 per annum (A$15 concession, A$30 joint membership for partners) to the Treasurer (address below), together with address, telephone and fax numbers, and email address. It would be appreciated if new members would calculate the part of the year remaining and remit the appropriate pro-rata amount, with the option of paying for the following year as well (make cheques out to E.R.A.) All members are entitled to receive the regular ERA publication *The ERA review*, and are entitled to vote at ERA meetings and participate in organized activities.

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ERA's Patrons Prof Stuart Rees, Prof Frank Stilwell, Prof Michael Pusey, Dr Evan Jones, Prof Steve Keen, Prof David Shearman, Dr Ted Trainer, Dr Shann Turnbull

NSW Division Inc

We are committed to maintaining our links and meet twice a year.
Details: Frances or Bruce Milne Ph (02) 9810 7812

SA Division Inc

Meetings are held on the last Saturday of each month at the SA Conservation Centre, 157 Franklin Street, Adelaide, SA 5000 (Level 1). Meetings begin at 2pm. Details: John Hermann Ph (08) 8264 4282

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Items suitable for publication may be sent to any member of the editorial committee. Please contact Victoria Powell if you wish to receive the ERA Review electronically as an email attachment, instead of as a posted copy

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AGM for ERA(SA) on 24 November

The ERA(SA) annual general meeting will be held on 24 November 2012 at the Conservation Centre (level 1, 157 Franklin Street, Adelaide), starting at 2pm, to precede the regular monthly ERA meeting. After appointment of a chairperson, the meeting will discuss any administrative matters relevant to the forthcoming year, and outgoing officers will be invited to make a statement on the preceding year's activities. Then all positions will be declared vacant, and voting will occur for the President, Secretary, Treasurer, Public Officer, and any other positions that the meeting may wish to set up, including (ongoing or new) membership of committees.

End of year meeting for ERA(SA)

The ERA(SA) end of year (post Christmas) meeting will occur on Saturday 29 December 2012, starting at 2pm. Unlike previous years, it will be held in the CCSA meeting room (level 1, 157 Franklin Street, Adelaide). There are kitchen and microwave facilities in the adjacent area plus seating and tables, so all will be able to enjoy a meal. Unfortunately we do not have barbecue facilities at this site. Attendees are invited to bring food items, including cold meats and salads, desserts, etc. and are also invited to share with others. A range of basic food items and drinks will be provided.

There will be presentations on topics of interest, details to be provided at a later date, however Assoc Prof Phil Lawn will be one of the speakers. Anyone wishing to make a presentation should contact the secretary (tel: 08 8264 4282) and indicate whether audio-visual facilities are required.

News and views from New Zealand
Don Richards

Positive Money NZ celebrates one year

Positive Money New Zealand, a campaign to reform the NZ banking system by having the government issue our money debt free, was launched on 17th October 2011 to a small but supportive audience in Wellington.

The idea to launch Positive Money NZ when co-founders Don Richards and his wife Sue Hamill viewed "The Secret of Oz" a documentary by Bill Still that suggested that the movie “The Wizard of OZ” was an as an allegory for the political, economic and social events of America in the 1890s. The documentary explained the history of money from biblical times to modern day and documented the battles the Americans engaged in, and ultimately lost, to gain control over issuing their money. The film also asserted that the current banking system enabled private banks to force recessions at will by refusing to offer new loans while simultaneously demanding payment on existing loans.

Don and Sue’s initial reaction was one of anger, followed by resignation and despair. However after reading the Positive Money UK website they became empowered and approached Ben Dyson, founder of Positive Money UK, asking to be allowed to become their New Zealand branch.

Ben was happy to oblige and provided the content of their website which was customised to the NZ environment. A kiwi version of their "One Good Cut" You Tube clip was also created which has had a modest 1,800 hits.

The “Positive Money” approach is for the Government to exercise its sovereign right and issue money debt free into the economy. This approach is summarised in the draft Executive summary of the Creation of Currency Bill. Another aspect of the Positive Money approach is the creation of an expert independent body within Government called the Monetary Policy Committee which would decide how much or how little money needs to be created in any one year. The Government could decide how this money would be spent, but could not mandate how much is created.

A precedent for this sort of thing was set back in 1936 by the First Labour Government who introduced money into the economy to allow kiwis to buy state houses. This put people into meaningful work building the houses, created tangible assets and New Zealand emerged from the Great Depression sooner, and in better shape, than a lot of other countries.

Back in 2011, little did Positive Money New Zealand know their first 365 days was to be so eventful. During October 2011, their first month in existence, the “Occupy Movement” took off and Sue and Don spoke and handed out fliers at “Occupy Wellington”.

The following month was the national elections and Don stood for parliament as an independent, on the platform of debt free money. Not only did the message get great profile, but Don stood against Annette King, the then deputy leader of the Labour Party, Russel Norman the co-leader of the NZ Green Party and Chris Finlayson, a Cabinet Minister. They heard the message at every public meeting.

During the same month of the Election Raf Manji, an economist living in Christchurch , was interviewed by National Radio's Kim Hill. Kim’s programme is one of the highest rating NZ radio programmes and Raf did a great job of explaining the current system in 30 minutes. The rebuild of Canterbury after the devastating earthquakes is an obvious candidate for direct injection of debt free money and this was mentioned by Raf and also during the election.

In addition New Zealand Investor magazine came out with a front page article on debt free money that was supported by a scathing editorial and a four page article, written by Deidre Kent on how money is created. Deidre wrote the book Healthy Money, Healthy Planet. During 2012 the following initiatives were taken:

- In January letters and supporting material were sent to the Head of Economics and the teachers of year 12 and 13 Economics of the 33 largest secondary schools in New Zealand. A follow-up email indicated that few were prepared to use the material provided.
- Letters were sent to the Mayor and Councillors of Christchurch and Wellington and letters are ready to send to their counterparts in Auckland, Dunedin and Hamilton.

- Don was interviewed by Steve Hart, a freelance journalist and contract editor on a special 10 minute podcast.
- Separate meetings were held with David Parker - Finance spokes person for the Labour party, Grant Robertson - Deputy Leader of the Labour Party, and Russel Norman - co leader of the Green Party. They appeared interested in what we had to say, but we did not think they would take it further.
- A very good article by Raf Manji called "Make the Boat go faster" was posted on the PMNZ website.
- Our Minister of Finance Bill English refused to meet with Positive Money NZ, but he did assure us in September that all was well as New Zealand was following “International Best Practice with our banking system. PMNZ responded with a few observations of their own and are awaiting a response.
- Sue spoke before the select committee on the Local Government Act 2002 Amendment Bill 27-1.
- Don wrote an article in the October New Zealand Investor magazine on the IMF Working paper titled The Chicago Plan Revisited.

To cap off a very good first year, Russel Norman, co-leader of the New Zealand Green Party announced their proposal to have the Reserve Bank create money to fund the rebuild of Christchurch and as a consequence bring down the value of our overpriced dollar. This idea was met with ill-informed ridicule by the current government, but it is heartening to see New Zealand’s third largest political party having the courage to make such a stand.

With such an eventful year, who knows what their second year has in store for Positive Money New Zealand.

Don Richards is associated with Positive Money NZ, a campaign advocating banking reform.

Money from Abroad: selling our land and water
Doris Phelps

It has been argued that Australia must welcome the sale of Australian land, such as the sale of Cubbie Station to China, because it brings in overseas investment money. Similarly, the reason that our governments regard our mineral deposits as a bonanza to be exploited and got rid of as quickly as possible, instead of regarding them as a store of real wealth to be drawn on only as needed for our own use, is because this policy brings in overseas money.

Allan Asher, ex-Commonwealth Ombudsman, recently said, "Australia simply wouldn't exist if it couldn't export to other countries, and import from other countries."

While thinking about his statement, I have been trying to picture what would happen if, through some imaginary catastrophe affecting the rest of the world, Australia was cut off, and we had to manage without any overseas money.

Would we need to starve? No, we have enough land, and enough skill to provide ourselves with all the food we need.

Would we need to go without homes? No, we can find all the materials and skills required to build houses.

Would we need to go without clothing and household articles? No, we produce the raw materials and skills to manufacture them.

Would we be incapable of producing cars, trucks and farm vehicles? No, we have the materials and skills to produce them.

