

SHOULD BANKS ENGAGE IN THE CREATION OF MONEY?

An Op Ed contribution
Submitted to the NY Times

By
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February 25, 2009

In the banking discourse of the last several months much is written about bonuses, regulation, nationalization, bailouts, financial frauds, etc. One of the most fundamental questions, however, is almost never raised. Who is to create the money that makes financial and economic activity possible? Is it the private sector, the government or a mixture of both?

Should commercial banks engage in the creation of money? At first blush this question may be puzzling to many. Banks make loans from the money that depositors loan to the bank which, in turn, pays interest for the service. Banks use those deposits to make loans to deserving clients and businesses. This may be the general conception of how banks work. However, banks not only lend those deposits, they use them as a springboard to create about 90% more money than the money that is deposited. So, a deposit of \$100 can become a \$1000 maximum after many depositors have deposited their ever decreasing amounts in the banking system, always maintaining 10% of this amount. ($\$100 + \$90 + \$81 + \$72.90 + \dots = \$1000$). This is how fractional banking works in the US and almost universally in the world.

Goldsmiths in the middle Ages noticed their clients did not call on their gold holdings all at once. Similarly, in the 17th century, the privately held Bank of England decided to profit from this fact by introducing fractional banking. This was a success in generating profits. Early settlers in America were free to set up their own system where government spent debt-free money for tasks that had to be done. King George III and his private bankers were not too happy when they saw how the colonies were flourishing without going into debt. Though it is generally believed that the tea tax, resulting in the Boston Harbor Tea Dumping, was one of the main reasons for the colonists to rebel, the abrogation of their debt-free monetary system can be considered to be as important or even more important for their rebellion. Without their debt-free monetary system that gave them abundance and contentedness, they now become indebted to the King and the English bankers.

It was in the 1890s that federal elections were being fought on the issue of who should create money and political parties in favor or opposed were started. President Lincoln had engaged in debt-free financing, particularly after the civil war. He did not even have to raise taxes! It is significant that FDR was open to debt free, given that his right of coinage embedded in the Constitution was emphasized by Congress in 1934 by the Thomas Amendment. Unfortunately, he hardly used it, because most of the moneys he needed he borrowed from the Federal Reserve and thus engaged in debt-financing and paying interest to the Fed which, by force of the Federal Reserve Act of 1913, is the

coordinating institution of its 12 regional banks and the private banking system with its fractional banking.

Obviously, the writer of this piece firmly believes that commercial banks should not create the money for the commonwealth—it is the citizens' common wealth that is not to be subjected to the profit motive and often the greed of large banking conglomerates. Thus, banks should become utilities that provide financial services without creating money. How can they be entrusted with such an important function while they are competing or colluding together? Is it fair when other industries cannot create their own money?

What can be done by the Obama Administration about the debts that have been accumulating on account of the previous administration's war spending, the TARP program, the Stimulus package and other pending programs?

As in the 1890s a national debate has to take place about the creation of money by commercial banks and the public sector's right and responsibility of providing an equitable and sustainable, and, therefore, a stable monetary system. Talking about nationalization as a temporary solution so that we can go back to the old fractional banking system misses the boat.

To be included in this national debate is the international dimension of the monetary system for we live in an integrated international monetary system with hedge funds, offshore banking, tax havens, etc. Also to be included in this debate is how the nation and nations are going to pay for the present and future damages of the climate crisis. It is suggested by International Institute of Monetary Transformation that in the debate the Terra Solution should be considered.

The Terra solution, while not a blueprint, provides a direction and a framework for policy making and action by government, business, and civil society. It can solve the economic crisis by solving the climate crisis. They have to be tackled simultaneously and that can be done in different ways and levels. The Terra solution provides a financing mechanism to fund the Millennium Development Goals and other social programs in the global South because of a steady flow of capital resources, i.e. Terras from the ecological debtor nations in the global North to the ecological creditor nations in the South. So, what is this famous Terra solution? A chimera? A pipe dream? A cargo cult?

The Terra solution is the basis not for the reform, but for the transformation of the international monetary system. Transformation entails a revamping, an overhauling, and a basic reorientation. Because of its radical restructuring people and organizations are hesitant. Who is ready for "Real Change"? Yes, we can? The Terra solution has the greatest chance of being adopted by governments, business and civil society when economic and climatological conditions are getting worse and worse, which they will.

So, what precisely is this Terra solution that is part of a transformed international monetary system? Terra (Latin for Earth) is the name that I have given to a new international reserve currency that is based, not upon gold, nails, cowries or a basket of major currencies or commodities, but on carbon emissions permits or CEPs. These

CEPS are allocated on an equal basis to adults on the planet—perhaps we should include youngsters because they sometimes also have a heavy carbon footprint—using the methodology of Cap and Share, www.capandshare.org. The targets of carbon reduction will determine the amount of CEPs each adult receives and the carbon price on the world market will determine the value of the CEPs.

The Terra international reserve currency is the basis of the Terra International Monetary Union—the TIMU system. Each nation will have its carbon account become a separate line in their balance of payments which will be administered by the proposed World Central Bank (WCB), roughly in the same way as the European Central Bank does for the European Monetary Union. This bank with a democratically chosen Board of Governors will have two additional functions, one dealing with credit and the other with liquidity. It will monitor credit creation around the world, so that a credit crisis of the present scope cannot occur again. It will also engage in making available extra liquidity, somewhat in the same way as the old Special Drawing Rights of the International Monetary Fund.

I consider the defractionalization of the national and global banking systems and the adoption of the Terra solution and its TIMU architecture necessary, though not sufficient, conditions for humanity to evolve into its third revolution on this planet, i.e. the sustainability revolution. This is how the first US Environmental Protection Agency Administrator phrased the challenge in the early seventies:

“Can we move nations and people in the direction of sustainability? Such a move would be a modification of society comparable in scale to only two other changes: the Agricultural Revolution of the late Neolithic, and the Industrial Revolution of the past two centuries. These revolutions were gradual, spontaneous, and largely unconscious. This one will have to be a fully conscious operation, guided by the foresight that science can provide. If we actually do it, the undertaking will be absolutely unique in humanity’s stay on Earth.”

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