

**MONEY**

**AND THE**

**BANKING SYSTEM**

Incorporating the article  
**'SOURCES OF MONEY'**  
reprinted, with permission, from the  
**'Bank of New South Wales Review'**  
Number 27 of October 1978

## **Part 1 – SOURCES OF MONEY    Page 1**

[Reprinted, with permission, from the  
'Bank of New South Wales Review'  
Number 27 of October 1978]

## **Part 2 – FOR AND AGAINST    Page 14**

by J. D. Malan

## **Part 1 - SOURCES OF MONEY**

[First published in the  
'Bank of New South Wales Review'  
Number 27, October 1978.  
Reprinted with permission.]

Despite its universal acceptance and use, money remains a rather mysterious element in the economy. Most people realize that banks and governments have something to do with the process of collecting and dispensing money, but few would have a clear notion of where it comes from and what forces regulate and influence its creation.

### **WHAT IS MONEY?**

Before looking at where money comes from it is necessary to clarify what money is. Money has taken many forms. Before the development of the banking system and the circulation of banknotes and coins with a minimal intrinsic value, a wide range of commodities, such as shells, oxen and gold and silver bars, provided the means to purchase goods, measure value between goods, settle debts and store wealth. A necessary prerequisite for any commodity functioning satisfactorily as money is that its supply can be controlled fairly easily. In primitive monetary systems this requirement naturally led to the choice of items which were relatively scarce. The most satisfactory forms of money were those which were durable, easy to move about and readily divisible without loss of value. As economies evolved, the less efficient forms of money were gradually discarded to facilitate economic development.

Nevertheless, the general criterion for transforming a particular commodity into money, irrespective of its efficiency, remained its general acceptability by people in exchange for other goods. For example, in Australia it is possible to pay the grocer

with paper notes issued by the Reserve Bank; but if, say, New Zealand dollar notes were tendered, the offer of payment in this form would probably be rejected. Consequently the New Zealand dollar is not money in Australia because it is generally not an acceptable form of payment.

Gold and silver coins were the first widely recognized metallic currency. A by-product of this usage was the genesis of the banking industry. People deposited surplus coin with goldsmiths, the owners of strong-room facilities. By the 17th century it had become accepted practice for goldsmiths to issue receipts for the deposits and for a receipt to be treated as a negotiable asset which ultimately could be presented to the goldsmith to be converted back into gold. In principle this procedure was the same as banks issuing banknotes. The early notes were pieces of paper issued by a bank which could be exchanged, when demanded by the holder, for a fixed amount of gold. This system of guaranteeing the convertibility of the note issue into gold was called the Gold Standard and it had its heyday in the nineteenth century. The arrangement was finally abandoned in the 1930s under pressure of the Great Depression. Despite the intense debate which took place in the early part of this century on the pros and cons of the Gold Standard, the acceptability of paper currency is not a special problem today. Banknotes are no longer convertible into gold, or any other precious metal, but they remain currency because people know that others will readily accept them in payment.

Today in Australia, as in most other modern economies, all money is a debt of the banking system. [In the original article the following footnote was inserted here: Not strictly true for coins which are minted by the Royal Australian Mint and, although distributed by the Reserve Bank, represent a claim on the Treasury.] Banknotes held by the public are liabilities of the Reserve Bank while bank deposits are claims on the

trading banks and savings banks. In a strict sense, only bank cheques along with notes and coins are acceptable as money, but since all other categories of trading and savings bank deposits can be readily converted into cash or current account deposits they are included in the official volume of money statistics. In Australia, notes and coins currently represent less than 9% of the total volume of money. Much more important are trading and savings bank deposits which each accounted for about 45% of total money supply of \$39 billion in June 1978.

The composition of the volume of money has altered with changing commercial practices. The wider use of cheques to settle payments has resulted in a decline in the importance of currency. Moreover, in the post-war era savings bank deposits have grown strongly as a form of money. Other items such as credit cards, undrawn overdraft limits, building shares, finance company notes and debentures and short-term government securities, too, are important sources of liquidity (i.e. assets which can be converted readily into money) in the Australian economy. But so far they have not been incorporated into official statistics of the volume of money (see Definitions) and other liquid assets.

### **DEFINITIONS OF VOLUME OF MONEY IN AUSTRALIA**

- M1: notes and coin held by public plus demand deposits of trading banks but excluding Commonwealth and State Government and inter-bank deposits.
- M2: M1 plus interest-bearing deposits of trading banks.
- M3: M2 plus savings bank deposits.

