

## WHY IS IT NECESSARY TO MAINTAIN CONFIDENCE IN BANKS?

We are often reminded that we need to maintain confidence in the banks and the banking system as a whole. The reason why, on one level, is obvious. People put their money into banks and they need to be confident that doing so is safe. On another level, we need to ask ourselves: given the apparent size and profitability of these institutions, is there any reason why we might not be confident? Surely, if there is nothing about which not to be confident, we will automatically be confident. If we need to maintain confidence, we must be missing something.

In this paper I intend critically to examine the current financial position of banks from the perspective of depositors. I intend to examine the current state of the banking system as a whole, how it produces unwanted by-products, what those unwanted by-products are, how they affect the rest of the economy and how to correct the system to stop it from producing them. It is my objective to demonstrate how insidiously and pervasively a fault in the banking system invades our every day life and destroys it.

### **Banks and Bank Deposits**

Perhaps our largest wholly British bank is Barclays. It is also the first by alphabetical order. Therefore, for these and no other reasons, I shall examine its financial position first.

Here is Barclays' balance sheet for 1999 as presented in its annual report.

(TABLE 1)

1. It presents itself as an enormous institution with assets of £246,753 million.
2. It has £1,166 million in cash and deposits at central banks.
3. Contingent liabilities of £18 billion are not an unmanageable threat in comparison to assets of £246billion.

These are, indeed, impressive figures.

Further, it is an institution subject to tight regulations and whose deposits are covered by the Deposit Protection Scheme.

Whilst the figures appear to provide a basis for confidence, the balance sheet presented does not indicate to whom the cash belongs or to whom the assets belong. Do they belong to the bank's shareholders or to its depositors? Neither the depositors' position nor their actual protection is clearly shown.

A banks is permitted to present its balance sheet in a very different format than any other company. If Barclays were to present its balance sheet as any other company had to present its, the picture becomes much more clear.

(TABLE 2)

1. The assets are suddenly reduced to £8,835 million.

2. Customer accounts are more accurately labelled. They are current liabilities of the shareholders.
3. The contingent liabilities of £18 billion are now seriously out of proportion to net assets of £8,835 million and deposits can be seen to be subject to a much more significant threat.

The bank now looks less strong and the question of the position of depositors as current liabilities begs clarification. On page 15 of the FSA's Occasional Paper Series 7, it clearly states

***“Bank depositors are generally unsecured creditors if the bank fails, ranking behind secured creditors (but ahead of subordinated debt holders and equity holders).***

The term UNSECURED CREDITOR gives a very different impression of the position of depositors than most people understand. Most people believe they are putting their money into the bank for safekeeping.

The security of deposits has weakened significantly since the first depositor lodged his gold coin with a goldsmith for storage on a shelf in the goldsmith's strong room for safe-keeping. Of course, in those days, shelves were known as banks. Hence the derivation of term 'banks' and 'bankers' today. Then the deposit was stored for the depositor. 'Banking' was a warehousing operation and the goldsmith had a responsibility to safeguard the deposits of each depositor. Then, it was accurate to say, "I put my money in the bank".

Today it is more accurate to say, "I loaned my money to the bank". When you put your money into your cheque account at the bank now, you are actually putting it into your loan account to the bank and, when you issue a cheque you are reducing the amount you have loaned to the bank.

Therefore, I suggest, it is important to examine - even more closely - the position of customer deposits in the banks' accounts to see how safe your loans are.

(TABLE 3)

This format examines the strength of the bank from the perspective of depositors.

1. The FSA document shows that deposits and loans to the bank are actually one and the same. They each represent cash put into the bank. Some deposits/loans are secured, others are unsecured. Cheque or demand deposits are not differentiated from time or interest bearing deposits. All deposits are loans.
2. In proportion to deposits, there is little actual cash held in the bank. The shortfall between deposited cash and the cash to available meet withdrawals is substantial.
3. Secured deposits exceed the amount loaned to borrowers deemed least likely to default. Therefore, secured depositors will have claim on all of the safest loans as well as to a substantial amount of the loans at greater risk.
4. This leaves all customer deposits covered only by loans at greater risk.

5. The notes in the accounts also reveal a substantial investment in derivatives - far beyond any reasonable relationship to shareholders' funds - substantially increasing the possible threat to depositors funds.

It is now possible to see why it is not only important, but essential, to maintain confidence in the banks: **there is little in them about which depositors can be confident (and, in the event of a run on the banks and failure, depositors will be shown little mercy).**

The only protection beyond the bank's assets offered to depositors is the Deposit Protection Scheme which insures depositors for 90% of the first £20,000 - a maximum of £18,000.

How is it that we have come to this position?

Why is our money not in our account?

Why are depositors merely unsecured creditors?

Why is there no fiduciary responsibility between the bank and its depositors?

What has led us to this position?

### **The Historic Erosion of Depositor Security**

A brief look at the history of banking will answer some of these questions.