So, in this imaginary situation, with no money coming in from overseas, would it mean that we should resign ourselves to doing without the things we are capable of producing? Or should our Government do the obvious thing? Couldn't it, through a Government Bank, issue a similar amount of money instead? It would enable goods and services to be distributed just as they are now. If this suggestion seems shocking, I pose a question. If money coming in from overseas is a GOOD thing, why would a similar amount of money, created here, be a BAD thing? The bulk of money today is only computer figures, so it is not difficult to issue, and, obviously, someone, somewhere, is in charge of deciding how much should be issued. Equally obviously, it is governments and banking institutions, with the advice of their economists, who decide what that quantity should be. The amount of inequality in the world shows that they do not always get it right.

In our imaginary scenario, clever accountants and economists, with the help of present-day statistic-gathering aids, should be able to estimate and advise the correct amount of money to be allowed into circulation in Australia; so that it would not be too much, causing inflation of prices, but enough to allow development of the things that need to be developed, and not so little that it would deny some people the right to take part in making use of the goods we need in order to have a good life.

There was a time when such a scenario was not entirely imaginary. In the early history of the Commonwealth bank (1912-1924) under the Governorship of Sir Denison Miller, it did function to a certain extent in this way, and its money-creating ability was used to help finance, at a very low interest rate, the 1914-18 war effort, the building of the Commonwealth railway across the Nullarbor, and to render assistance to primary producers, without leaving a large debt for the populace to pay. (See Peter Lock - "The Saga of the Commonwealth Bank").

It is a shame that our politicians allow the sale of Australian land (and water!) and other intrinsically valuable natural resources, because they have been educated to believe that computer figures, transferred from overseas, are more valuable than those created here.

Doris Phelps is a member of ERA living in SA

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Let's get real
Alan Ecob

One glance at Steve Keen's Figure 1 (*ERA Review*, Vol 4, No 5, p.25) brought to mind the significance of WWII in getting us through the trough following the action peak of 1932 to the peak of 2009. And similarly, no doubt, with WWI in the previous period through to 1932. The post-war stimuli in terms of new/increased commercial/economic prospects were essentially three-fold:

1). The vast destruction of physical assets such as property and infrastructure created an immediate and obvious opportunity for replacement, as with Marshall Aid, etc. with what Herman Daly (ERA Review, Vol 4, No 1, p.3) calls 'bankable concrete projects'.

2). Major new technologies developed under the pressures of conflict offered massive market opportunities.

3). The previous order of national economies inhibited by excessive debt was replaced by visions of an unlimited future.

If Steve Keen's sense of timing is right, what we need now is WWIII. The problem is, it would be so destructive. Yet purely financial stimuli cannot possibly match the conjunction of the three outcomes we have noted. Bernanke's idea of $100 notes dropped from helicopters is physically impracticable. Perhaps one hundred billion notes? A million helicopters? No way! Steve Keen's six categories of 'handout' is more sophisticated, yet still only money. Obama (as quoted by Keen, 2009, p.3) was evidently hoping, by paying money bailouts to the banks, to take advantage of the multiplier effect. But for realization, this required the funds to be invested in bankable concrete projects. The projects didn't and don't exist. And the banks preferred to invest in derivatives anyway for their better returns.

Perhaps the practical question becomes – if not from WWIII, from whence may come the next boom? Perhaps it's a bit like Charles Lamb's story about roast pork. Perhaps to get it, we don't have to burn the house down. But for a solution, we're going to have to get real. It's going to have to be a 'burster' if it's to do the job!

Alan Ecob is an ERA member living in NSW

Economics and science
Bruce Dinham

Doris Phelps ("Scientists and economists" Sept-Oct ERA Review) raises a question – is economics a science?

The economy - or what we call the economy - is an artificial, man-made system, superseding direct bartering, for convenient trading of goods and services using tokens and symbols called money as indicators or measures of comparative value. Money units are set by fiat but the value of units in trade or exchange is variable and determined by the market, in other words by mob psychology and the so-called “invisible hand” of greed and self-interest.

The system has positive feedbacks in the form of interest, especially compound interest, and fractional reserve banking, creating money as debt out of nothing so is inherently unstable and subject to continuing inflation and recurrent booms and busts. With feedback the artificial money world expands at a rate unrelated to the real material world it is supposed to represent and a disconnect develops between the two. This situation is compounded by the fact that some things, entertainment for example, are ephemeral and others, such as coal and oil, change character in use. While parts of the material world lose value, change form or disappear, the originally representative parts of the money world remain unchanged.

In effect we live in two worlds, a real material world of the things we need and use to survive and enjoy life and an artificial world of money. Money has little or no value or use in itself. You can’t eat it, drink it or wear it. Most of it exists only as ink marks on paper or bits in a computer. Money is simply an abstract instrument giving the holder a right to make future claims for goods and services. The right can exist through legislation, agreement or established custom. However it carries no guarantee or assurance that goods and services will be available when sought or that original market values will apply. Values can change and money units, having no defined or absolute value, can become worthless, especially as the disconnect between the artificial money and real material worlds widens.

Science, in the real material world is based on the immutable natural laws of physics and chemistry with fixed and defined units of measure. Economics, in the artificial world of money, is based on questionable assumptions of human behaviour with undefined and variable units of measure. There is no science in economics.

Bruce Dinham is an ERA member living in SA

Greek crisis? Separate the parts

Darian Hiles

Regardless of the presence of the Euro, it is quite feasible for debt inside of Greece to be separated from that outside.

Greece could operate internally as a self-regulating state and externally as an EU entity if it had an additional internal medium of exchange, which could then be converted into Euros for payments outside.

Such an approach would retain the EU monetary mechanism across member states but allow Greece to operate an additional system for its internal management. Other individual EU states could adopt a similar process if imbalances such as those in Greece arise, at the discretion of the EU and the state involved. This dual financial system could be achieved by:

- Paying all wages and costs within Greece in drachmas (including electronic payments).

- Greek banks converting payments to external agents in drachmas into Euros or other international denominations.
- Euro cash presented by visitors to Greece accepted at the discretion of the recipient for subsequent conversion into drachmas.

Once internal balances are achieved, stability with the Euro would be the next step, which would allow a more accurate full integration with a greater chance of success.

This process could also be adopted as a first step for other countries planning to adopt the euro. The EU project has been marked by large leaps in order to achieve quick short-term progress but a steadier approach may be more effective and hence faster in the long run.

Darian Hiles is an ERA member living in SA.

Neoliberalism savages the universities
John Hermann

University administrations have become compliant tools of the neoliberal establishment. Its new handmaidens are the professional managers who have taken over university administrations, boards and committees. By and large, this new class of managers possesses few if any academic credentials, and is not in a position to evaluate any program of activity on the basis of its merits or its real value to society. The bottom line of their deliberations is a conjunction of commercial profit and ideological "correctness".

A second handmaiden of neoliberalism is the central government. And it matters little which party happens to be in office. Both of the major party groupings have been captured by the neoliberal view of the world and the neoliberal agenda. Both are obsessed with the objective of achieving budget surpluses at all costs, which they imagine represents fiscal responsibility. To this end, the federal government seems committed to a course of hitting "soft" funding targets. This includes federal funding that has hitherto been available for research programs in universities and federal government departments.

The neoliberal view is that universities are commercial organisations whose entire funding should be extracted from fees charged for teaching courses regarded by the neoliberal establishment as relevant to its interests, as well as from any investments that are possible and perhaps also from donations and bequests. This viewpoint removes from university syllabuses a considerable range of traditional studies, and also removes from university campuses good research programs which happen to be regarded by the professional managers as irrelevant to its commercial interests.

John Hermann is the ERA network editor

Neoclassical economics insists that advertising cannot force consumers to buy anything they don't already want to buy. Christopher Lasch

The 1930s Chicago Plan
Stephen Zarlenga

(Notes: CP refers to *Chicago Plan* by Ronnie J. Phillips; EP refers to *Economic Policy for a Free Society* by Henry Simons; LSM to my book *The Lost Science of Money*)

Why is monetary reform so critically important?

Because the money power has more impact on citizens day to day lives than the Executive, Legislative and Judicial branches. It's really a fourth branch of government, and leaving it in private hands is dangerous and unacceptable – it negates the balancing of powers principle of our constitution and creates an aristocracy – a plutocracy – the rule by wealth.