## THE GOVERNMENT AS A SOURCE OF MONEY

The first and most obvious source of money is the Commonwealth Government. It has exclusive rights over the printing of banknotes and the minting of coin. The quantity of currency in existence, however, is attuned to the community's need for cash which, apart from a short boost in December for Christmas spending, is relatively constant - and in any case is an insignificant cause of variation in the money supply. It is only in exceptional circumstances, for example the conversion to decimal currency in Australia in February 1966, that a surge takes place in the production of new coins and banknotes.

The expansion or contraction of money by government depends on the amount of domestic expenditure it has to finance for which no tax revenue or loan funds from the non-bank public are available. In the case of a revenue deficit, the money supply will expand and, in the case of a surplus, it will contract. It is not normal for a government to meet a revenue shortfall by the excessive printing of new banknotes, though there have been occasions in the past where this has occurred: for example in Germany after the First World War and in Hungary after the Second. In both cases the rapid expansion of notes in circulation led to the complete destruction of the existing monetary system, and economic and social chaos ensued.

In the Australian economy today, the so-called 'printing press' operations necessary to cover the Government's revenue shortfalls are actually achieved by the Reserve Bank as the banker extending credit to the Commonwealth Government. When government cheques are presented through the banking system for settlement, the Reserve Bank effects payment, which increases bank deposits and consequently the volume of money. To cover the Government's indebtedness the Reserve Bank normally agrees to purchase low-yielding treasury bills.

The money supply rises as if the note issue had increased, except that people have larger holdings of bank rather than cash money. This increase in the money supply, however, can be offset by government borrowing from the non-bank public which would reduce bank deposits.

The accompanying table indicates that the Government has become a much more important source of money growth in Australia since 1973/74, after acting as a damper on monetary expansion in the early part of the decade.

Budgetary considerations, however, are not the only way the monetary authorities are able to influence the volume of money. Changes can also be effected by the Reserve Bank selling or buying government securities on the open market. By altering the price or interest rate expectation on government securities, excess liquidity can be drained from the capital market or, conversely, a tight money situation can be alleviated. For example, the Commonwealth Government's announcement last year [1977] that it hoped to have official interest rates cut by two percentage points during 1978 induced strong buying of government securities by individuals and institutions in the expectation of the capital gains to be made as yields were reduced in the year ahead. These purchases of bonds mopped up excess liquidity from the capital market left idle by the low rate of economic activity. Large increases in the non-bank private sector's holdings of government securities of \$1.5 billion in 1975/76 and \$1.1 billion in 1976/77 were sustained at \$1.3 billion in the following year and reduced the expansionary impact on the money supply of the Government's large domestic deficit.

In the latest June quarter [1977] during the customary seasonal drain on liquidity caused by collection of provisional personal and company taxes, the Reserve Bank was able to prevent the money supply from

becoming unduly tight by, among other things, purchasing government securities from the private sector.

By encouraging the non-bank private sector, as opposed to the banking system, to hold national debt, the Government has been able to dampen the monetary impact of the budget deficit. The Government has been able to find willing buyers for its bonds with the prospect of capital gain and because of the activity in the private sector which has resulted in a diminution of alternative investment opportunities. And in part the slow growth of production, accompanied by high rates of unemployment and sharply rising costs, has held back the elimination of the recent large budget deficits. Should the pace of economic activity quicken, the deficit can be expected to shrink gradually as tax receipts rise and welfare payments fall with rising income and employment. But increased demands on the capital market for finance from the private sector could force the Government to revert to financing a larger portion of its budget deficit through the banking system in order to prevent interest rates from rising. The consequences of this alteration in the holding of the national debt, however, would be an increase in the volume of money, unless the deficit could be reduced at a similar rate.

### **BANKS CREATE MONEY**

Another important source of money creation is by the banks. A deposit, or claim on a bank, can be formed in two ways. The first is by a customer taking coins and banknotes to his banker. The depositing of cash in a bank, however, is a substitution of one type of money for another. Cash has disappeared out of circulation and has been replaced by an equal amount of bank money, so that the total quantity of money has remained unchanged. This method of deposit formation is relatively insignificant.

Bankers, however, do not only lend out money

they have received from others. They have the capacity to create money because their liabilities (deposits) are accepted as money. Consequently, the second and more important method by which a claim on a bank can come into existence is for the bank to acquire an asset. For example, if a bank wishes to purchase a government bond in the market, it makes payment for it by crediting the seller's bank, thus increasing total bank deposits.

