FIXING OUR BROKEN ECONOMY

a simple guide for the rest of us

PositiveMoney

1. PRIVATISED MONEY

We see all around that the economy is broken. We have an unemployed labour force and we have empty factories, offices and shops – everything we need in fact to produce the goods and services we need. Yet the economy seems to be unable to produce enough real wealth, for lack of money. What is going wrong? The root of the problem is the privatisation of the creation of money.

MONEY AND WEALTH

Money is not the same as wealth. Real wealth comes from people using their skills to produce goods and services that other people want. Money is a claim on that real wealth, a tally of how much wealth we are entitled to. Money is the life-blood of the real economy.

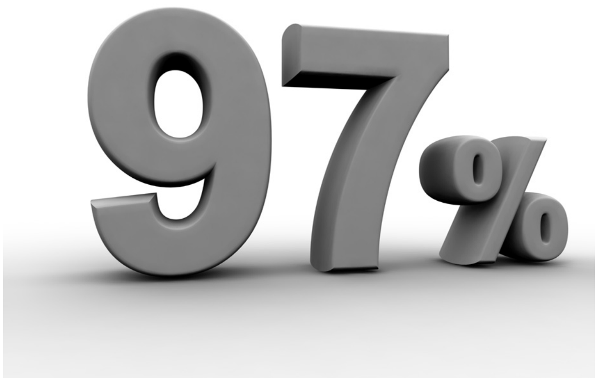
Money grows – but not on trees! Between 2000 and 2007, the amount of money in the UK doubled, but since the crash the 'money supply' has actually been shrinking. It is easy to see how real wealth is created, but have you ever wondered where money comes from (or where it has disappeared to since the crash)?

WHERE DOES MONEY COME FROM?

Most people assume that money is created by the Royal Mint or the Bank of England. But they're wrong.

We now live in an almost cashless society, and less than 3% of money in the UK is notes and coins. These are created by the Bank of England, which is the only body legally allowed to create notes and coins in the UK.*

The other 97% is just numbers stored on computers, which we can use for purchases, to pay our bills and taxes, but which has no physical existence. This digital money was all created by profit-oriented commercial banks.



WHAT HAPPENS WHEN YOU 'SAVE' MONEY?

If you pay cash into a bank, then you might look at your statement and see that the balance has increased. You might think that the bank is keeping it safe for you, but in fact you have given it to the bank; they take legal ownership of it, and they can do what they want with it, including gambling on speculative and unethical investments. Your statement is simply their promise to give you money back when you want it - an IOU. Money in the bank is just information, a computer record of the bank's promise to pay.

The banks know that not everyone will want their money back at the same time, so they only need to keep a small amount in reserve.

WHAT HAPPENS WHEN YOU 'BORROW' MONEY?

When someone goes to a bank wanting a loan, the bank creates a new IOU by simply entering the loaned amount into the borrower's account – just numbers. The borrower can then 'spend' the newly created IOU (transfer it to someone else's account), or can withdraw cash from it. Contrary to popular belief, this money has not come from savers! The banks have created new money from nothing.

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* In addition, three private banks in Scotland and four in N.I. are permitted to print bank notes, regulated by the Bank of England

The banks can make many such loans, all in theory backed by the same small reserve. Mandatory reserves were abolished by the government in 1981, with the result that banks can now create as much digital money as they choose, only truly limited by how much we want to borrow and can be trusted to repay. In fact, by 2007 (before the credit crunch), the banks had created up to £100 of new credit for each £1 in reserve.[1]

Why do the banks do this? Because they charge interest on their loans! Their profit stream comes from lending something they never had in the first place. This is where 97% of our money has come from – out of thin air.

HOW DOES MONEY DISAPPEAR?

We have seen how money is created from thin air when banks make loans. It may surprise you to learn that the opposite is also true – when a loan is paid back, money disappears. That is why the money supply is now shrinking; loans are being repaid faster than new ones are being created.

“Banks extend credit [ie. make loans] by simply increasing the borrower’s current account” - Paul Tucker, Deputy Governor of the Bank of England, 2007

2. MONEY AND DEBT

Money and debt are created when banks make loans. If someone takes out a mortgage and buys a house, then the borrower ends up with debt, and the person who sold the house ends up with money. Neither the debt nor the money existed before the mortgage was taken out.

So banks simultaneously create ‘money’ and ‘debt’ every time someone takes out a mortgage, spends on a credit card, overdraws, or a business borrows. For every £1 you’ve got in your bank account, someone somewhere must have a £1 debt.