1. People lodged their gold coins with banks (goldsmiths) for safekeeping. This was a warehousing or storage business and there was a "trust" or fiduciary relationship between banker and depositor.
2. Bankers noted that, between deposits and withdrawals, only the coins at the front of the shelves moved. The remainder gathered dust. They began to use those from the back for their own purposes. They loaned them to borrowers for profit. Initially, this was fraudulent behaviour.
3. The borrowers then used the borrowed coins in exchanges. The recipients of those coins then deposited them in their bank and the banks issued new deposit receipts to them. But, there were already deposit receipts issued against these very coins. Thus a gap was created between the number of coins for which receipts had been issued and the number of coins available to meet these receipts.
4. The receipts, themselves, were also being used in exchanges in lieu of coins and they became the first paper money.
5. The government could see the benefits being derived from these practices of the bankers and, to pay for the First World War, printed an enormous amount of paper claims on its gold and coins whilst, at the same time, it sent a great amount of its gold to America to pay for armaments. The gap between the amount of paper money and the gold available to honour it took a quantum leap.
6. Eventually the discrepancy between the number of coins and the amount of gold for which receipts, claims or paper money had been issued and the number of coins and the amount of gold available to honour them became so obvious that many people were questioning the value of the claims and refusing to accept paper money in any of its forms. The banking system faced a crisis.
7. The fraudulent behaviour won the day. Under pressure from bankers and financiers and aware of its own role in creating the crisis and the resultant

weakness of its own position, the government legitimized the fraud. It removed from those who were prudent the security provided by their holdings of real gold. It made the ownership of gold illegal. Instead of chastising bankers and admitting its own role in creating the crisis, the government made ownership of gold illegal - except for governments - and proclaimed its own paper the only valid currency. In essence, it honoured fraud and dishonoured integrity. Those who trusted real gold and coins lost, but the banking system was saved. Banks could continue to make money by issuing more than one receipt against the same deposit. Now, however, these essentially fraudulent practices were made legal.

8. This was the birth of what was known as “the fractional reserve banking system”. Under this system, banks were required to maintain a proportion of their deposits either as cash or as deposits with the Bank of England. The proportion remained at 20% for a long time. Thus, a depositor was assured of at least 20% of his deposit. The other side of this assurance is that the banks could each lend up to 80% of each new deposit. Thus, a bank which received a deposit of £5,000 could lend £4,000 and the bank which received the borrowed £4,000 as a deposit could lend £3,200 etc. So, whilst the individual bank which received the £5,000 deposit was limited to lending only its excess reserves and could create but £4,000 in new deposits, the banking system as a whole could create £25,000 - many multiples of each bank’s excess reserves.
9. In July 1988, the Basle Accord removed the fractional reserve system and replaced it with the “capital adequacy system”. Under the capital adequacy system, banks can lend up to a set multiple of its capital. The current rules mean a bank can issue about 12.5 times its capital. Should a bank, which is already fully loaned, wish to lend some more, it can simply issue new capital. By raising £80 million in new capital a bank can lend £1 billion. Of the £80 million, only a small proportion needs to be equity. The rest can be loan stock. In other words, by issuing a certain type of loan a bank can authorise itself to issue a great deal more.
10. Worse, under the capital adequacy system reserves are no longer required except to the extent needed to fund the Bank of England. Reserves are now less than 1% of deposits.
11. In fact, no longer needing to concentrate on maintaining reserves, banks have now become so sophisticated in their operations that they now lend without concern for how much they have on deposit. If they lend more than they have on deposit they add to their deposits by borrowing overnight. Banks have to balance their books every night. Thus, the overnight market has become an essential backstop to bank liquidity and the only real limit on the banks’ ability to create new money is the availability of acceptable borrowers.
12. The British banking system is not different in its fundamentals than other banking systems throughout the world. By 1971 even the American government had to admit that the amount of paper money it had issued against the gold - which governments around the world had allowed themselves to keep in order to maintain at least a tenuous relationship between their own paper money and gold - was far in excess of the gold actually held. President Nixon was being pressed by other governmental holders of dollars throughout the world to exchange them for gold at the rate of \$35 per ounce to which all nations had agreed at Bretton Woods in 1944. There wasn’t enough gold in Fort Knox to meet the demand. American industries had borrowed from domestic banks and gone on a spending spree abroad, exporting US dollars. These US dollars had ended up in the central banks

of countries all over the world and the central banks were now claiming the gold to which they were entitled. He had to admit that the U.S. didn't have enough gold to honour its commitments. The American banks had defeated even the American government. Nixon's closure of the 'gold window' - i.e. refusal to honour the Bretton Woods agreement - ended any relationship between paper money and gold. From that moment on the world was on a 'debt based monetary system'. Paper money was no longer exchangeable for a fixed amount of any commodity. Another constraint to limit the production of new money had been removed.

Here we see a perspective of history which shows how the banks and the governments together have eroded the security of depositors. From the situation where the bank stored depositors' money for them in trust and with a fiduciary responsibility - in essence a 100% reserve system, through a 20% reserve system under which depositors became unsecured creditors of the bank and the bank's fiduciary responsibility towards its depositors became less clear, to the current system of virtually no reserves and the banks having no more responsibility to their depositors than any other company has to its creditors.

This perspective also shows how the banking system's ability to create new money has increased as the amount banks were required to keep in reserves decreased. This, of course, may be in the best interest of banks but it is not in the best interest of taxpayers, savers, pensioners and others on fixed incomes and society as a whole. Whilst we as citizens authorize our government to create and maintain a money stock for us, the government license banks to create new money for them. The ground rules under which banks operate are drafted in consultation with banks. Most members of the government are not familiar with the intricacies of finance and, therefore, seek the advice of bankers.

**The reality is that the ground rules are designed by bankers, for bankers.**

### **Bank Creation of Money**

We have observed how depositors' security has been eroded as the banking system has been empowered to create more and more new money. Now we must ask, at what cost and for whose benefit?