A privately controlled money system can nullify hard-won reforms in other areas such as the environment, medical care, or peace initiatives because such concentration of wealth and power will eventually overwhelm and be used against the people to unwind whatever other gains we've achieved. Witness the attack on Roosevelt's social security reform. You can't secure real progress with the private control of society's money system behind your lines.

What does monetary reform really mean?

It means establishing a fair system that doesn't give special privileges to some and disadvantage to others – that doesn't concentrate wealth and power. It means helping the society create values for living well.

It's vitally important to be ready with a workable plan – when not if – the next financial meltdown occurs. No one knows when that will be, since there's tremendous power in the control over a money system, but warning signs have been there for years. It could be triggered by a couple of bad hurricanes!

The American Monetary Act is part of a long reform tradition going back to the Chicago Plan of the Great Depression (and that plan was close to one advanced independently by the great scientist Frederick Soddy in Britain in 1926). Let's start in December 1932:

It's been only twenty years since the U.S. Federal Reserve was created by America's banking 'elite' (see LSM, Ch. 19). But in those brief 20 years, the Fed brought America to its knees:

* Farms were wrecked with huge debt and falling land prices.
* Factories were closed.
* Exchanges were destroyed.
* Banks were closing.
* The economy collapsed – people couldn't find work and many were hungry.

From 1929 to 1932:

* National income dropped 52%.
* Industrial production fell 47%.
* Wholesale prices fell 32%.
* The real value of debt rose 140%.
* Unemployment rose 329% from 3.5 to 15 million people, over a quarter of our workforce was unemployed.

All that destruction in less than 20 years!! In that horrendous climate, many economists were aware that the banking system caused the problem and major changes were needed. One fear of bankers and economists was that all the banks would simply be nationalized, because People were angry. They feared violent revolution might be sparked. In this atmosphere, the best economic minds in the country devised a reform plan:

Henry Simons from the University of Chicago created the proposal and prominent economists from other universities joined him in what became known as the "Chicago Plan." Economists like Paul Douglas of the University of Chicago; Frank Graham and Charles Whittlesey of Princeton; Irving Fisher of Yale; Earl Hamilton of Duke; and Wilford King of NYU, to name a few.

One version was sent to all the academic economists – about a thousand in total. Of those responding, 235 from 157 universities agreed with the proposal; another 40 approved it with reservations; and only 45 disapproved. So the plan had broad professional support.

Variants of the Chicago Plan usually started by condemning the banking structure as foolish and harmful: "If the purpose of money and credit were to discourage the exchange of goods and services, to destroy periodically the wealth produced, to frustrate and trip those who save, our present monetary system (does that) most effectively!"

They dispensed with the gold standard as not a real standard, because the value of gold had changed violently up and down against commodities. From 1914 to 1917 wholesale prices rose 65% and then increased another 55% to May 1920, so gold coins lost over 75% of their value against wholesale prices in the Fed's first six years. Then, by June 1921, wholesale prices fell 56% against gold. "Hard money" advocates who believe that gold money has been stable should study these facts.

One version of the plan quoted Roosevelt's referring to gold as an "old fetish of so-called international bankers."

The main features of the Chicago Plan:

First: Only the U.S. Government would create money. The U.S. Federal Reserve banks would be nationalized, but not the individual member banks. The power to create money was to be removed from private banks by abolishing fractional reserves – the mechanism through which the banking system creates money. So the plan called for 100% reserves on checking accounts, which simply meant banks would be warehousing and transferring the money and charging fees for their services.

Second: The Plan separated the loan-making function, which can belong in private banks, from the money-creation function, which belongs in government. Lending was still to be a private banking function, but lending deposited long-term savings money, not created credits. In this way, they'd restrict an unstable practice known as borrowing short and lending long – making long term loans with short term deposits. Some variations proposed this be done through mutual fund-like mechanisms, or by chartering entirely new types of banks.

Third: The proposal recognized the distinction between money and credit, which had been confused through fractional reserves and what was called the “real bills doctrine.” The confusion was seen as one of the causes of the depression, because when businesses reduced their borrowings on commercial bills, which occurs during any downturn, parts of the money supply had been automatically liquidated. The Chicago Plan saw the instability of this – that it aggravates a downturn.

Simons made this grand observation of the problem, which still afflicts us today: “The mistake … lies in fearing money and trusting debt.”
And: “Money itself is highly amenable to democratic, legislative control, for no community wants a markedly appreciating or depreciating currency … but money is not easily manageable alongside a mass of private debt and private near-moneys … or alongside a mountain of public debt.” (EP, p. 199)

Some variations of the plan had the U.S. Government lending banks all or part of newly printed cash needed to achieve 100% reserves. This was a crucial part of the plan, because depositors were going to the banks and withdrawing their accounts, deflating the system.

This loaning of reserves feature also elegantly converted all the previously monetized bank credits into real U.S. money, on which the banks paid interest to our government. It post facto made them intermediaries, earning some reasonable spread for their loaning work.

The best economic minds supported the Chicago Plan:

Paul Douglas wrote: “This proposal will of course be opposed by the bankers from whom it takes the lucrative privilege of creating purchasing power. It would however insure the safety of deposits, give large revenues to the government, provide complete social control over monetary matters and prevent abnormal fluctuations in the capital market. At the same time it would permit the allocation of productive resources…to remain primarily in private hands. All in all it seems the most promising program for the reform of our monetary and credit system…” (CP, p.141)

Frank Graham wrote it was self evident that the right of issuing money belongs in government, and that the banks seigniorage profits were a kind of tax on the community: “This privilege that the banks enjoy is in no way essential to the lending process.”

Marinner Eccles, who became Fed Chairman under Roosevelt, testified that the best course would be for the government to nationalize the Federal Reserve banks. Congressman Jerry Voorhis made the case for 100% reserves and putting money into circulation by paying pensions and disabled persons. As late as 1945, Voorhis introduced legislation for a U.S. Monetary Authority as our sole creator of money. (CP, p.162)

James Angell, who disagreed with parts of it, still wrote that “it would go far toward making economic activity reasonably stable” (CP, p. 144)

Maurice Allais, the great French economist, backed the plan and published a book on it in 1948.

Irving Fisher of Yale wrote on the subject extensively and popularly well into the 1940s.

The young Milton Friedman was the best known advocate for the Chicago Plan in the postwar period, writing: “Henry Simons held the view…which I share - that the creation of fiat currency should be a government monopoly.” Friedman testified on this before Congress as late as 1975 and in 1985 wrote: “I have not given up advocacy of one-hundred percent reserves.” Friedman thought the transition to 100% reserves would not be difficult – “say 25% a year from now, 50% two years from now, etc.” (CP, p. 173, 181)

But turning the Chicago Plan into law proved elusive. When University of Chicago’s Chancellor Maynard Hutchins sent a copy of the plan to Senator Bronson Cutting in December 1933, Cutting asked him to draft a bill. Four months later he telegrammed Hutchins asking where it was, and Simons went to present the essentials of the plan to Cutting, who introduced it in the Senate on June 6th, 1934 (S. 3744). Wright Patman introduced it in the House (H.R. 9855).

The bill required 100% reserves on checking accounts, which it separated from savings accounts (which had to keep 5% reserves). It set up a Federal Monetary Authority to control the supply of currency and the buying and selling of government securities.

The American Monetary Act, a three-part reform to bring our money system under proper public control, agrees in its main features with the Chicago Plan:

First: It incorporates the Federal Reserve banks into the U.S. Treasury, where money will be created by the government as money, not as private interest-bearing debt; and will be spent into circulation to promote the general welfare, and be monitored to be neither inflationary nor deflationary.

Second: It removes the banks privilege to create purchasing media through the fractional reserve system. Fractional reserves are elegantly ended by the U.S. Government initially loaning banks enough money at interest to bring reserves to 100% , converting all the past monetized credit into U.S. government money. (Note: This feature is altered significantly in the latest version, where the banks automatically owe the U.S. Treasury the amount of their credit that has been turned into money.) Banks then act as intermediaries: accepting deposits and loaning them out to borrowers – what people think they do now.

Third: It Spends newly-created money into circulation on infrastructure, including education and health care needed for a growing society, starting with the $2.2 trillion that the American Society of Civil Engineers estimate is needed for infrastructure repair, over the next 5 years; creating good jobs across our nation, re-invigorating local economies and re-funding all levels of government.

