Monetary Reform CPG #4 Tuesday November 26th 2013

- Darren Millar (Chair)
- Ben Dyson (Speaker) [Positive Money]
- Justin Lilley (Secretary) [Arian Cymru]
- Selwyn Runnett (William Powel AM Support) [Rural Banking]
- Duncan Higgnet (Bethan Jenkins AM Support) [Financial Education & Inclusion]
- Harry White [Positive Money Wales]
- Indyren Yagambrun [GT Law]
- Neil Turner [Positive Money Wales]
- Gruffydd Meredith [Arian Cymru]
- Jane Taylor [formerly Positive News]
- Nathan Penn [Plaid Cymru]
- Mike Colbourne [Canolog]
- Parag Patel [Funding Empire]
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1. Introduction and Apologies for Absence

DM: Intro to CPG Process requires at least one AM from all parties to attend. Apologies from other AMs who could not attend. Next CPG will be the AGM with more present. Went around table and those present introduced themselves (see list above).

HW: Ben Dyson has become the champion of modern day monetary reform building on the excellent work from James Robertson and Joseph Huber.

DM: On November 7th Assembly Member for Ceredigion, Elin Jones hosted a meeting at the Senedd with businesses and members of the 'Bully-Banks' campaign to discuss the misselling of Interest Rate Hedging Products in order to get justice and stop these unethical and unfair practises. Link here.

2. Presentation by Ben Dyson of Positive Money

BD: Where does money come from? Most people assume the Bank of England but they only create the cash portion, amounting to just 3%. The other 97% are just numbers created digitally by private banks when they make loans.

"When banks make loans, they create additional [bank] deposits for those that have borrowed the money" – *Bank of England 2007 Q3 Quarterly Bulletin, p377*

"The essence of the contemporary monetary system is creation of money, out of nothing, by private banks' often foolish lending..." *Martin Wolf, Financial Times, 9th November 2010*

The economy is overly dependent on bank lending for its money supply. Between 2001-2009 the money supply doubled fuelled by debt artificially but since then the money supply, until very recently was shrinking as banks were reluctant to lend due to fears about the future of the economy and as they build their capital to meet requirements.

The new money that was created by the banking system in the 10 years running up to the financial crisis was distributed as follows; housing (40%), financial (37%), non-financial (13%), credit cards and personal loans (10%)

"The financial crisis of 2007/08 occurred because we failed to constrain the private financial system's creation of private credit and money." *Lord Adair Turner, former chairman of the Financial Services Authority, Speech to the South African Reserve Bank, 2nd November 2012*

The recovery has not reached pre-crisis levels and businesses are still struggling to get loans from banks. The human cost of the crisis has been a real terms fall in living standards.

In the current system extra borrowing leads to the creation of more money by the banking system. But conversely, loan repayments lead to the destruction of money by the banking system. Consequently, as a general rule:

more money => more debt, less debt => less money

The focus of government and Bank of England policy has been to "get banks lending again".

Loans repaid are monies taken out of circulation. If loans are repaid faster than new loans are made the amount of money in the economy will shrink, and the likely result is recession. This is why we see the continued policy of ultra low interest (0.5%) and Help2Buy schemes. But incentivizing further mortgage lending is dangerous as it could inflate another bubble.

Adair Turner, formerly chairman of the Financial Services Authority, described the Help to Buy stimulus to private leverage as a "hair of the dog that bit us" economic strategy (on Newsnight).

Bank of England has the ability to create money debt free but they don't exercise it.

QE was the creation of £375 billion by the Bank of England. This newly created money was used to buy government bonds from pension funds and insurance companies (primarily) to pump money into the financial markets.

Mervyn King said that “a damaged system means banks are not creating enough money and we have to do it for them”, through QE. The result of QE was a 20% increase in stock prices, but because of the ownership of assets in the financial markets, this resulted in an average rise of £128,000 for the top 5%.

The idea was that people holding assets feel wealthier so should SPEND more in the real economy allowing wealth to trickle down and money circulate. In reality, they see rising stock prices and invest more in the markets, further fuelling asset price bubbles.