(TABLE 4)

1. In 1970, money supply figures were based on M3 which did not include building society deposits. In 1999, money supply figures are based on M4 which does include building society deposits. Therefore, to compare like with like, we must subtract building society deposits from the M4 figures provided in 1999.
2. Bank deposits have grown from £16,041 in 1970 million to £666,695 million in 1999.
3. The money supply is measured by adding the amount of currency (notes and coins) in circulation - that is, not in the bank - to the money in the bank (deposits).
4. There are differences of opinion as to which deposits should be included in the M3 and M4 figures. Economists argue about which ought and which ought not. M3

and M4 are “official”. They confirm that, regardless of the arguments of economists, there has been an enormous growth in the “official” measurements of the money supply over the thirty year period.

5. We, as citizens, authorize governments to create and maintain a money supply for our use. Governments license banks. Banks create money. Therefore, governments have actually authorized banks to create all of this money for them.
6. Had the government created this money itself, printed it and spent it into the economy, all £650 billion of it, we could by now have the finest schools in the world, the finest national health service in the world and the finest public transportation system in the world.
7. The government didn't print it because of the nature of the system. Had it printed the money and spent it into the system, the banks, under either the fractional reserve system or the capital adequacy system, would have used any new money created by the government to create multiples of it as it was spent into the economy and became new deposits - the fodder for the banking system's capacity to expand the money supply. The growth of the money supply and the inflation we have already suffered would have been significantly worse.

I am not impugning the integrity of bankers when I say that they have created more money and more inflation. Most bankers that I know are men and women of integrity. It is perfectly correct and natural for them to seek to manage their banks as efficiently and as profitably as they can.

Yet, they haven't critically examined the system within which they find themselves and within which they operate. Within the existing banking and monetary system, when they pursue their natural and normal activities - money lending and managing their banks as efficiently and as profitably as they can - they are actually acting against the best interests of their depositors and society. This is because of the structure of the system within which they function. It is the system that is wrong. It is a system that has grown out of an original fraud and which, although the fraud has long since been made legitimate, still maintains those faulty mechanisms within it.

Many will say that it is not fraudulent because they receive interest on their deposits from their bank. Therefore they expect their bank to use the money. In this respect they will be accurate. It is not fraudulent from their perspective if they expect the bank to use their deposits. Nevertheless, the banking system will have issued more than one receipt against the same deposit. That is still a faulty mechanism.

Examine the extent to which new deposits were created in 1999 alone

(TABLE 5)

1. In 1999, Barclays Bank alone created more new deposits than the total money stock in 1970.
2. The annual growth in total bank deposits exceeded five times the total money stock in 1970.
3. This growth is clearly not by one bank at the expense of another. Barclays increase in deposits is not due to competition amongst banks for deposits. None of these banks lost deposits.

In the case of each of these seven banks - and they constitute the bulk of the high street banks in the UK - the growth of loans exceeded the growth of deposits. It is the pursuit of increasing their loan portfolios and, thereby, increasing their profits that occupies the time and energy of banks. Look how successful they have been.

(TABLE 6)

So, our bankers have indeed been successful. Each one of the new Pounds created by the banks represents another Pound loaned and earning money for banks.

**As the system now stands, the more successful our bankers are, the greater the burden of debt on our economy and the greater the burden of debt on future generations. That is an unacceptable by-product of bank success.**

### **The Cost to Society of Banks Creating Money**

There are other unacceptable by-products. We have already seen in Table 4 above that the government has forgone £650 billion in expenditure by allowing banks to create money rather than creating the money itself and using it for the benefit of taxpayers and citizens. We also know that, when the government did need to spend money on behalf of its citizens, instead of creating money itself as it has been authorised to do, it borrowed the money and taxpayers have paid interest on the borrowed money. That is money for which taxpayers need not have been taxed.

(TABLE 7)

In addition to the £650 billion forgone, the taxpayer has spent £450 billion on interest costs since 1970. This year alone taxpayers will pay over £25 billion on interest on money which they have authorised governments to create at no running costs. Yet, the government claims it cannot find enough money to provide pensioners sufficient income to maintain a decent standard of living.

Indeed, the success of the banks breeds a great deal more unwanted by-products than a burden of debt on the economy and unnecessary interest costs. The combination of the inflation produced and the solutions offered by governments of all persuasions and their advisors has divided the economy into two distinct sections.

The top section includes all the financial institutions. The ever-growing pile of money created by the banks remains within the banking system. Money managers and money managing institutions have a bigger and bigger stock to manage every year. It doesn't take more and more people to manage the bigger and bigger supply of money. The fees earned for the management of an ever-growing money supply also grow. Yet, through the process of consolidation - also known as mergers and acquisitions, the numbers involved in the management of this growing supply of money tends to shrink. Therefore, the salaries and bonuses of people in this top section tends to grow at a greater rate than the increase in the money supply itself.

The rest of the economy has a different set of ground rules - and they stem directly from the very activities that produce the increases in the top section. Over the past

thirty years, the effects of inflation and the cures offered to control inflation have squeezed the rest of the economy.

1. To claw back the loss in purchasing power in their pay packets as the value of money was being debased, workers demanded and received higher than normal wage settlements during the seventies and early eighties. For this they have been severely criticized - and even blamed for causing inflation - by those in the top section.
2. The new money created was used to produce more - and more modern - production facilities both here and abroad, bringing to the marketplace excess productive capacity and greatly increasing price competition.
3. To curb inflation, interest rates were increased. As a result:
  - a. banks were encouraged to lend more - the higher the level of interest they could charge, the greater their profits,
  - b. first rate borrowers were discouraged from borrowing,
  - c. to lend more, banks reduced the quality of their loan portfolios
  - d. banks increased their interest rates even more to compensate for lending at greater risk to borrowers of lower quality,
  - e. existing borrowers were locked in and had to pay the higher interest costs, and
  - f. business overheads increased.