The false specter of inflation is always raised against such suggestions that our government fulfil its responsibility to furnish the nation's money supply. But that knee-jerk reaction is the result of decades, even centuries, of propaganda against government. When one actually examines the monetary record, as The Lost Science of Money does, it becomes clear that government has a far superior record issuing and controlling money than bankers have.

So both plans envision taking over the Federal Reserve System and regional Federal Reserve banks. Both separate the money-creation and money-lending functions; placing the money-creation function in government and leaving the money-lending function in banks. Both set up national monetary authorities to control the money supply.

One difference between the plans is their greater awe of the "free market." But the empirical nourishment we've received since they wrote calls for greater care in defining what's meant by "free market" terminology. They strongly supported free markets, but their definition differed from the present conception.

For example, Henry Simons thought only stiff governmental regulation could create free market conditions. He wrote: "The presentation of laissez faire as a do nothing policy is misleading…it's an obvious responsibility of the state…to maintain the legal and institutional framework within which competition can function effectively…the state (must have)…heavy responsibilities and large control functions" (EP, p.42-43)

Like the great 19th century reformer Henry George, Simons strongly believed that companies like railroads and utilities should all be government owned: "The state should face the necessity of actually taking over, owning and managing directly both the railroads and the utilities, and all other industries in which it is impossible to maintain effectively competitive conditions."(EP, p. 50-51)

Greater attention to defining "free markets" might have avoided their current degeneration into mere forms of kleptocracy, falsely promoted under the banner of freedom. Better yet, instead of misusing the term free, the word fair is what people really have mind. Some groups equated free markets with no governmental regulation – just the opposite of what's needed to have real "free markets." Another difference was their preference for an automatic system with little discretion. We are not so worried about that.

The American Monetary Act goes beyond the Chicago plan in some important improvements derived from the lessons of history – experience with the Bank of England's nationalization in 1946, and our American experience of the past 50 years:

First: The Act proposes that infrastructure expenditures, including education and health care and farming parity programs, be used as mechanisms to get newly created money spent into circulation to promote the general welfare. We've observed that the privately controlled money system can't or won't make the necessary infrastructure expenditures.

Second: The Act introduces considerations of fairness, sustainability, sound environmental practice and social cohesion as values in monetary decision making. In other words moral considerations are explicitly considered. I wish we were the first to do this, but Article Two of the treaty protocols establishing the European System of Central Banks and the Euro beat us to it, and it's already operational in the Euro system. That Euro provision is quoted in Chapter 23 of the The Lost Science of Money book: "To promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States." (However, it says this is to be done "without prejudice to the objective of price stability," by which they mean less than 2% inflation.)

Third: The Act places more reasonable nationwide legal limits on the charging of interest, with an 8% cap – about what it was under most state laws until 1980/81. It's obscene that people are being forced to pay over 30% p.a. interest.

Friends have told us that economists and bankers will strongly object to that, and to other parts of this proposal. But we didn't expect them as allies in this fight – a fight we didn't start, but are involuntary participants in. Remember billionaire speculator Warren Buffet's warning remark: "If there is class war in the United States, my class is winning."

He was being facetious – Buffet would never describe the purposeful destruction of our most vulnerable fellow citizens and their children, by the 'most clever', as "winning!" He'd probably join me in calling it cannibalism and agree that indigestion and worse is coming.

But finally, let's remember that Warren Buffet's role as a speculator is largely negative and certainly less creative economically than the average bricklayer.

Why didn't the Chicago Plan pass?

First: There was no understanding or support for the proposal among the electorate. Only Irving Fisher seems to have understood the necessity for popularizing the matter. Simons himself got cold feet and shied away from promoting the plan, desiring to remain on a level of professorial discussion. He even threw a wet towel on Fisher, who was promoting the reform, suggesting that Fisher avoid popularizing the idea! Simons was demanding perfection from his own proposal and was being overly cautious. The proper goal was not perfection, but should have simply been the substantial improvement that the Chicago Plan clearly represented over the existing system. Instead, Simons became obsessed with how banks would evade the reforms.

Second: The Plan was mishandled politically. Senator Cutting appears to have misunderstood his own bill, and incorrectly said in interviews that credit as well as money creation was also to be a sole function of government.

Third: The bill suffered a major setback when Cutting died in an airplane crash in May, 1935, while being forced to defend his election results in New Mexico by challenges from the Roosevelt Administration, which was then held responsible for his death.

The last attempt at 100% reserves was when Senator Nye of North Dakota tried to place it in part of the Administration's 1935 banking reform legislation, but his amendment was defeated.

The FDR administration had its own banking reform bill and remained ambiguous on the Chicago Plan, never commenting on it even though the political climate and professional support for the plan was sufficient to get it passed, had they made some effort.

Instead, his Treasury Secretary Morganthau was trying to make minor adjustments without fundamentally challenging the banking system.

The brilliant economist Lauchlin Currie had taken up the fight for hundred percent reserves from within the administration. Currie pointed out that economists had not really agreed on the nature of money and focused his attention to defining what is money in our system. But he made 2 political errors:

First, he thought he could "sneak" the 100% reserves proposal through in the administration's 1935 banking legislation with a provision giving the Fed the power to raise reserves. He thought "we'll just get them raised to 100%." But Senator Carter Glass, representing banker interests, easily blocked this by putting in a provision in the conference committee limiting the reserve requirement to double what they were at that time, which was about 15%.

Second, Currie made the error of compromising in advance, writing: "An advisor in Washington is of limited usefulness unless he acquires some sense of what is feasible and how projects and policies should be presented to have the best chance of being adopted." (CP, p.128)

I completely disagree regarding this type of reform. Promoting the reform in terms of morality rather than mechanics and economics is the better approach. The only time that such major reforms become possible are when either enough people are educated on the matter, or during a crisis, when no-one cares what the economists and bankers want, and then compromise is both unnecessary and counterproductive.

Remember, we are promoting a reform that would be good for over 99% of the population. It is only deception that blocks it, and one need not compromise with deception. Perhaps if it had been more clearly stated, in terms of ending that special banker's privilege rather than solely in terms of technical considerations, there would have been greater public understanding and support. We have to learn from the mistakes these fellows made.

Can we learn from what John Maynard Keynes was doing during all this?

He was squarely behind the bankers and against such real reform. Yet he knew that he had to break out of orthodox economics or the whole system was in danger of being overturned. Keynesianism was a way to allow banks not government to keep control over the money-creation process, and while more narrow-minded economists fought Roosevelt's attempts to create money and jobs as inflationary during the nation's worst deflation, Keynes knew better.

Keynes approach was direct to the public:

The New York Times, in December, 1933, working with Felix Frankfurter (who wrote a rather poor book called Other Peoples Money, and later became a Supreme Court Justice), got Keynes to write an open letter to Roosevelt, which they published. Keynes wisely advised Roosevelt that: "Only the expenditures of public authority" could turn the tide of depression. Well, that was obvious enough!

However, Keynes inappropriately warned Roosevelt not to create the money for this, but only to borrow it, and wrongly advised him that there was already enough money in circulation, and that: "increasing the quantity of money … is like trying to get fat by buying a larger belt."

Several times his letter attempted to influence Roosevelt to drop his program of necessary reforms, and to concentrate on short range actions: "…even wise and necessary reform may, in some respects impede recovery…N.I.R.A. [National Industrial Recovery Act of June, 1933] which is essentially reform and impedes recovery…" (see LSM, Ch. 20)

Keynes was therefore not "revolutionary" except in relation to the utter backwardness of the financial establishment. He didn't come close to a real solution, but essentially protected his class.

The real question has always been whether the nation's money should be created under law, by government, or under the private caprice of bankers.

What were the Austrian economists up to?

Friedrich Hayek was arguing against national currencies – arguing for an international control over all economies through the gold system, incredibly writing: "There is no rational basis for the separate regulation of the quantity of money in a national area that remains part of a wider economic system;" arguing that independent national currencies cannot insulate a country from foreign shocks; and that fluctuating exchange rates would be bad.

Hayek tried to twist 100% reserves to covering them 100% with gold – a deflationist. This is the position supporting the creditors and usury and plutocracy; the normal outcome of Austrian economics. They talk a freedom game, but promote serfdom. Psychologically, they remind me of those middle ages cults that used to whip their own backs with chains.