The largest proportion of bank assets is in overdrafts and loans. When a banker grants a customer credit by overdraft, the bank 'opens an account' in its books and gives the client the right to draw funds without first having to put money into the account. But bank deposits only increase when the customer actually draws on the account to pay his creditors. In the case of loans, funds are deposited directly to the customer's credit and results in an immediate increase in the volume of money. In either case the money supply increases as a result of the bank's lending activities. As long as the debt remains outstanding the community's quantity of money is increased.

Money created by bank lending increased in importance in Australia during the 1970s. This growth partly reflected the increased dependence of the corporate sector on external sources of finance following a sharp erosion in business profits. Banks also attempted to meet the stronger demand for personal finance, and savings bank housing loans in particular increased markedly during the decade.

Unlike the Government, the banks' ability to create money indefinitely is circumscribed. Initially, banks need to maintain a safe minimum ratio between cash and deposits. They have to hold a certain amount in cash reserves to meet the requests of customers who wish to have their deposits converted into coin or banknotes. Not all of the banks' cash is held in the form of notes and coin in the till; savings banks in

particular have large deposits with the Reserve Bank. The trading banks in Australia currently operate on a cash ratio of about 2%, while savings banks operate on a ratio of approximately 7%. In June 1978, near-liquid assets, such as short-term money market loans and holdings of treasury notes, accounted for another 1.5% of trading bank deposits and 1.2% of savings bank depositors' balances.

The banks' credit-creation ability is further constrained by the Reserve Bank's direct controls. The relatively high cash ratio of the savings banks results from the Reserve Bank requirement that those savings banks subject to the Banking Act (which, excluding State Savings Banks, account for about 75% of total business) hold at least 7.5% of their deposits in cash, on deposit with the Reserve Bank, or invested in treasury notes. In all, 40% of savings bank deposits must be held in cash, Commonwealth, local, or semi-government securities and loans to authorized short-term money market dealers.

Trading banks, too, are subject to control by the Reserve Bank. First, a specified proportion of deposits is required to be lodged in low-yielding (2.5% p.a.) statutory reserve deposits (S.R.D.s) at the Reserve Bank. The ratio can be varied at the central bank's discretion to take account of changes in monetary policy or seasonal variations in liquidity. In May and June the ratio was low, at 4%, to enable banks to maintain an adequate rate of lending during the seasonal liquidity trough. This determination compared with 8% at the beginning of the current financial year. In addition, the seven major trading banks, which account for approximately 90% of the total banking business in Australia, have agreed with the Reserve Bank to hold at least 18% of their deposits in liquid assets and government securities. This arrangement is known as the L.G.S. convention and has no statutory basis. Rather it is a formal agreement and it has been varied relatively infrequently since it was first introduced in 1956. The

higher the combined influence of the S.R.D. determination and the L.G.S. convention, the more limited is the banks' ability to lend as is their capacity for increasing deposits and the money supply. A further restriction has been the quantitative limits placed by the central bank over new lending.

The key element in the banks' ability to create money is the alteration in their cash holdings - notes and coins and Reserve Bank balances - and statutory reserve deposits. And since cash is a liability of the Reserve Bank, it will reflect changes in the asset structure of the central bank. Whether the banks choose to increase their lending, and thus create deposits, or invest their surplus cash in near-liquid assets, such as government securities, largely depends on their assessment of the amount of L.G.S. assets they need to hold above the required minimum. The bank's choice can be circumscribed of course by quantitative restrictions on lending imposed by the Reserve Bank.

# **SOURCES OF MOVEMENTS IN THE VOLUME OF MONEY IN AUSTRALIA**

(Values represent billions of dollars)

	69/70	70/71	71/72	72/73	73/74	74/75	75/76	76/77	77/78
(1-A)	0.2	-	0.1	0.7	0.3	2.6	3.6	2.7	3.3
(-B)	0.5	0.5	0.5	0.5	0.5	0.6	0.7	0.9	1.0
(-C)	-0.3	-0.5	-0.4	0.2	-0.2	1.9	2.9	1.9	2.4
(-D)	0.1	0.3	0.7	-0.1	-	0.6	1.5	1.1	1.3
(-E)	-0.4	-0.8	-1.1	0.3	-0.2	1.3	1.4	0.8	1.1
(2-A)	0.5	0.4	0.6	-2.0	2.4	1.1	1.4	1.5	1.7
(-B)	0.2	0.3	0.3	0.5	0.8	1.1	1.4	1.3	1.2
(-C)	0.7	0.7	0.9	2.5	3.2	2.2	2.8	2.8	2.9
(3)	-	-0.1	-	0.1	-0.1	0.1	0.2	-0.1	-0.1
(4)	0.3	-0.2	-0.2	2.9	2.9	3.6	4.4	3.5	4.1
(5)	0.6	1.2	1.9	1.6	0.2	0.2	-0.5	-	-1.2
(6)	0.9	1.0	1.7	4.5	3.2	3.8	4.0	3.5	2.9