The effect of all of this has been a squeeze on business costs. The increased competition, brought by the increased productive capacity here and abroad - greatly increased by the demand for 'free trade' - made it difficult for businesses to increase their prices. Thus, more efficiency was demanded. Managers had to choose between meeting the rising interest costs - which had to be met or the entire business was at risk - and paying employees. "Downsizing" roared in with a zest. Employees at all levels were laid off. Employers could no longer afford to feel loyal to their long-standing employees. Loyalty between companies and their employees was sacrificed in the name of efficiency. The bond had been broken. Employees could no longer afford the luxury of feeling loyal to their employers. The trust between them has been destroyed. Suddenly, everyone was on his own. Society as a whole is the poorer.

It made little difference whether an employee was in management or on the shop floor. No job was safe. Employees were not in the position to demand higher wages or salaries. The pressure on their income is downward.

At the same time, money managing institutions wish to encourage those managing the businesses and industries in which they have invested to produce greater profits. Good managers are offered stock options and other incentives to improve the performance of their businesses. They, too, are money managers. They control the flow of money through their businesses. They must control costs. It is part of their job to maintain the downward pressure on employee incomes - except their own, of course.

Money managers have a different set of ground rules. They are encouraged to make their businesses more and more efficient and more and more profitable. The better they constrain wage and labour costs, the more they, themselves, can earn. Their

remuneration increases according to their success. The pressure on their income is upward.

Yet, with both prices and wages under pressure not to rise, the currently accepted measurement of inflation has remained very low. Governments and economists have celebrated the end of inflation.

Inflation is not dead. The celebrations are premature. Asset inflation is readily apparent in the stock market and in house prices - especially in the price of houses sought by those earning huge sums managing money and businesses. It trickles down to other houses.

In the top section - in top management and in 'the city' in particular - wages and salaries and bonuses have escalated to the point that the differential between their earnings and the earnings of those in the rest of the economy has become so great that it threatens the very fabric of society. Still the money supply keeps growing - as we have seen above - and the levels of income generated in 'the city' continue to rise. But, other than in top management, in the rest of the economy wages and prices have been constrained.

What in the UK is currently labeled "the North/South" divide is not a geographical divide. It is fundamentally a division between money managers and top corporate managers and the rest of the economy.

On the world stage this division is labeled "Western industrial countries/third world countries". The western banking system - and American banks in particular - have created money and purchasing power at rates with which smaller countries cannot compete. Thus, the western banking and monetary system has severely disadvantaged third world countries.

When third world countries have found themselves in difficulties the western response has been to help them by lending them money. This allows western banks to create even more new money creating even more new purchasing power. American banks were instrumental in helping to form the World Bank and the International Monetary Fund (IMF) specifically to help less fortunate countries. Hidden by the mask of helping the poor throughout the world, these banks created and spread new dollars throughout the world.

Too often, however, the policies of the World bank and the IMF have helped to cripple the very countries whom the western banking system had already disadvantaged. These policies required that borrowing countries produce crops to sell on the open market for dollars so that the borrowing countries can have dollars to repay their loans. Borrowing countries have then had to concentrate on producing "cash crops" rather than developing an agricultural policy designed to feed their own people. Only countries which can feed themselves are free.

All of these unfortunate effects have been produced because governments and economists have failed to understand the real nature of the western monetary and banking system. Their failure to understand what is actually happening and the

consequent failure to correct the faults in the system, has allowed an enormous gap to develop between the two sectors of the economy. The continued growth of this gap breeds anger and frustration as those who do not participate in sharing the spoils of this growth in the money supply watch the behaviour of those who do. Most people don't understand what is wrong. They are acutely aware, however that something is wrong. Social unrest is breeding.

We have seen at Seattle and Prague how strongly an anti-capitalist movement is growing in Western countries and around the world. This movement is led by people who feel genuinely aggrieved about the huge gap between rich and poor - and these are decent people mostly from within the western industrialized countries themselves - blame capitalism. This movement is growing.

**Yet it is not capitalism itself which is creating the disadvantage. It is the money-lending mechanism within the banking system. Our failure to understand that there is a serious fault within our monetary and banking system and our failure to act, to get governments to act and thus, our failure to remove the fault and correct the system is threatening capitalism itself. The practice of money-lending is putting all of the advantages of capitalism at risk.**

One of the unwanted results of the recent orgy of bank lending - inflation - has removed from too many governments, businesses, families and individuals their margins of comfort and safety.

In businesses, the demand for efficiency, often driven by managers seeking to maximize their personal profits, have led to banks reducing the level of stored cash - either in their own vaults or at central banks - from the original 100% of deposits where every depositor was safe, to 20% during the 'fractional reserve' period, to now where they maintain just enough to meet their daily needs.

We all saw what happened during the petrol crisis in the UK. Petrol stations no longer have sufficient tank storage to serve their customers for more than a few days. The nation's fuel supply disappeared almost instantaneously. Supermarkets no longer hold sufficient stock to supply their customers for more than a few days. Without fuel to operate delivery vehicles, supermarket shelves soon became bare.

None had maintained prudent margins of safety and comfort. All were caught out by 'events'. The country was in crisis.

Our banking system no longer maintains prudent margins of safety and comfort. Banks are not immune from the effects of 'events'. The only absolute protection is to return to a cash level of 100% of deposits.

Why do we allow this threat to continue?  
Why don't we demand protection from 'events'.