An alternative to fuelling the recovery through debt:

“‘Helicopter money’ – by which we mean overt money finance of increased fiscal deficits – may in some circumstances be the only certain way to stimulate nominal demand, and may carry with it less risk to future financial stability than the unconventional monetary policies currently being deployed.” Lord Adair Turner

Positive Money have released similar proposals to those described by Lord Turner. The proposals outline how the Bank of England can create “sovereign” money, which is transferred to the government and then spent into the economy. The money can be distributed via:

- Public spending (such as building affordable housing, retrofitting houses, building renewable energy infrastructure, transport link improvements etc)
- Tax cuts (income, road or fuel tax reductions)
- To business (low interest credit to SMEs)
- Citizens’ dividend (£cash payment to each citizen to spend or pay down debt)

Separation of Powers

How much money should be created? > Decision to be taken by the Monetary Policy (Control) Committee

What should the money be used for? > Decision taken by elected government.

This separation of powers prevents elected government from abusing the power to create money for short term political ends. It can only decide how to distribute the money, but not how much money to actually create.

Example

If the Bank of England creates £10 billion of new money through Sovereign Money Creation and spends this on the construction of affordable housing, the step by step effect is:

1. BoE creates £10 billion > Government pays Employer > Employer pays Employees

2. Employees spend their income in the economy

3. Employees and employers pay taxes. For every £10 billion spent, with the multiplier effect on GDP, ultimately £5.6 billion returns in tax revenue.

4. Further wave of spending means that every £10bn created and spent into the economy leads to about £28bn of extra GDP.

5. Some recipients of the extra spending use it to repay loans. This reduces the overall size of the banking sector balance sheet and reduces bank leverage. With lower leverage (i.e. relatively more capital) banks are more likely to resume lending.

Compare history, in July 2005 banks created £7 billion of new money for the mortgage market and September 2007 £16 billion.

In contrast, Welsh schools that currently need rebuilding: government has approved £1.361 billion up to 2015 and £4.6 billion over 20 years. But they delayed this program for lack of funds. If the Bank of England had funded it through the creation of money, in particular immediately following the crisis, it could have boosted GDP, employment and saved money for the taxpayer.

End result of £375 billion QE > £23 billion rise in GDP – “Stock Market Bubble”

HelpToBuy £?>?% rise in property prices – “Uneven distribution”/“South East bias/drain”

Through Sovereign Money Creation, the creation of £10 billion > £28 billion rise in GDP. £5.6 billion in tax revenue. Reduction in personal debt

The current economic recovery is fuelled by rising personal/household debt. But this is unsustainable. The way to make the recovery sustainable is to have the Bank of England create money through Sovereign Money Creation and get this money directly into the real economy (via government spending, tax cuts or a citizens’ dividend).

3. Question and Answer Session

Following the presentation there was a question and answer session.

4. Concluding Remarks

DM: Summing up about Sovereign Money Creation. The national currency and banking system is a non-devolved issue but in Wales we can do our best to educate the public and provoke a discussion in the Assembly.

The Welsh Government could in theory operate a public bank and utilize policy from Sovereign Money Creation with permission from the Bank of England.

The major role of this CPG should be to tear down the veil of complexity, to educate and reveal the simplicity of money creation and how it can work for the people and for business. In so doing we hope to highlight the merits of Money Reform and other potential solutions such as complimentary currency and peer to peer lending.

This has been very informative meeting. Slides are available from Ben Dyson on request.

Please register with Positive Money UK to find out more and support Money Reform in Wales through www.ariancymru.eu

5. Date of next meeting

The next meeting will be the AGM and dates will be circulated in due course.

<u>Question and Answer Summary</u>

JT: How does QE reach the people?

BD: Currently, not very much does. The Bank of England buys bonds for money, the bond sellers then invest in other assets inflating the markets. As the top 5% own 40% of assets they benefit most. This concentration is detrimental to the whole economy.

HW: Are the top 5% more influential in bond markets than pension funds?

BD: Yes but they are linked and it is likely they will have shares in pensions funds.

GM: Could this fit in with a Public Bank of Wales?

BD: Such a bank would have to meet requirements of banks with the Bank of England but no reason why not. Green Investment Bank set up with £3 billion.

DM: Is this a global issue?

BD: Yes, Prof. Michael Kumhof from the IMF published the Chicago Plan Revisited where he validates the proposals of Irving Fisher to restrict bank lending to Full Reserve.

DM: Won't that cause the banks a problem? Banks are chasing profits and currently that is how they have been allowed to make risk-free money.

BD: Yes, commercial banks lend money they do not possess and have gotten used to profiting from the interest on the debt. To make them only lend money they do have is not going to be easy.

DM: What about HelpToBuy?

BD: More mortgages chasing the same number of houses is going to lead to asset price inflation by increasing. The alternative is to build new houses and increase the supply and productive capacity.