Always remember, had we followed the ideas of the Austrian School, there would have never been a United States of America. If we follow their ideas now, there will soon not be a United States of America. Unfortunately, the present administration has made this seem like a worthy goal to many of the world's oppressed peoples.

Roosevelt's 1935 bank legislation, though an improvement over what had existed, wasn't considered the final word in banking reform – additional laws were expected. Over and over we see the better economists calling for an end to fractional reserves – ending the bankers' privilege to create money. Such was the effect of the horrendous experience with banking.

Most of the efforts to enact Chicago Plan reforms ended with World War II, as the country went onto a war footing.

How the American Monetary Act can get enacted into law

From the experience with the Chicago Plan we learn the importance of:
First – having an informed body of people among the electorate to promote and intelligently echo such proposals in their own cities, in meetings, with lawmakers and with media.
Second – being ready with an intelligently thought out program.
Third – staying on message and not shying away from the politics of it.
Fourth – not being afraid of not having all the answers. Some of it requires Aristotle's method: we learn by doing – but we learn.
Fifth – not compromising in advance, or trying to sneak through important provisions.

The great reformer Henry George wrote in the late 1890s that there are many ways to argue the principles of political economy, but his preference was to examine it from a moral viewpoint. This is one reason we are still reading and hearing about Henry George today.

This is one of the best ways to proceed today – showing the unfairness – that is the immorality – of granting special privileges within our society. Who is going to dare argue for special treatment in principle? For what justification? There is none. Their position is untenable. Their focus on mechanics and ill-defined, and therefore confusing, concepts can be viewed as a diversion. They are happy to argue over those things forever, so long as they are holding the special privilege – the money power – in the meantime.

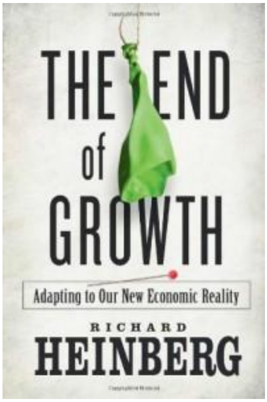
In terms of facts, the under-funding of American infrastructure by $2.2 trillion remains an unanswerable indictment of our present money system. It has been unable or unwilling to fulfil this crucial responsibility. It must be cast aside. It is a danger and an insult to our country, and to humanity – even to the planet earth. Back in the 1930s there was the thought that the Chicago Plan represented an ideal system of control, and as such represented a goal for future evolution.

This is an edited version of a paper by Stephen Zarlenga, director of the American Monetary Institute (AMI Monetary Reform Conference, Chicago, Oct 2005). Stephen is the author of an impressive scholarly work 'The Lost Science of Money' (AMI, 2002) which has established him as a leading voice in monetary history, theory and reform.

Economics has failed us, but there is life after growth

Lindsay Curren

Review of *The End of Growth*, by Richard Heinberg (New Society Publishers, 2011)



Meet Richard Heinberg, the most mild mannered thrasher you'll ever encounter. Heinberg, the geeky brains behind the energy and culture think tank Post Carbon Institute, has toiled away over the past few decades crunching the numbers on energy depletion. In the process, he has come to some some pretty grim conclusions.

It's a wonder, then, that the guy seems so peppy. Perhaps it's a survival mechanism to keep us from shooting the messenger. Because the truth is Heinberg seldom has good news on the reality of our energy situation. And he knows that situation back and forth, having penned such blunt tomes as Powerdown: Options and Actions for a Post Carbon World; Peak Everything: Waking Up to the Century of Declines; and Blackout: Coal, Climate and the Last Energy Crisis.

He's kind of the contemporary wonkish father of the peak oil movement here in the States, inheriting the legacy from its first spokesperson, M. King Hubbert, from whose foundation he received the namesake's award for excellence in energy education.

Now Heinberg's got as much downer news to share on the economy. A regular trove of thestuff is revealed in his latest book, The End of Growth; Adapting to Our New Economic Reality. (Also on Kindle.)

It's the economy, stupid

For a while, popular peak oil observers such as Nicole Foss, Michael Ruppert, James Howard Kunstler and Dmitry Orlov have linked energy to the economy, citing peak oil as the precursor to a major economic crisis.

Each has also opined on the simultaneous debt crisis as an equal problem, one likely to come before energy depletion really hits. They expect an unforgiving financial crash that would make the 2008 downturn look like chicken feed. Foss's lecture "A Century of Challenges: Peak Oil And Economic Crisis" and Ruppert's book Confronting Collapse: The Crisis of Energy and Money in a Post Peak Oil World, particularly hammer home this point.

Now, Heinberg joins their ranks with a full-length book specifically predicting the end of economic growth as a result of the convergence of peak energy, unsustainable debt and climate chaos. But it mostly centers its case around economic factors, fingering fractional reserve banking, escalating sovereign and consumer debt, currency jiu jitsu, Wall Street shenanigans and government fecklessness as complicit contributors to a runaway crisis about to implode.

Indeed the first few chapters go into extreme detail on just how convoluted, incestuous and wily the various pieces of the debt and banking crisis are, whether as a result of bad-faith players, the Fed's hand, cultural presumptions about the need for endless growth and its role in corporate culture, or because of the weak stance of federal regulators and absentee enforcers of law.

In all honesty, all this back story was, for me, TMI, laden as it was in technical minutiae. My brain glazed over after all the deficits, foreclosures, bailouts, financial instruments, credit default swaps, mortgage-backed securities, quantitative easings, deflation and inflation and whatnot. I just understand enough of it to know that I want to hogtie the bastards behind it all.

Heinberg, however, is much more evenhanded than me, explaining in patient detail how all these factors combine into one helluva recipe for disaster. And that's before considering the impact of volatile oil prices, which did precede the 2008 near-death economic crisis. In the meantime, he says we're hanging on, but only tenuously, and not without a lot of contortions:

> In general, what we are actually seeing so far is neither dramatic deflation nor hyperinflation. Despite the evaporation of trillions of dollars of wealth during the past four years, and despite government and central bank interventions with a potential nameplate value also running in the trillions of dollars, prices (which most economists regard as the signal of inflation or deflation) have remained fairly stable. (While at the time of this writing food and oil prices are soaring, this is due not to monetary policy but to weather events on one hand, and political turmoil in petroleum exporting nations on the other.) That is not to say that the economy is doing well: the ongoing problems of unemployment, declining tax revenues, and business and bank failures are obvious to everyone….Rather, what seems to be happening is that the efforts of the US federal government and the Federal Reserve have temporarily more or less succeeded in balancing out the otherwise massively deflationary impacts of defaults, bankruptcies, and falling property values.

And all in the name of so-called growth, that increasingly elusive chimera.

Who should care?

When I interviewed Heinberg earlier this month (stay tuned later this week for that piece, and read my interview with him from earlier this year in the meantime), he said he hoped the book would influence thoughtful leaders and policymakers, and make the jump to the general reader. On the first two scores, there's no doubt this is the must-read of 2011. Heinberg's got the bona fides to back up every case he makes - from Wall Street's role to Washington's - in a logical, clear, and non-partisan manner.

General readers will enjoy the book too, immensely, if they already have a penchant for teasing out economic and banking intricacies. But some may find this part a bit tedious, as did I. You'll be rewarded, however, once you're past all the quadrillion in credit default swapping talk and the Fed's song and dance and move on to what it means in the larger context of the expectation by America's elites that such a major financial debacle was just a bump in the road on the way to getting back to growth as usual.

But returning to past levels of growth will never happen, argues Heinberg, qualifying that statement always with the realistic acknowledgement that, yeah, we may see one quarter's GDP or earnings higher than a previous one. But don't think you have a trend there, friend, warns Heinberg. No way. And that's because of peak oil, he says, which the International Energy Agency said hit in 2006, though with a few mitigating statements that Heinberg doesn't really buy.

Quibbling over the exact meaning of the word "peak," or the exact timing of the event, or what constitutes "oil" is fairly pointless. The oil world has changed. And this powerful shock to the global energy system has just happened to coincide with a seismic shift in the world's economic and financial systems.