### **Inaccurate Measurements**

Part of the reason lies in the lack of understanding of the real nature of the system. We have been misled by errors in the very presumptions of economics. In the most

basic courses on economics we have been taught that when banks lend money the money supply increases and when those loans are repaid the money supply decreases. Thus, we are told, these activities cancel each other out. We have accepted this idea and have acted on it in good faith.

But it is not true. The money supply does not decrease. It is only the measurement of the money supply that decreases. When a loan is repaid it goes into the bank's own account. The bank's own account is included under the heading "Cash in hand and balances at central banks". Look again at Tables 1 and 2. On the bank's balance sheet, like any other company, money in its own account is considered an asset and is shown on the asset side of its accounts. Customer deposits, on the other hand, are considered liabilities and appear on the liability side of the balance sheet. When economists measure the money supply, they measure the sum of Customer deposits and cash in circulation (not in the banks). But, deposits into the banks own account are not included. They are missing from the measurement. Nevertheless, once deposited into their own account, banks can use that money as they see fit. They can pay bills with it, they can pay wages with it, they can make investments with it and they can lend it to another borrower. It is a nonsense to suggest that it disappears and thus, somehow - mysteriously - the money supply diminishes. It does no such thing. The measurements are inaccurate and, as a result, the theory is inaccurate.

Further, the measurement of the Customer deposits itself is inaccurate. Earlier I observed that economists argued about which type of deposit should be included in the measurement. All agree that demand or cheque accounts are part of the money supply. It is about which other deposits to include that economists argue. Time deposits, many argue, should not be included and many are not. That is like the goldsmiths claiming that the only real coins are the coins at the front of the shelf - the coins which move in or out as customers make deposits or withdrawals. The rest, we are asked to believe do not exist. Of course that is nonsense. That explains the apparent anomaly between Tables 4 and 5. It appears that the banks created an excessive amount of new money in 1999 compared to the amount they created over the preceding 30 years. The reality is that the thirty year figure is not accurate. The amount of new money created is actually substantially higher.

The reality is that economics is not a science. Nor can it be. The money supply increases daily as banks create new loans. As the supply increases, the value of previously existing money diminishes accordingly. But, one of the functions of money is to act as a unit of measurement of exchange value. Yet, the size of the unit of measurement diminishes daily. Imagine the chaos that would occur if the size of the inch or the meter or the minute diminished daily. Measurements taken by different people or at different times could not be validly compared. Calculations based on such comparisons would be equally invalid. Formulae derived from such calculations could not possibly produce the results predicted. So it is for economics. Economics is not a science. Nor are economists scientists.

Yet, we have turned the entire management of our economy over to economists and bankers. And now we wonder what has gone wrong. The truth is we haven't understood what has been happening - and neither have they.

## **Removing the Fault**

Now that we have a better view of reality, we must begin immediately to focus on correcting the monetary and banking system. We must remove from it the fault that produces such unwanted and unacceptable by-products whilst retaining the bits that serve us well.

We must stop banks from creating new money by lending depositors funds.

We must return to a system of 100% reserves.

We must ensure that when we put money into the bank it stays there unless we specifically authorize it to move from our account.

We must ensure that when it moves from our account it moves in a manner which does not produce false receipts.

We must ensure that this highly profitable institutional money-lending mechanism doesn't reappear in some other guise, off-balance sheet or beyond the banking system to continue to produce its insidious and unacceptable effects and by-products in the name of profits.

People must demand new legislation ensure that banks clearly differentiate between their 'storage and distribution' function and their 'investment' function. In their capacity as a provider of storage and distribution of money for depositors they must be subject to strict and regular audits to ensure that 100% of the money entrusted to them by depositors is factually stored within their vaults. They must not again be allowed to lend their depositors' funds.

Having said that, we must also ask: what is the alternative? How else can we get the investment we need in the economy? How else can we stop the money needed in the economy from just sitting in the bank doing nothing?

## **The Equity System**

There are, of course, two types of investment: debt and equity.

Debt investments are investments where the amount of money invested is fixed and must be returned with interest. Equity investments are investments where money is exchanged for a fixed proportion of the ownership of the business or property in which the investment is made.

Part of the difference between the two, then, is what it is that is fixed. In debt investments it is the amount of money that is fixed, with no ownership conferred, and in equity investments it is the proportion of the asset that is fixed and its monetary value can change upward or downward. Also, in equity investments the rate of return will vary according to the profitability of the investment whereas, in debt investments, the rate of interest is fixed by contract.

On the surface, it looks like - at least in terms of money - debt investment is safer. In fact, it isn't. Money loses value and, as we have seen, that value loss is caused by the very act of lending itself. So, the money returned to the lender is not the same as the

money loaned. It is only the same amount of money. The loss to the debt investor is purchasing power. Nevertheless, it appears to be safer.

The appearance of safety is enhanced by the legal preferences given to lenders. If the investment fails, the investor will have made an error in judgment and, regardless of which type of investment the investor made - debt or equity - the same error in judgment will have been made.

In the case of debt investments - lending - taxpayers will provide the lender with courts, police, bailiffs and, if necessary even prisons, to help the debt investor correct his or her error in judgment. That is not the case with equity investments. Equity investors must shoulder the full burden of their own errors in judgment. They can lose the total investment.

Why should taxpayers spend their hard earned money to help investors to correct their own errors in judgment? In particular, one must ask, why should taxpayers spend any money to support investors whose chosen method of investment produces all of the unwanted side-effects we have seen above? It is a waste of taxpayers money and it encourages the production of these unacceptable by-products.