JL: Similar groups now exist in New Zealand, Israel, Germany, France and many other places, are Positive Money linked in with others working on this?

BD: We recently set up the International Movement for Monetary Reform to do just that. People are really starting to listen and get involved all over the world.

JL: Prof. Richard Werner, one of Positive Money's Directors has proposed establishing a (private) Full Reserve Bank, is there any progress on this?

BD: Full Reserve Banks would have limitations in terms of competition under the current system. Managing the risk and rewards would fall on the bank rather than society.

MC: It seems like money has been disconnected from resources through complexity.

BD: Agreed. That is why we need Sovereign Money Creation to act as a stimulus and to people to understand the process by informing them and continuing the debate.

DM: A stimulus towards growth but is GDP the best indicator for a healthy economy?

BD: Growth based on debt is unsustainable just look at RBS because if they had been 'allowed to fail' then 10 million customers would have been affected. GDP may not be perfect but it measures activity and that is what we need but are lacking through a contraction of money and tightening of credit.

MC: An infinite growth paradigm is not sustainable and we need a Resource Based Economy.

BD: In a monetary system we are bound to certain rules just like in the political system. We are trying to change the strategy within the rules to produce stable longevity.

JL: Are bank depositors considered unsecured creditors?

BD: Yes but the problem is that because the Government guarantees £85,000 of customer's deposits there is no incentive for commercial banks to change their ways.

HW: The bail-ins threatened by the European Central Bank, Federal Reserve, Bank of International Settlements and Bank of England means that our deposits could be seized and replaced with an equity certificate in a worthless bank.

BD: This could come about when the liabilities of a bank's balance sheet outweigh the assets, usually occurring if a bank is carrying a lot of bad debt.

JL: This is what has happened with the Co-operative Bank being demutualized because of bad debt and is now losing its co-operative structure and becoming private. Shouldn't people know more about what is going on.

BD: Yes, the Co-operative like other mutuals forgot its remit and started behaving like a commercial bank. All politicians at the time seemed in favour of the Co-operative taking on the Britannia loan portfolio because few understood it.

NP: What else is being done?

BD: NEF have published Strategic QE which is similar to OMF, 'helicopter money' and Sovereign Money Creation but will involve redistributing money from the £375 billion QE back into the productive economy.

HW: Explain Seigniorage?

BD: The benefit of cash flows to the state equal to the value of money minus the cost of producing it. The benefits of electronic money flows direct to the commercial banks and there is no cost to producing it. If this was changed and the state created all money then all the benefits or seigniroage would go to the state.

DM: How many supporters in Parliament?

HW: About 25 were shown as supporting the EDM.

NP: Recently the motion to bring back the Bradbury pound as part of the 100th anniversary next year has received more interest.

BD: We are talking with lots of Parliamentarians as well as other bodies with influence.

IY: In Simon Johnson's work on "Debt Bubbles" he says forget about 'too big to fail' it is the 'too big too save' we want to worry about. How can we get justice for the people of Wales for the thousands of financial products mis-sold?

DM: We must remember that our powers are limited to what is devolved. There is a lot of good work going on in the Assembly with the group acting against swap-missellings.

BD: Groups fighting class actions are having success because banks have received fines and have funds ready to pay off claimants quickly. The fines are still only a fraction of the profits that are made through private money creation and therefore not punitive.

DM: Thank you Ben and everyone. As I understand it calling for a change of the national money system is non-devolved but the Welsh Government could in theory operate a public bank and utilize policy from Sovereign Money Creation with permission from the Bank of England.

The major role of this CPG should be to tear down the veil of complexity, to educate and reveal the simplicity of money creation and how it can work for the people and for business. In so doing we hope to highlight the merits of Money Reform and other potential solutions such as complimentary currency and peer to peer lending.

The next meeting will be the AGM and will have a different feel but this has been very informative. Slides are available from Ben Dyson on request.

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"The key function of banks is money creation, not intermediation." ~*Michael Kumhof, Deputy Division Chief, Modeling Unit, Research Department, International Monetary Fund*

"The banking system can thus create credit and create spending power – a reality not well captured by many apparently common sense descriptions of the functions which banks perform. Banks it is often said take deposits from savers (for instance households) and lend it to borrowers (for instance businesses) with the quality of this credit allocation process a key driver of allocative efficiency within the economy. But in fact they don't just allocate pre-existing savings, **collectively they create both credit and the deposit money which appears to finance that credit."~***Adair Turner, Chairman of the FSA, Speech: 'Credit Creation and Social Optimality', Sept 2011*