Reneging

Debt is all about future promises to pay. Knitting together the factors that moved the industrial world into a credit-based economy run on fractional-reserve banking, Heinberg ties economic growth to that thing so almost totally forgotten that it seems quaint to bring it up: Nature. Natural resources that is. Or what the ecological economist geeks like to call "the primary economy."

Though the financial sector has dragged the rest of us along into their delusional stupor over the possibilities of ghost wealth, paper assets and huge accumulations of enormous earnings tied to…well, to nothing…Heinberg reminds us once again that, uh, yeah, in the end it's our natural resources, the work done by God, or Time, or chemistry and geology that yields to our inheritance the vast stores that allow us to build, do, make, become. Debts are all promises of future payment, and unless you're content with getting paid in notional money mined from thin air, you're likely to expect your payout in reliable stock, backed by a real ability to pay—to make good on what's owed.

And there's the gum in the works, when almost every key resource today is stretched to the breaking point due to overuse, overpopulation, declining resource quality and the law of diminishing returns. This is a problem not just for now, but into the future as our kids inherit this compound, dysfunctional mess.

Given that cheap, abundant fossil fuels have been the real-world key driver of economy during the industrial age, its peak, and the ensuing precipitous decline, means the inability to pay back debts, which is crisis enough. But it also puts the kabosh on the entire paradigm of endless growth. That's a good thing for the commons and climate change and our grandkids. But try telling that to Eric Cantor or Lloyd Blankfein, who are emblematic of those who remain focused on the paradigm of growth that Heinberg says is dying before our eyes.

Perhaps the meteoric rise of the finance economy in the past couple of decades resulted from a semi-conscious strategy on the part of society's managerial elite to leverage the last possible increments of growth from a physical, resource-based economy that was nearing its capacity. In any case, the implications of the current economic crisis cannot be captured by unemployment statistics and real estate prices. Attempts to restart growth will inevitably collide with natural limits that don't respond to stimulus packages or bailouts. Or the end of taxes.

His white hat

Heinberg's not the kind of guy to just give you one-two sucker punches of depressing news without offering clear examples of how communities, NGOs, think tanks and even governments are looking at ways to avert the worst outcomes from the inevitable decline in credit and resources. The close of his book gives insight into where relocalization meets profit and prosperity through resilient, human-scale endeavors as well as through redefining socio-economic success with metrics other than GDP, suggesting Gross National Happiness as a better overall barometer.

He gives many resources to plumb, singling out the Transition Movement, Common Security Clubs and Community Economic Laboratories as proven, successful ways to meet decline - with workable plans at the individual, family, community and municipal levels. But will it work for everyone? Not easily.

There's no guarantee that the participants in this evolutionary and revolutionary transformation will view it as an extension of human progress, rather than the ending of civilization as we have known it. Unless we completely fail to rise to the occasion, in which case the human project will simply cease, there will probably be both elements of collapse and renewal.

On aesthetics

One final note speaks to Heinberg's place as a researcher, a role which his book amply reflects with its copious grids, box explanations and citations. But in this, the book loses some accessibility from time to time, at least in reference to his stated hope for it to filter out to the general reader.

Stark, bright white paper, and a bevy of tables at first flip might turn off some readers before they dig deeper.

The book almost cries out for a companion piece, The End of Growth for Everyman or Dummies or something. In this it would be preferable for Heinberg to operate from the presumption that the end of growth is a done deal, offering only a cursory glance, and instead tipping toward more heart and soul in teasing out the alternatives. His ranging intellect, balanced perspective, ability to contextualize and toolbox of do-able options for the future would benefit from his unleashing some inspiration so that one need not be a closet wonk to get the benefit of his unparalleled insight into the critical challenges of our times.

Lindsay Curren is Editor-in-Chief of Transition Voice, the online magazine on peak oil. She also writes Lindsay's List, the women's conservation blog, and co-founded Occupy Parenting. Follow her on Twitter @LindsaysList.

Source: http://transitionvoice.com/2011/08/economics-has-failed-us-but-there-is-life-after-growth/endofg/

White paper fails to recognise fundamental truth
John Coulter

The government white paper on the Asian century fails to recognise the most fundamental truth about the economy, namely, that Nature is about to impose a multitude of impediments in the way of the destination sought by the white paper.

Nowhere in the white paper is there any acknowledgement of the fact that 'the economy' is totally dependent on a healthy and functioning natural environment; in fact the word ‘environment’ only appears a few times.

Nowhere is there recognition that we live on a finite planet and we have come to the end of growth, that we urgently need to transition to a new economic model that is nested within Nature’s ability to provide.

The 1972 publication ‘The Limits to Growth’ developed a number of scenarios bringing together population, resource exploitation, pollution etc and indicated that under the business as usual (BAU) scenario of continuous growth, global civilisation would likely collapse in the first half of the 21st century. Dr Graham Turner of CSIRO has made several studies at 30 years and now 40 years post-1972 and matched the actual data with the 1972 predictions. He has shown that we are right on track with the BAU scenario. He suggests that a global collapse is imminent.

The world faces a severe energy shortage with rising costs and falling availability. Water is being over used across the world and rivers and water tables are falling precipitously, not least in China. As a consequence the world faces a global food shortage with rising prices and consequent political unrest, within and between nations. While the Gillard Government has paid some slight attention to climate change, there is no mention of climate change's impact on the aims of the white paper.

Media commentary so far on the white paper has been found wanting. It underlines the failure of our educational system to produce a biologically literate population, one that understands the foundational role of Nature in Economy and acts accordingly. The need to produce a biologically and ecologically literate society is far more pressing than the teaching of Asian languages.

As a society, we must now make a historically significant transition in our thinking about Nature/Economy/Society/Sustainability. Yet the white paper is oblivious to this transition.

The exercise of producing a white paper is useful but the data fed into such an exercise must be based on reality. It should not be based on a now discredited and no longer applicable ideology of endless economic growth.

Dr John Coulter is an ERA member living in SA and is also
National Vice President of Sustainable Population Australia

How brazen must bankster fraud be to bring prosecution?

William K. Black

I'll get the obvious out of the way first and then turn in future discussions to aspects of the Department of Justice's (DOJ) civil suit against Bank of America (BoA)/Countrywide that are vital to understanding but are more subtle. The obvious issue arises from the facts that the DOJ alleges that its investigation has found.

The complaint and the DOJ press release state that elite financial criminals committed tens of thousands of "brazen" frauds targeting U.S. government funds. We're on the hook for all the resultant losses because Fannie and Freddie were systemically dangerous institutions (SDIs) that the Bush administration concluded had to have their creditors bailed out to prevent a far graver global systemic crisis.

DOJ alleges that the fraud persisted for years, that senior officers were warned that the lending program they designed would cause endemic fraud, that the senior officers knew that BoA was selling billions of dollars of fraudulent loans to Fannie and Freddie by making false representations, that BoA's senior leadership consciously covered up the information that the loans were commonly fraudulent, that the senior leadership created perverse bonus systems for their junior (non-professional) employees with the expectation, desire, and actual knowledge that doing so led to the origination (and sale to Fannie and Freddie) of endemically fraudulent loans, and that even when Fannie and Freddie confronted BoA with its violations of its representations and warranties BoA refused to honour it contractual obligation to repurchase the fraudulent loans.

DOJ alleges that the frauds persisted for years and continued after BoA purchased Countrywide. The obvious question (not asked by the AP, WSJ, and NYT articles about the lawsuit in the online version on Wednesday 24 October) is: why the DOJ has refused to bring a criminal prosecution of the senior officers who led this "brazen" fraud?

The only slightly less obvious question (again, not asked by any of the three articles) is: if the DOJ is going to bring only a civil complaint, why did it fail to include the culpable senior executives in that civil lawsuit? It does not appear that the reporters asked the DOJ either of these questions. Our top reporters are so used to DOJ abdicating its responsibility to prosecute elite frauds that they approach the newest example of elite impunity from criminal sanction as not worthy of discussion or even note. The obvious has become unfathomable to our elite media.

William K Black JD PhD is Associate Professor of Law and Economics at the University of Missouri (Kansas City). Bill Black testified before the Senate Agricultural Committee on the regulation of financial derivatives and the House Governance Committee on the regulation of executive compensation. His interview by Bill Moyers on PBS went viral. He appeared extensively in Michael Moore's recent documentary: "Capitalism: A Love Story." He featured in the Obama campaign release discussing Senator McCain's role in the "Keating Five" (his testimony was highly critical of all five Senators' actions). He is a frequent guest on local, national, and international television and radio and is quoted as an expert by the national and international print media nearly every week.