The government further encourages debt investment by allowing the interest costs of businesses to be deducted before the calculation of their taxes. Dividends must be paid out of the profits left after they have paid taxes. Individuals cannot deduct interest costs in the same way. Therefore, individuals pay a disproportionately higher level of taxes than they ought and companies pay less than they ought. Once again the banks have succeeded in getting preferential treatment for debt investment and the taxpaying citizen ends up paying the price.

The taxpaying citizen should now say "Cease. Desist. Enough is enough. We are no longer willing to support this defective monetary and banking system with its privileged personnel bringing social division and huge and unnecessary costs in its wake. We are no longer prepared to pay the costs of helping lenders collect there money if a loan goes bad. We will no longer pay for the time of courts, bailiffs and police in pursuit of debtors. We demand legislation to make all debt like gambling debts - legally unenforceable. If lenders make errors in judgment let them bear their own costs. We are no longer willing to pay. And, if anyone chooses to lend money, the borrower must not be allowed to deduct interest costs as an expense. Any interest paid must be paid from the income left after taxes have been paid."

Of course, before people are going to make such a demand they will want to be confident that a system based on equity alone can produce the economic services they want.

If banks don't lend money, what is going to stop the money from simply sitting in the bank doing nothing? The answer is, quite logically: storage charges. If the banks are not receiving interest on loans, they will have to charge the full cost of storing and distributing depositors' money for them. Bank charges are already high. They will have to be even higher. Few will want to pay such fees for any longer than necessary. High fees will erode their savings.

Instead, people with savings or money stored will want to invest it in a safe investment that will pay them an income. Once loans are no longer legally enforceable, lending will not be safe. The borrower does not have to return the money borrowed. Who will lend to anyone other than those close enough to them to know that they are sufficiently honourable to repay their loans. Even that carries risk. Savers will seek a safe equity investment that will pay them a dividend.

The safest equity investments have always been property and public utilities - water and sewage companies, electricity companies and gas companies. The latter are considered safe because there is always a strong demand for their products: they are essential to support life and they are sufficiently regulated to ensure proper management.

Under an equity system, housing will join the list of essentials needing equity finance. Without security for lenders, mortgages will no longer be available. How will people be able to buy a house? The answer is just as easily as with the current mortgage system and with a much better system for both the current borrower and lender.

Historically in this country, house buyers have paid about 10% of the cost of a house per annum for both a mortgage and an endowment policy to ensure repayment of the mortgage. An equity based purchasing system need cost no more and the market to provide funds will be there. Savers will be actively seeking secure equity investments for their savings. What could be safer than houses?

Funds would be set up to invest in housing with home purchasers. Shared ownership funding is available even now. Savers will buy shares in the funds and the funds will buy a share of each house. Home owners could begin by purchasing 5% of the house with the fund purchasing 95%. In the absence of inflation, a public utility has historically paid 3% per annum in dividends. On a rental rate of 5%, with management costs of 2%, savers who were shareholders could continue to receive 3% income on their investment. So, the homeowner can afford to pay 5% per annum in rental and to purchase a further 5% of the house every year. The fund will thus continue to receive new funds to invest in other houses. By the 10<sup>th</sup> year, the homeowner will own 50% of the house.

Should a homeowner find himself or herself with financial pressure due to a medical problem, school fees, or whatever, he or she can simply stop purchasing the 5%. The rental costs will also have diminished each year from rent on 95% of the house to rent on only 50% of the house. Further, if for any reason the house has to be sold, the homeowner will receive 50% of the proceeds or whatever the percentage that the homeowner actually owns at the time.

It is a much more user friendly system. These types of systems will be developed in every area of the economy. There is much to recommend them.

What of banks? They will return to their original role of warehouses and distribution centres. Their vaults will have to be audited regularly to ensure that the money deposited is still there. Banks will no longer be able to create new money and

increase the money supply. Inflation can then well and truly be dead. The only genuine increases in the money supply will then be what governments produce and they are accountable to voters.

Bankers, themselves, however, have a great deal of information about the financial condition and probity of individuals and businesses in their own community. Their knowledge will be in great demand as people seek equity investments and businesses seek to raise equity funds. Banks may well become the new marketplace for equity investing. Their advice would be sought. They could broker investments. They could open their own equity investment funds. And bankers would no longer need to fear loss of confidence. The possibility of ‘events’ triggering a run will have been removed. In fact, there is no reason at all for banks to fear the future under an equity system.

Once banks can no longer lend and multiply the monetary base, the government can create the money to buy back and repay its own debts. This will remove from the budget £25 billions in annual debt servicing costs. Pensions, for instance, could then be substantially increased and provide pensioners with a better standard of living.

In my book “Honest Money” I set out how these changes could be made in one go and what would be required if that were to be done. That is the ideal and I felt it important to set out the ideal. Human nature being what it is, however, we are unlikely to make such a radical change. The process, though, can also be gradual.

It could begin passing the required legislation removing the protection from lending and making it the case that any loans issued after a certain date would not be legally enforceable. Further legislation could require banks to maintain 100% reserves for any deposit made after the same date and to use the proceeds from loan repayments after that date to purchase existing government debt.

Then, bank vaults would begin to fill with government debt instruments. The government could then purchase those debt instruments from the banks - replacing them in the banks’ vaults with notes and coins which could be measured at regular intervals by approved auditors.

The new money created by the government to repay its £400 billion current debt would give substance to existing deposits. There would be no increase in either deposits or money in circulation. Therefore, it will not increase the money supply and will not produce any inflation.