## **DESCRIPTIONS OF EACH ROW OF FIGURES**

- (1) MONEY CREATED BY GOVERNMENT -
- (1-A) Budget deficit (+) or surplus (-)
- (1-B) Less Government overseas deficit
- (1-C) Commonwealth Government's domestic deficit (+) or surplus (-)
- (1-D) Less changes in non-bank public holdings of Commonwealth Government securities
- (1-E) Net Creation of Money by Government
- (2) MONEY CREATED BY BANK LENDING -
- (2-A) Changes in Trading Bank Loans
- (2-B) Changes in Savings Bank Loans
- (2-C) Net Creation of Money by Bank Lending
- (3) MONEY CREATED BY OTHER DOMESTIC FACTORS (A)
- (4) TOTAL CREATION OF MONEY FROM DOMESTIC SOURCES (I.E. (1) + (2) + (3))
- (5) MONEY CREATED BY PRIVATE SECTOR FOREIGN EXCHANGE TRANSACTIONS (B)
- (6) TOTAL GROWTH IN MONEY SUPPLY (M3) (C) (I.E.

(4) + (5))

#### FOOTNOTES:

(A) Includes rural credits advances, Reserve Bank transactions in commercial bills, movements in the trading banks' statutory reserve deposit accounts, other loans and advances and miscellaneous accounts of the Reserve Bank, and balancing item (largely due to the different timing basis used).

(B) Defined as movements in the Reserve Bank's holdings of gold and foreign exchange adjusted to exclude government budgetary and financing transactions overseas and valuation effects arising from changes in foreign currency value of these assets and exchange rate variations.

(C) Defined as holdings by the public of notes and coin plus deposits by the public with banks.

### **MONEY FROM OVERSEAS**

Mention has already been made of the effect of changes in the central bank's holdings of government securities which reflect the Government's budgeting policy and open-market operations. The remaining important source of money which influences the Reserve Bank's assets, and consequently the bank's ability to create credit, is that which flows in from overseas. The foreign exchange regulations of the Banking Act require all foreign exchange receipts to be surrendered to the Reserve Bank and converted into Australian dollars.

The inflow of money from overseas into Australia as a result of private transactions increases the Reserve Bank's holdings of gold and foreign exchange. Such an increase will, other things being equal, boost the cash balances of the public and the banking system. A decline in overseas reserves would have the opposite impact and reduce the volume of money.

Throughout most of the post-war period Australia depended on a strong private capital inflow which, together with export receipts, offset high import demand and a recurrent deficit on invisible trade transactions. Consequently money supply growth was boosted. As the table indicates, the contribution to money supply from private sector foreign exchange transactions fell away sharply during 1973/74 and has so far shown no sign of recovering its former pre-eminence as a factor in money creation. The initial decline in private overseas transactions as a source of money resulted from the marked turnaround in private capital flows. More recently, however, monetary expansion has been inhibited by slower growth in export earnings and a steadily increasing deficit on invisible transactions, so that domestic credit expansion has from time to time outstripped the growth in M3, the most commonly used definition of the money supply.

### **EFFECTS OF CONTROLS OVER THE SOURCES OF MONEY**

The Government's attempts to control the factors which influence money growth form an integral part of its anti-inflationary strategy. Growth rates for M3 of 8% to 10% were adopted for 1977/78 and the lower end of the target was achieved. An even lower target of between 6% and 8% has been set for the current financial year.

The inflation rate as measured by the consumer price index slowed down markedly in 1977/78. The links between money supply growth and such economic factors as prices, production, employment and the balance of payments remain tenuous and controversial. Also it is not only the officially recognized creators of money which need to be considered in assessing the impact of monetary regulations, for the published volume of money can give a misleading impression of the total liquidity available to the community. For instance, if bank interest rates subject to control are kept down, it could

encourage a switch from bank deposits to other types of financial institutions not subject to interest rate restrictions, such as building societies or finance companies. Like the banks, these intermediaries can issue claims which, while not recognized as money, are generally treated by the holders as liquid assets. Thus when a tight rein is being kept on rate of growth in the volume of money, these institutions have the capacity to speed up the rate at which money circulates. Post-war evidence in Australia supports this point. Direct controls over the creation of money were imposed on the banking system, limiting its growth. The inability of banks to meet demand for funds in an expanding economy fostered the proliferation and rapid growth of a wide range of usually more costly financial institutions.