DROWNING IN DEBT

Can you visualise a trillion pounds? Imagine a £1000 note, and what you could do with it. Now imagine you are a millionaire – your stack of £1000 notes would be over 4 inches high. Now imagine your stack is 68 miles high – that is a trillion pounds!

Total money in the UK is currently £2.1 trillion, but total debt is £2.4 trillion.[2]

Total debt is higher than total money because interest owed on the debt keeps mounting up. For the UK as a whole, interest has to be paid on the entire digital money supply – all £2.1 trillion - because it was all created as debt. This means there is always more debt than there is money! If we all tried to pay off the debt, the country would run out of money before all the debt was paid off.

CATCH 22: CAN’T WE HAVE MORE MONEY AND LESS DEBT?

Not under the present system. Money is only created when banks make loans, so **more money means more debt,** and **less debt means less money**.

If an individual is in debt then, when they have paid it off, they have more disposable income. It may seem counter-intuitive, but the opposite is true for the nation - the more debts that are paid off, the less money there is, because the money used to repay the debt has disappeared back into nothing. If that is a surprise to you, then you are in good company. David Cameron wants everyone to pay off the credit cards (less debt), and he is also calling for the banks to lend more (more money) without realising the contradiction in his statements.

3. OUR BROKEN ECONOMY

Because money and debt are created simultaneously, the amount of money the banks choose to create depends on how confident they are that the debt will be repaid. This is the main cause of the boom/bust cycle.

BOOM

As long as they are confident we can repay, banks encourage us to borrow heavily - this maximises their profits. New loans are created faster than old ones are re-paid, and this creates lots of new money. The new money created each year ensures that there is enough to pay the interest on last year's loans, so defaults are low and confidence is high. It's an upward spiral - the 'credit boom'. It reached a peak in 2008 when the banks created over £260 billion of new money in a single year, fuelling unsustainable consumption and high property prices.

BUST

When the bubble bursts, the opposite happens. Banks fear defaults because they destroy their profit and can cause them to go bankrupt. Lending becomes 'risky', so they stop lending, and the money supply shrinks. With a shrinking money supply, there is not enough to pay the interest, defaults increase, and the banks' confidence drops further. It's the vicious downward spiral we are all too familiar with. Unemployment rises, businesses close, and the production of real wealth slows down.

Since January 2010, money supply has shrunk by £101 billion.[2] That's the equivalent of over 1000 millionaires leaving the country each week, and taking their money with them! The economy is being starved of the pounds that we need to swap in shops and businesses to keep the economy moving.

Economic instability happens because we have given private banks the power to create and destroy money.

THE POOR GET POORER AND THE RICH GET RICHER

In this crazy system, the only way the economy can get the money it needs is by people going into debt! Those on below average incomes end up with much of the debt, and have to pay the interest. Those with the money get interest on their savings, in effect meaning that **the poor get poorer while the rich get richer.**

Businesses are dependent on bank lending. The interest that banks charge sucks money out of the 'real' economy and into the financial sector. The real economy (public and private sector) creates real wealth, the financial sector consumes it.

Most of the financial sector's salary payments are concentrated within the City of London. This means that there is **redistribution of wealth from the rest of the UK to the City of London. That is why the City is seeing a building boom, while shops and factories are being boarded up in the rest of the UK.**

All of these re-distribution effects are inherent to the system and will continue year after year as long as the money supply is issued by commercial banks as debt.

BANK BAIL-OUTS AND PUBLIC SERVICE CUTS

By July 2007, UK banks had expanded their lending - by creating money - to a record £100 for each £1 they had in reserve.[1] Two months later, Northern Rock collapsed. If the banks had been allowed to fail, millions of people would have lost their savings in the meltdown, so the government had no option but to bail the banks out.

Saving the banks has cost £124 billion in taxpayers' money to date,[3] much more than the £81 billion of public spending cuts over 4 years that George Osborne announced in the 2010 spending review.

What about next time? - the crisis is not over yet! In addition to the £124 billion already paid, the government has given the banks a further guarantee of £332 billion,[3]and even that might not be enough. The need for a fundamental rethink is even more urgent.

4. THERE IS A 'PLAN B': POSITIVE MONEY!

It is a scandal that the nation's money supply has been privatised. The power to create money should be taken from the banks and returned to the people to whom it properly belongs.