Similarly, the debtor countries currently burdened by the requirements of the IMF and the World Bank can unleash their shackles. Some of these debtor countries have been granted debt relief thanks to the unstinting efforts of Jubilee 2000 and others. These are well intended efforts and we should all be grateful for them. Nevertheless, having been forgiven their debts, these countries have needed money to rebuild and the IMF has loaned them more. They remain tied to and shackled by IMF policy. They need a better answer.

There is one. They, too, can make all debt issued after a certain date legally unenforceable. They, too, can repay their domestic debt without producing further inflation. Having done that, they can then repay their dollar debts by issuing the dollar equivalent in their own currency and using it as payment for all their foreign debts. Then they will be free of debts, they will be free of the ties to IMF policy and they will have investment to rebuild their economies. The IMF and other foreign creditors will now hold their currency. There will be no other place to spend or invest it but in those countries. Of course, they will also have to ensure a regime that is both investor friendly and does not disenfranchise their own citizens. All of the above is possible.

So, we can survive without debt investment. We can free ourselves and the rest of the world from the shackles and worry of debt.

It is time to begin.

It is time to take back control of our economy.

It is time to stop the waste of taxpayers' money.

It is time to end the division between 'the city' and the rest of us.

It is time to stop the continued debasement of our currency.

It is time to stop increasing the burden of debt on the economy and future generations.

It is time to remove the fault from our monetary and banking system.

It is time to return to a system where 100% of our deposits are actually stored in the bank.

Then we will have confidence in the banks without having to maintain it.

Then we will have returned integrity to our banking and monetary system.

Then we will once again have a system which rewards thrift not fecklessness.

Then we can begin to heal the divisions within our own society and throughout the world.

Then we can begin to convert the huge burden of debt that now exists to equity.

Then we can concentrate on building a collection of assets for future generations.

These are worthwhile objectives. We can achieve them. We need only to start.

John Tomlinson October 5, 2000

BARCLAYS BANK plc

1999 Balance Sheet as currently presented  
(£ millions)

	<u>1999</u>	<u>1998</u>
<b>ASSETS</b>		
Cash and balances at central banks	1,166	942
Items in course of collection from other banks	2,492	2,475
Treasury bills and other eligible bills	7,176	4,748
Loans and advances to banks	42,656	36,612
Loans and advances to customers	113,538	96,110
Debt securities	53,919	45,180
Equity shares	5,604	4,888
Interests in associated undertakings	106	150
Intangible fixed assets	183	196
Tangible fixed assets	1,800	1,939
Other assets	15,910	16,617
Prepayments and accrued income	<u>2,203</u>	<u>2,552</u>
<b>Total Assets</b>	<b><u>246,753</u></b>	<b><u>212,409</u></b>
<b>LIABILITIES</b>		
Deposits by banks	44,486	34,420
Customer accounts	123,966	108,805
Debt securities in issue	23,329	17,824
Items in course of collection due to other banks	1,400	1,279
Other liabilities	35,119	33,350
Accruals and deferred income	3,290	3,074
Provisions for liabilities	1,731	1,767
Long term loan capital	<u>4,597</u>	<u>3,734</u>
	<b><u>237,918</u></b>	<b><u>204,253</u></b>
<b>MINORITY INTERESTS AND SHAREHOLDERS FUNDS</b>		
Minority interests	352	314
Called up share capital	1,495	1,511
Share premium account	1,583	1,381
Capital redemption reserve	207	179
Other capital reserve	320	320
Revaluation reserve	37	36
Profit and loss account	<u>4,841</u>	<u>4,415</u>
	<b><u>8835</u></b>	<b><u>8,156</u></b>
<b>Total liabilities and shareholders funds</b>	<b><u>246,753</u></b>	<b><u>212,409</u></b>
<b>Memorandum items</b>		
Contingent liabilities	18,934	15,237

Table 1

BARCLAYS BANK plc

1999 Balance sheet as any other company would be required to present it  
(£ millions)

	<u>1999</u>	<u>1998</u>
<b>Fixed Assets</b>		
Intangible fixed assets	183	196
Tangible fixed assets	1,800	1,939
Equity shares	5,604	4,888
Interest in associated undertakings	<u>106</u>	<u>150</u>
	7,693	7,173
<b>Current Assets</b>		
Loans and advances to customers		
Loans and advances to other banks	113,538	96,110
Treasury bills	45,148	39,087
Debt securities	7,176	4,748
Other assets	53,919	45,180
Prepayments and accrued income	15,910	16,617
Cash and balances at central banks	2,203	2,552
	<u>1,166</u>	<u>942</u>
	239,060	205,236
<b>less Current Liabilities</b>		
Deposits by banks	44,486	34,420
In course of collection	1,400	1,279
Customer accounts	123,966	108,805
Debt securities	23,329	17,824
Other liabilities	35,119	33,350
Accruals and deferred income	3,290	3,074
Provisions	1731 - 233,321	1,767 -200,519
	<u>5,739</u>	<u>4,717</u>
	13,432	11,890
<b>less Long Term Loan Capital</b>	<u>-4,597</u>	<u>-3,734</u>
	<u><u>8,835</u></u>	<u><u>8,156</u></u>
<b>Capital and Reserves</b>		
Minority interests	352	314
Called up share capital	1,495	1,511
Share premium account	1,583	1,381
Reserves	527	499
Revaluation reserve	37	36
Profit and loss account	4,841	4,415
	<u>8,835</u>	<u>8,156</u>
<b>Memoranda items:</b>		
Contingent liabilities	18,934	15,237
<b>Notes:</b>		
Exchange-rate related derivatives	369,461	434,452
Interest-rate related derivatives	1,259,856	1,111,858