Source: http://neweconomicperspectives.org/2012/10/how-brazen-does-a-banksters-fraud-have-to-be-before-hes-prosecuted.html#more-3595

Sir Mervyn King states that banks create money

Mira Tekelova

Sir Mervyn King, the Governor of the Bank of England (BoE), in his recent speech on 23 Oct to the South Wales Chamber of Commerce (The Millenium Centre, Cardiff), was talking about the role of banks in creating the nation's money supply - the aspect of banking which is still poorly understood among policy-makers and economists:

> ***When banks extend loans** to their customers, **they create money** by crediting their customers' accounts.* Sir Mervyn King

Here is a short extract from his speech:

" The usual role of a central bank is to limit this rate of money creation, so that an excessive expansion of money spending does not lead to inflation. But a damaged banking system means that **today banks aren't creating enough money.** We have to do it for them.

Over the past three years, the BoE has bought £375 billion of government bonds - gilts - from the private sector to create a lot of new money. Many - perhaps some of you – are understandably concerned about the use of such an unusual and unfamiliar policy. Some people talk about the dangers of money creation. I want to explain why it is important to distinguish between "good" and "bad" money creation. In essence, the argument is very simple.

"Good" money creation is where an independent central bank creates enough money in the economy to achieve price stability. "Bad" money creation is where the government chooses the amount of money that is created in order to finance its expenditure. Insufficient money creation can lead to a contraction of the money supply and a depression. We saw that in the U.S. during the Great Depression and we see it today in Greece. Excessive money creation leads to accelerating inflation and ultimately the collapse of the currency.

The role of the BoE [Britain's central bank] is to create the right amount of money, neither too much, nor too little, to support sustainable growth at the target rate of inflation. We are not doing it at the behest of the Government to help finance its spending. It is the independence of the Bank that allows us to create money without raising doubts about our motives. Just as it is crucial that governments do not control the printing of money, so too the unelected central bank must not determine the levels of taxes and public spending. Fiscal policy is a matter for elected governments. "

Mira Tekelova, a member of staff of Positive Money UK, has an economics background and is doing research into problems associated with the current monetary system.

The whole speech of Sir Mervyn King may be seen on the following link:
http://www.telegraph.co.uk/finance/financevideo/9630043/Sir-Mervyn-King-banks-still-have-insufficient-capital.html

The Bubble and Beyond: Fictitious Capital, Debt Deflation and the Global Crisis

Michael Hudson

This is an overview by Prof Michael Hudson on his latest book, published in 2012.

This summary of my economic theory traces how industrial capitalism has turned into finance capitalism. The finance, insurance and real estate (FIRE) sector has emerged to create "balance sheet wealth" not by new tangible investment and employment, but financially in the form of debt leveraging and rent-extraction. This rentier overhead is overpowering the economy's ability to produce a large enough surplus to carry its debts. As in radioactive decay, we are passing through a short-lived and unstable phase of "casino capitalism," which now threatens to settle into leaden austerity and debt deflation.

This situation confronts society with a choice either to write down debts to a level that can be paid (or indeed, to write them off altogether with a Clean Slate), or to permit creditors to foreclose, concentrating property in their own hands (including whatever assets are in the public domain to be privatized) and imposing a combination of financial and fiscal austerity on the population. This scenario will produce a shrinking debt-ridden and tax-ridden economy.

The latter is the path on which the Western nations are pursuing today. It is the opposite path that classical economists advocated and which Progressive Era writers expected to occur, given the inherent optimism of focusing on technological potential rather than on the political stratagems of the vested rentier interests fighting back against the classical idea of free markets and economic reforms to free industrial capitalism from the surviving carry-overs of medieval and ancient privileges and essentially corrosive, anti-social behavior.

Today's post-industrial strategy of "wealth creation" is to use debt leveraging to bid up asset prices. From corporate raiders to arbitrageurs and computerized trading programs, this "casino capitalist" strategy works as long as asset prices rise at a faster rate than the interest that has to be paid. But it contains the seeds of its own destruction, because it builds up financial claims on the assets pledged as collateral – without creating new means of production. Instead of steering credit into tangible capital formation, banks find it easier to make money by lending to real estate and monopolies (and to other financial institutions). Their plan is to capitalize land rent, natural resource rent and monopoly privileges into loans, stocks and bonds.

This leads the banks to act as lobbyist for their rentier clients, to free them from taxes so that they will have more available to pay interest. The resulting tax shift onto labor and industry adds a fiscal burden to the debt overhead. This is not a natural and even inevitable form of evolution. It is a detour from the kind of economy and indeed free market that classical writers sought to create. With roots in the 13th-century Schoolmen discussing Just Price, the labor theory of value was refined as a tool to isolate economic rent as that element of price that had no counterpart in actual or necessary costs of production. Banking charges, monopoly rent and land rent were the three types of economic rent analyzed in this long classical tradition. These rentier charges were seen as unnecessary and exploitative special privileges carried over from the military conquests that shaped medieval Europe. A free market was defined as one free of such overhead charges.

This classical view of free markets as being free of an unearned "free lunch" was embodied in the Progressive Era's financial and tax reforms. But the rentiers have fought back. The financial sector seeks to justify today's deepening indebtedness on the ground that it "creates wealth" by debt leveraging. Yet the banks' product is a debt overhead, leaving debt deflation in its wake as debtors try to pay debts that can't be paid without drastically reducing consumption and investment. A shrinking economy falls further into arrears in a debt spiral.

The question today is whether a new wave of reform will arise to restore and indeed complete the vision of classical political economy that seemed to be shaping evolution a century ago on the eve of World War I, or whether the epoch of industrial capitalism will be rolled back toward a neofeudal reaction defending rentier interests against reform. What is up for grabs is how society will resolve the legacy of debts that can't be paid. Will it let the financial sector foreclose, and even force governments to privatize the public domain under distress conditions? Or will debts be written down to what can be paid without polarizing wealth and income, dismantling government, and turning tax policy over to financial lobbyists pretending to be objective technocrats?

To provide a perspective on the financial sector's rise to dominance over the industrial economy, Part I reviews how classical economists developed the tools to measure how finance now plays role that landlords did in Physiocratic and Ricardian theory: as beneficiaries of feudal privileges that oblige society to pay them for access to credit as well as land. As land ownership has been democratized, new buyers obtain credit to purchase homes and office buildings by pledging the rental income to bankers. About 80 percent of bank loans in the United States, Britain and other English-speaking countries are real estate mortgages, making land the major bank collateral. The result is that mortgage bankers receive the rents formerly taken by a hereditary aristocracy in post-feudal Europe and the colonies it conquered.

Whatever the tax collector relinquishes is available for this end. This has led the financial sector to subsidize popular opposition to taxing property – reversing the ideology of free markets held by the classical economic reformers. And with the financialization of real estate providing the post-industrial model, corporate raiders since the 1980s have adopted the speculator's motto, "Rent is for paying interest," using corporate cash flow to make a deal with their backers to obtain loans to take over companies already in place – and bleed them.

This phenomenon is called financialization, and Part II of this book describes how it has transformed the economics of real estate, industry and pension fund saving into a Bubble Economy based on debt-leveraged asset-price inflation – leaving debt deflation in its wake. The banker's business plan, after all, is to turn as much of the economic surplus as possible into a flow of interest payments. But this must be self-defeating. Paying debt service diverts revenue away from being spent on consumption and tangible capital investment. This causes debt deflation and imposes financial austerity. Capital and infrastructure are bled to squeeze out the revenue to pay bankers and other creditors, depleting the economy's reproductive powers.

What is unique to the post-1980 Bubble Economy is the tactic by which austerity has been averted, by new credit creation to inflate asset prices in what is rightly termed a Ponzi scheme. (The appendix at the end of this volume defines the terms and concepts by which I describe this process.) Instead of interest rates rising to reflect the increasing risks of the debt-ridden economy, banks kept the financialization process going by easing credit terms: lowering interest rates and the amortization rate (culminating in "interest only loans), and also lowering down payments (for zero down payment loans) and credit standards (appropriately called "liars' loans").