The Positive Money proposals are simple and intuitive: firstly, only the Bank of England should be allowed to create new money, and secondly, all new money should be created debt-free, ie. not requiring repayment or incurring interest.

MONEY CREATION

A healthy economy needs a stable money supply; a small steady expansion each year would support growth, without the wild swings inherent in the present system.

Only the Bank of England should be permitted to create new money, and the amount should be governed by the politically independent and neutral Monetary Policy Committee. Their remit, as now, should be to keep inflation at a target level set by the government (currently 2%).

The newly created debt-free money would be added to government revenue, and could be used in a range of ways, eg. distributed directly to citizens, given as investment grants, or used to pay for public services. It could also be used to reduce taxes, or to pay down the National Debt.

Then high-street banks would be left to carry out their natural and legitimate functions of keeping our money safe, and bringing lenders and borrowers together.

KEEPING OUR MONEY SAFE

'Transaction accounts' would replace current accounts; these would offer electronic transfers, debit cards, ATM facilities etc. but the money would be held in a safe account at the Bank of England, so that even if the bank goes bust, your money would still be safe. Your money would remain your legal property and the banks would not be permitted to lend it out or invest it. When a bank fails, the accounts can just be transferred to a healthy bank, and the tax-payer never picks up the bill.

LENDING AND BORROWING

There will always be some people who have more money than their immediate needs, and some who need to borrow eg. for business capital, for a mortgage, or on a credit card. Banks would act as the middlemen between savers and borrowers.

Banks will offer a range of savings products ranging from low to high risk, and for various periods of notice. These will provide a pool of money for lending.

Banks can only lend what has been saved. They cannot create new money out of nothing.

In the event of a borrower defaulting, the risk never falls on the taxpayer. In some products the risk will fall entirely on the bank, in others a large proportion of the risk will fall on the investor.

Investors will be fully aware at the time of the investment what their money will be used for, and what the risk is.

Interest rates will reflect the true risk, the supply of savings, and the demand for loans.

We would have a stable money supply, resulting in a stable economy. There would be no more taxpayer bail-outs. There would be less debt, and less extreme inequality.

These fundamental reforms would be like a heart transplant for our ailing economy.

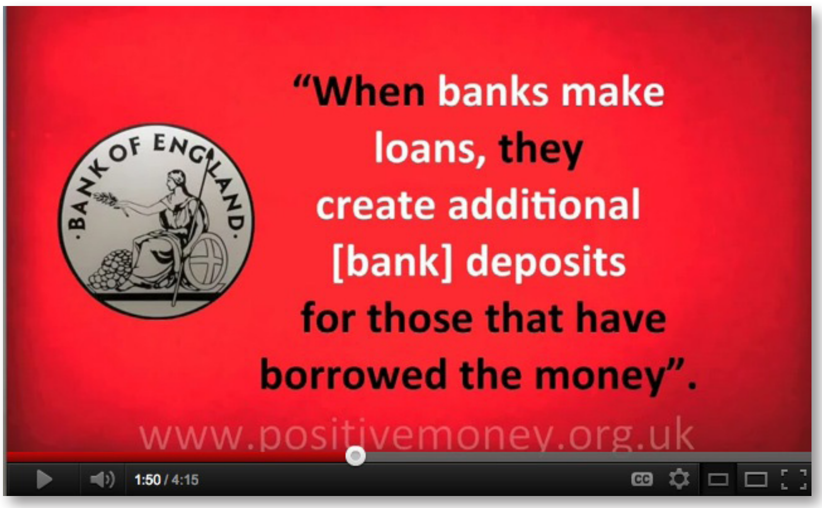
HOW DO WE CHANGE IT?

Many people are angry at the banks, or individual bankers. But it is our economists and politicians who have yet to learn the new rules of play brought about by our switchover to digital money. They still work on a model of banking that has not applied in the UK for several decades!

It's essential that we understand how money works and what effect it has on our lives. When we let banks create money out of nothing and let them decide how this new money is spent, then we end up with a society that reflects the priorities of the banks: skewed towards speculation and house price bubbles, with little investment in real businesses and jobs.

Join us in demanding a banking system that works for society, not against it.

Visit **www.positivemoney.org.uk** to watch a free video that explains everything you need to know about our privatised money system and how it affects your life...



Text by Peter Verity for Positive Money

References:

[1] Bank of England, Reserves and M4 supply, July 2007

[2] Bank of England, M4 supply and M4 lending, Oct 2011

[3] National Audit Office report 'The Financial Stability Interventions', July 2011