Table 2

BARCLAYS BANK plc

1999 Financial information as depositors ought to examine it

	(£ millions)	1999	1998
<b><u>CASH ON DEPOSIT</u></b>			
<b>Secured</b>			
by banks		44,486	34,420
in course of collection due to banks		1,400	1,279
debt securities in issue		<u>23,329</u>	<u>17,824</u>
		<b>69,215</b>	<b>53,523</b>
<b>Unsecured</b>			
customers' deposits		123,966	108,805
<b>Total</b>		<b>193,181</b>	<b>162,328</b>
<b><u>LESS CASH IN HAND AND BALANCES AT CENTRAL BANKS</u></b>		<b>1,166</b>	<b>942</b>
<b><u>CASH SHORTFALL</u></b>		<b>192,015</b>	<b>161,386</b>
<b><u>INVESTMENTS INTENDED TO COVER CASH SHORTFALL</u></b>			
<b>Loans to borrowers deemed least likely to default</b>			
Treasury bills and other eligible bills		7,176	4,748
loans and advances to banks		42,656	36,612
in course of collection due from other banks		<u>2,492</u>	<u>2,475</u>
		<b>52,324</b>	<b>43,835</b>
<b>Loans at greater risk</b>			
loans and advances to customers		113,538	96,110
debt securities less non-recourse borrowings		<u>53,919</u>	<u>45,180</u>
		<b>167,457</b>	<b>141,290</b>
<b>Total</b>		<b>219,781</b>	<b>185,125</b>

MEMORANDA:

**FURTHER THREATS TO DEPOSITORS' FUNDS**

contingent liabilities	18,934	15,237
exchange rate related derivatives - for the Group	369,461	434,452
interest rate related derivatives - for the Group	<u>1,259,856</u>	<u>1,111,858</u>
	<b>1,648,251</b>	<b>1,561,547</b>

**ASSESSMENT OF RISK TO CUSTOMERS' DEPOSITS**

Total investments available to cover depositors' funds	219,781	185,125
Less secured deposits	<u>69,215</u>	<u>53,523</u>
Balance available to unsecured depositors	<b>150,566</b>	<b>131,602</b>
<b>Cover - excluding further threats to depositors' funds</b>	<b>1.2</b>	<b>1.2</b>
Shareholders' funds	8,483	7,842
<b>As a percentage of customers' deposits</b>	<b>7%</b>	<b>7%</b>
Further threats to depositors' funds	1,648,251	1,561,547
<b>As a percentage of customers' deposits</b>	<b>1330%</b>	<b>1435%</b>
<b>Percentage loss which will wipe out customers' deposits</b>	<b>8%</b>	<b>7%</b>

Table 3

**UK MONEY SUPPLY ANALYSIS 1970 - 1999**  
(£ millions)

1999 M4 Money stock	813,868	
Less 1999 building society deposits	<u>121,593</u>	
1999 Bank deposits plus notes and coins		<u>692,275</u>
Less 1999 notes and coins		<u>25,580</u>
1999 Bank deposits		666,695
1970 M3 Money stock (excluding building society deposits)	20,240	
Less 1970 notes and coins	<u>4,199</u>	
1970 Bank deposits		<u>16,041</u>
<b>Bank created deposits since 1970</b>		<b><u><u>650,654</u></u></b>

**Table 4**

**BANK CREATED GROWTH OF MONEY SUPPLY 1998 - 1999**  
(£ millions)

	<u>1999 Deposits</u>	<u>1998 Deposits</u>	<u>Increase</u>
Bank of Scotland	51,422	47,514	3,908
Barclays Bank plc	193,181	162,328	30,853 *
Halifax Group plc	123,218	110,732	12,486
HSBC Holdings plc	273,450	229,050	44,400 **
Lloyds TSB Group	122,805	118,678	4,127
Natwest	118,778	112,942	5,836
Royal Bank of Scotland plc	51,481	42,487	<u>8,994</u>
<b>Annual growth in money supply</b>			<b><u>110,604</u> ***</b>

\* In excess of the total money supply in 1970

\*\* In excess of twice the total money supply in 1970

\*\*\* In excess of five times the total money supply in 1970

**Table 5**

**BANK CAPITAL AND EARNINGS 1998 - 1999**

(£ millions)

	<u>1999 Capital</u>	<u>Operating Profits 1998 - 1999</u>
Bank of Scotland	3,104	829
Barclays Bank plc	8,835	2,598
Halifax Group plc	6,943	1,610
HSBC Holdings plc	22,943	4,579
Lloyds TSB Group	8,726	3,735
Natwest	8,804	2,165
Royal Bank of Scotland plc	<u>8,990</u>	<u>1,211</u>
<b>Total capital and earnings 1998 - 1999</b>	<b><u><u>68,345</u></u></b>	<b><u><u>16,727</u></u></b> *

\* The total operating profits of just these seven banks exceeds the total of all bank deposits in 1970 (16,041)

**Table 6**

CENTRAL GOVERNMENT DEBT INTEREST  
(£ millions)

1970	2,088
1971	2,184
1972	2,413
1973	2,825
1974	3,671
1975	4,335
1976	5,609
1977	6,606
1978	7,450
1979	9,126
1980	11,404
1981	13,399
1982	14,781
1983	15,192
1984	16,909
1985	18,426
1986	18,486
1987	19,530
1988	19,830
1989	21,001
1990	20,900
1991	18,659
1992	18,737
1993	19,981
1994	22,963
1995	26,305
1996	27,975
1997	29,935
1998	30,547
1999	<u>26,495</u>
TOTAL	<u><u>457,762</u></u>

Table 7