The direct effect of collateral-based lending is to bid up prices for the real estate, stocks and bonds pledged as collateral for larger and larger loans. An asset is worth whatever a bank will lend against it, and easier credit terms serve to preserve the market price of assets pledged for debt. This is the case even as the economy diverts more of its income – and transfers more of its capital and future income – to the financial sector, which concentrates wealth in its own hands.

Federal Reserve Chairman Alan Greenspan encouraged mortgage borrowers to think of themselves as getting richer as the market price of their homes rose in the early 2000s. But the "wealth creation" was debt-leveraged, and easy credit obliged new buyers to take on a lifetime of debt to afford housing. After 2008 their mortgages had to paid even as a quarter of U.S. residential real estate fell into negative equity when market prices plunged below the level of the mortgages attached to it.

A similar phenomenon has occurred as education has been financialized. Students must take on decades of student-loan obligations and pay them regardless of whether the education enables them to get jobs in an economy shrinking from debt deflation. The magnitude of these loans now exceeds $1 trillion – larger even than credit-card debt. Instead of being treated as a public utility to prepare the population for gainful work, the educational system has been turned into an opportunity for banks to profiteer from a debt market guaranteed by the government. The economy's circular flow becomes a vicious circle as paying debt service leads to smaller market demand for goods. Investment and employment are cut back, government budgets move into deficit, forcing cutbacks in revenue sharing with localities and subsidies for education. Schools raise their tuition levels, obliging students and families to take on more debt, creating yet more debt deflation.

Other public infrastructure is sold off to pay down debts, and the buyers raise access prices and tolls on roads and other privatized transportation - and so on throughout the economy. Debts mount up increasingly owing to arrears in making payments, losing all relationship with the realistic ability to pay.

What has gone relatively unremarked by economists is how financialization of the economy has transformed the idea of saving. In times past, saving was non-spending on goods and services – in the form of liquid assets. Typically on a national scale, between one-sixth and one-fifth of income would be saved – and invested in capital on the other side of the balance sheet. But since the 1980s, as banks loosened lending standards on real estate and made and the financial sector in general turned increasingly to financing corporate raiders, mergers and acquisitions, the way to create future wealth was not to save, but was to go into debt. The aim was capital gains more than current income. And after 2001 many families “made more” on rising market home prices than they made in salary (not to speak of being able to save out of their salary).

Under financialization, the strategy was to seek capital gains, riding the wave of asset-price inflation being fueled by Alan Greenspan at the Federal Reserve Board. Investment performance was measured in terms of “total returns,” defined as income yield plus capital gains. And the way to maximize these gains was to borrow at a relatively low interest rate, to buy assets whose price was rising at a higher rate. For the first time in recorded history, large numbers of people went into debt not out of need, not involuntarily and as a result of running arrears as a result of inability to pay, but voluntarily, believing that debt leveraging was the quickest and easiest way to get rich!

The national income accounts were not designed to trace this process. Using debt leveraging to obtain capital gains meant that bank loans found their counterpart in debt on the other side of the balance sheet, not new tangible investment. The result was a wash. So the nominal savings rate declined – to zero by 2008. Yet people thought of themselves as saving, as long as their net worth was rising. That is supposed to be the aim of saving, after all: to increase one’s net worth. The result was a financial “balance sheet boom,” not the kind of expansion or business cycle that industrial capitalism generated.

As this process unfolded “on the way up,” financial lobbyists applauded the asset-price inflation for real estate, stocks and bonds as “wealth creation”. But it was making the economy less competitive, as seen most clearly in the de-industrialization of the United States. Debt-leveraged real estate required families to pay higher prices for housing – in the form of mortgage interest – and pension funds to pay higher prices for the stocks and bonds they buy to pay retirement incomes. That is the problem with the Bubble Economy. It is debt-driven. This debt is the “product” of the banking and financial sector.

When asset prices finally collapse to reflect the debtor's ability to pay (and the falling market price of collateral bought on credit), these debts remain in place. The "final stage" of the Bubble Economy occurs when foreclosure time arrives and debt-ridden economies shrink into Negative Equity. That is the stage in which the U.S. and European economies are mired today. Economic jargon has called it a "balance sheet recession" - counterpart to the "balance sheet boom" that was the essence of the preceding Bubble Economy.

The process became political quite quickly. Banks and high finance sought to shift their losses onto the economy at large. As debts went bad in 2008, Wall Street turned to the government for bailouts, and demanded that the Federal Reserve and Treasury take their bad loans onto the public balance sheet. This has occurred from the United States to Ireland. The effect was to increase U.S. federal debt by over $13 trillion – without running a deficit of this magnitude, but simply by taking Fannie Mae and Freddie Mac onto the public balance sheet ($5.3 trillion), by the Federal Reserve swapping $2 trillion in newly created deposit liabilities in a "cash for trash" swap with Citibank, Bank of America and other banks that were the worst offenders in making junk mortgages, and with other policies confined to the balance sheet, not current spending.

This vast increase in money and credit was not inflationary. At least, it did not increase consumer prices, commodity prices or wages. The aim was indeed to increase asset prices, but the banks were not lending, given the fact that debt deflation was engulfing the entire economy. So the traditional monetary formula MV=PT became irrelevant. Asset prices were the key, not prices for goods and services – and asset prices could not rise as long as so many assets were in negative equity. So money creation became a pure giveaway to the financial sector – a "transfer payment," not a payment for the purchase or sale of a consumer good or investment good.

Part III discusses the global dimension of "socializing" (or more to the point, oligarch-izing) unpayably high debts. The world's money supply now rests ultimately on government debt – and the government's acceptance of this debt as money in payment of taxes and public services. Yet there is something fictitious about all this: the debts can't be paid!

The most obviously unpayable are those of the U.S. Government. This makes these debts "fictitious," inasmuch as dollar holders are unable to convert their savings into tangible assets, goods or services. Gold convertibility ended in 1971 in response to the Vietnam War's drain on the U.S. balance of payments. Yet the dollar has remained the foundation of most central bank reserves even as the U.S. trade deficit deepened as the economy was post-industrialized while overseas military spending has escalated. This military dimension grounds the global financial system in U.S. military hegemony. This has prompted the BRIC countries (Brazil, Russia, India and China) to seek an alternative payments and debt-settlement system so as not to base their international savings on a system that finances their military encirclement. As it stands the dollar standard provides a free lunch for the U.S. economy ("debt imperialism"), above all for its government to create money without regard for the ability (not to mention the will) to pay.

If the dollar deficit were used to promote peaceful economic development in an atmosphere of global disarmament, the rest of the world would be more willing to see the U.S. Treasury act as global money creator on its electronic computer keyboards. But when this is done for national self-interest that other countries see as being at odds with their own aspirations, the system becomes politically as well as financially unstable. That is the position in which the world economy finds itself today.

It became even less stable when the Federal Reserve provided $800 billion in credit to U.S. banks in 2011 under the Quantitative Easing (QE2), which the banks used to make easy money on international interest-rate and foreign currency arbitrage. Given the refusal of Congress to permit China or other countries to buy major American industrial assets (e.g., as when CNOOK was blocked from buying Unocal), and financial deregulation leading to decriminalization of financial frauds (as in the "toxic waste" of subprime mortgage packages), the world's monetary system is in the process of fracturing into regional blocks.

What is not clear is what kind of regulatory, financial and tax philosophy will guide these blocs. At best, the world will return to the debates that marked economic discussion a century ago on the eve of World War I. At issue is whether the financial sector will translate its recent gains into the political power to take debt and financial policy out of the hands of elected government representatives and agencies and shift economic planning and tax policy into the hands of an international central bank authority controlled by bank lobbyists.

The lesson of history is that this would be a disaster of historic proportions, because the financial time frame is short-term and its business strategy is extractive, not productive. I hope the papers in this volume will serve as an antidote to the head start that financial lobbyists have achieved in sacrificing economies to austerity in what must be a vain attempt to pay debts under adverse financial conditions that make them less and less payable. By distinguishing tangible wealth creation from debt overhead and other rentier overhead – the task of classical political economy, after all – the policy debate can be cast in a manner that reverses the financial sector's attempt to replace realistic analysis with euphemistic lobbying efforts and what best can be characterized as junk economics rather than empirical science.

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Source: http://michael-hudson.com/2012/08/overview-the-bubble-and-beyond/

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