PositiveMoney

Briefing for back bench Money creation and society debate Thursday 20th November 2014

Cross party support for a public debate about money creation

'The mechanics of money creation are poorly understood by politicians, the public and even economists. The result is a thoroughly inadequate debate about the causes of the economic crisis, the fundamental reasons for economic injustice and the source of some of the most corrupting influences on our society. Until money creation and its consequences are widely understood, it is difficult to see how public policy will serve the public good.'
Steve Baker, Conservative MP

'I do welcome that such fundamental questions are being asked about how the money in our economy is being created and used, how our financial system can be more transparent and accountable and work for the benefit of the country as a whole.'
Ed Miliband MP, Labour Leader

'I do accept that there is a problem that not enough people, including policymakers, understand how new money is created. This is a problem for a number of reasons, not least that it can hamper attempts at effective reform of the banking system. The creation of money is a matter of significant public interest and we need to make sure it does not become an obscure and technocratic debate.'
Nick Clegg MP, Liberal Democrat Leader

'The debate that Positive Money has started is an incredibly important one. We all need to better understand the role that money and its creation plays in our economy. There is no doubt that our financial system and the ecosystems on which we depend are at the point of collapse. We can tackle both problems simultaneously if we'd only admit their interdependence. If we'd only recognize that how we spend money and how we create money, has an impact on our environment.'
Caroline Lucas, Green Party MP

'[C]ommercial banks have an even greater power than that: they have the power to create credit—that is, money—by expanding their balance sheets. It is not widely understood how important this power is: of the money presently in circulation in the UK economy today, three per cent takes the form of cash; 97 per cent is in credit and deposits. This financial alchemy is an extraordinary privilege, which we as citizens and taxpayers underwrite.'
Jesse Norman, Conservative MP, The Case for Real Capitalism

'The key issue which this country has got to face up to is the restoration of democratic accountability via the control over the money supply.'
Michael Meacher, Labour MP

This subject is gathering momentum:

The **International Monetary Fund** released a paper called the '*Chicago Plan Revisited'*[1], which lays out proposals to prevent the creation of money by the banking system along the lines of Irving Fisher's proposals following the Great Depression. The paper's "full reserve banking" reform aims to return the control of the supply of money to the state and prevent financial crises from occurring.

The **Treasury** released a *'Review of the Monetary Policy Framework"*[2] alongside the government's 2013 budget. The review explicitly permits the Bank of England to use *"unconventional policy instruments"* in order to help the government meet its

[1] https://www.imf.org/external/pubs/ft/wp/2012/wp12202.pdf
[2] https://www.gov.uk/government/publications/review-of-the-monetary-policy-framework

policy objectives to *"achieve strong, sustainable and balanced growth that is more evenly shared across the country and between industries"*. This opens the door to alternative methods of creating money and getting it into the economy, and provides the opportunity to stimulate a wider public debate about the monetary system.

Martin Wolf, chief economics commentator at the Financial Times, wrote an article on 24th April, called "Strip private banks of their power to create money"[3]. In this article Wolf comes out in support of switching from bank-created debt, to a nationalised money supply: "*Printing counterfeit banknotes is illegal, but creating private money is not ... [This anomaly] could – and should – be terminated."*

Lord Adair Turner (former Chairman of the Financial Services Authority) delivered a speech in February 2013 entitled, '*Debt, Money and Mephistopheles: How do we get out of this mess?'*[4] In this speech Turner discussed an alternative to Quantitative Easing, which he termed Overt Money Finance (also known as Sovereign Money).

The **Institute of Public Policy and Research** released a report recommending that a parliamentary commission is set up to investigate the role of money and credit within the economy and research alternatives to current monetary policy.[5]

Centre Forum released a report entitled 'The wrong sort of money'[6] suggesting that current monetary policy tools are out of date. They stated that 'QE is not the only game in town: there are other attractive options out there ready to be explored'

The New Economics Foundation has released a report suggesting that 'Strategic Quantitative Easing'[7] could have had a better effect on the economy. They propose that 'We suggest the formation of a Monetary Allocation Committee that would be accountable to the Treasury and Parliament but separate from the Bank of England's existing Monetary Policy Committee (MPC). The new committee would decide how best to allocate new QE funding and any reinvestment of maturing gilts (almost £100bn are being repaid over the next five years).'

The Cobden Centre advocate that significant changes must be made to the monetary system. They state that: 'a society must be built on honest money.'

Not Debated in Parliament for 170 Years

Parliament places huge scrutiny on how taxpayers' money is *spent*. But for the last 170 years, parliament has ignored the question of how money is *created* in the first place.

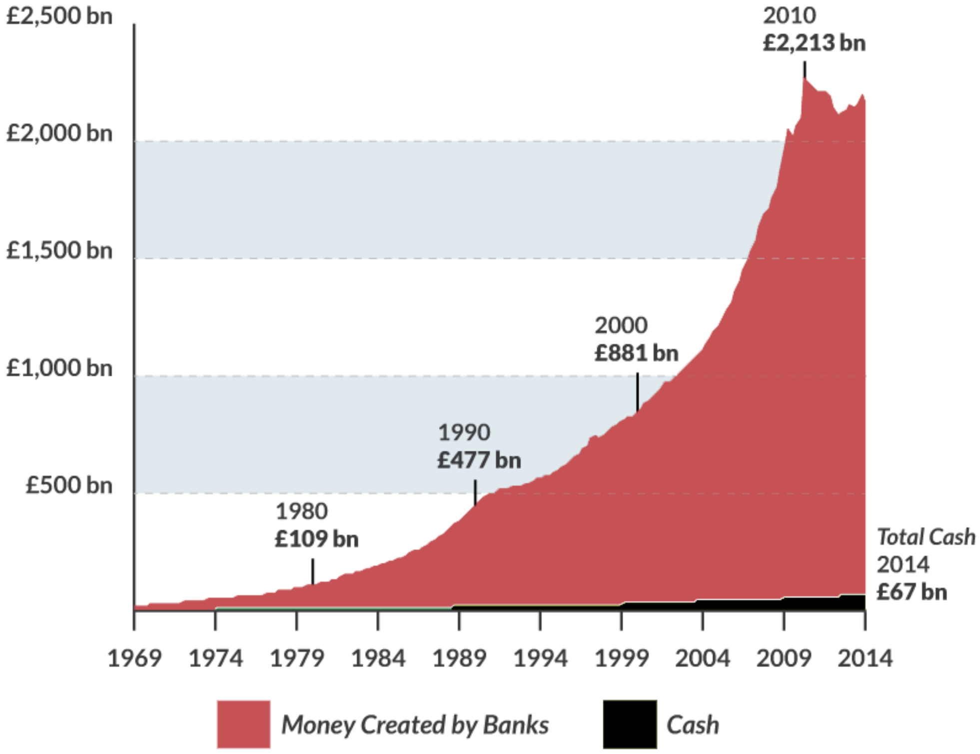
Money creation affects almost every aspect of our lives, but it's very poorly understood. A recent poll found that 7 out of 10 MPs believed that only the government can create money[8], when in fact 97% of money is created by banks as they make loans, as recently confirmed by the Bank of England[9]:

'In the modern economy, most money takes the form of bank deposits. But how those bank deposits are created is often misunderstood. ***The principal way in which they are created is through commercial banks making loans****: whenever a bank makes a loan, it creates a deposit in the borrower's bank account, thereby* ***creating new money….*** *97% of the money held by the public is in the form of deposits with banks, rather than currency.'*

A 2010 survey[10] shows that two-thirds of the British public believe that banks take people savings and lend those savings to borrowers - suggesting that the British public do not understand that private banks create money out of nothing. In a time when finance literacy is becoming compulsory in education, a better understanding of how banks and money work is vital.

3 http://www.ft.com/cms/s/0/7f000b18-ca44-11e3-bb92-00144feabdc0.html#axzz32zxNSitC
4 http://www.fsa.gov.uk/static/pubs/speeches/0206-at.pdf
5 www.ippr.org/assets/media/publications/pdf/definancialisation_Sep2014.pdf
6 http://www.centreforum.org/index.php/mainpublications/492-the-wrong-sort-of-money
7 http://www.neweconomics.org/publications/entry/strategic-quantitative-easing
8 http://www.positivemoney.org/2014/08/7-10-mps-dont-know-creates-money-uk/
9 http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q101.pdf
10 http://www.cobdencentre.org/2010/06/public-attitudes-to-banking/

As shown below, between 2000 and 2008, the amount of money – and debt – in the UK economy doubled as a result of money creation by bank lending. This created the debt-fuelled boom that ultimately led to the financial crisis.



From 2011-2014 just 8% of new loans were made to businesses. The majority of new loans are directed to financial markets and mortgage lending[11]. This may explain why our economy is skewed so significantly towards housing and financial services.

Public polls show that the economy is consistently ranked as the most important issue that people and their families are facing.[12]

The problems resulting from private money creation have not been debated in Parliament since 1844, when Sir Robert Peel brought in the Bank Charter Act, forbidding the private banks from printing paper money. In light of the financial crisis, the urgent need to re-visit this issue and consider updating the 1844 Bank Charter Act to include electronic money, is increasingly evident.
There are important questions that Parliament should address, such as:

Who should create money? Should high-street banks have the effective right to create money every time they make a loan, given the recent consequences for the economy? Would parliament ever have voted to delegate the power to create money to the same banks that caused the financial crisis? Should the creation of money be the sole right of the state, through the Bank of England?

How should newly created money be used? Currently the bulk of money created by bank lending goes directly into the property market, pushing up house prices. Just 8% of UK bank lending goes to businesses outside the financial sector. Do we want banks to have the power to create money when this leads to unaffordable housing and financial instability? Should we have allowed the Bank of England to create £375bn with little scrutiny from parliament, and use this money to inflate financial markets? Were there better uses of this money?

For more information please see www.positivemoney.org

11 Source – Bank of England statistical database
12 http://d25d2506sfb94s.cloudfront.net/cumulus_uploads/document/jxo2nz2p9p/YG-Archives-Pol-Trackers-Issues(2)-Most-important-issues-281014.pdf