More recently the greater dependence on market oriented controls, such as open market operations, appears to have dampened the ability of non-bank financial intermediaries to act in a fashion contrary to the thrust of monetary policy. Control of non-bank financial institutions has been assisted by the willingness of the Reserve Bank and the intermediaries to discuss monetary objectives. This technique of moral suasion by the Reserve Bank has contained lending by the non-bank financial institutions while the Government has concurrently slowed down the growth in the volume of money. Moreover, synchronization of lending policies of all major financial intermediaries is likely to prove much more effective in controlling liquidity pressures when price stability is threatened than were the more selective and direct controls imposed in the past.

(End of article from 'Bank of New South Wales Review')

. . . . .

## Part 2 - FOR AND AGAINST

by J. D. Malan

Upon analysis, the article 'SOURCES OF MONEY' provides significant evidence to support the important, though often challenged, fact that banks do create money. It also discloses evidence which questions the level of expertise of at least some bank officers, in particular the unnamed author of the article.

There is no doubt that many people believe they have suffered because of what they perceive as unreasonable actions of banks, without really understanding how or why the banks act as they do. The following commentary should provide food for thought for and against some commonly held, but sometimes erroneous, beliefs about how the banking system operates and what its role in society should be.

Although the author of the article is not acknowledged in the original publication, it may be assumed that it was written with the knowledge and approval of responsible officials of the Bank of New South Wales (now Westpac Bank). It therefore provides authentic evidence of several aspects of money which, even today in 1991, are denied by businessmen, politicians, economists and bankers.

The first point to note is that the author, although referring to the historical commodity value of money, does not claim, as many do today, that money is still a commodity.

The many references to money being created by the banks are summed up in the statement (page 2) 'Today in Australia, as in most other modern economies, all money is a debt of the banking system'. However, the footnote to that quotation is incorrect because coins, and also notes, only reach the community in

exchange for a corresponding reduction of the balance in an existing bank account. This means that the statement quoted above is correct, but only if the footnote is ignored.

The fact that the footnote referred to above is not correct is supported by the statement on page 7 relating to the depositing of currency (coins and notes) into a bank account. The writer correctly states that such an action, and, by implication, the reverse process of withdrawing from a bank account, does not change the amount of money available to the community. This fact also supports the proposition that coins and notes have no face value while they are in the possession of the banking system - their only value to the banking system is their intrinsic value as manufactured items made of metal, paper or plastic.

Following this line of reasoning, the author's statement (page 8) that the banks must limit their creation of money according to the amount of coins and notes, or currency, in their possession, is equivalent to saying that the limitation is based on the availability of simple commodities of relatively low intrinsic value which may be readily manufactured in any desired quantity.

Since the creation of money by the banking system occurs only if their customers intend to use it to purchase some form of real wealth which they know is available or can be produced, it is illogical if the amount of money which can be lent in this way is based on the currently held quantity of relatively worthless pieces of metal, paper or plastic. This is stated again on page 9 where there is another reference to the banks' holdings of 'cash' in such a way as to imply that it is regarded as being worth its face value. It would appear that the author is unclear on this vital point and is unaware that it has been established by a court ruling that coins and notes have no face value while in the possession of the banking system (See NOTE on page 20).

A most important aspect of this question of the creation or cancellation of money, by the banking system or any other appropriate authority, is an understanding of how the correct quantity should be decided. Since the only references to this subject are those quoted above, it must be assumed that the author was not aware of any other possible basis for calculating the correct amount, apparently ignoring the fact that it should be related to changes in the value of the community's real wealth. Any other basis for calculating the amount of money to be created or cancelled makes it impossible to maintain any recognizable relationship between the total amount of money available to the community as a whole and the real wealth it is supposed to represent.

The article 'SOURCES OF MONEY' does not make any reference to the cancellation of money, but it can reasonably be inferred that the process of cancellation occurs when bank loans are repaid since the author correctly explains that granting the loan creates money.

Although the question of interest on loans is not fully dealt with in the foregoing article, money created by the banks (which, as stated, comprises all the money available to the community) always passes from the banks to the community as an interest bearing loan. Irrespective of the rate of interest, the only source of money with which to pay that interest must, according to the author's own statement, be another bank loan. It is therefore mathematically impossible to repay all bank loans at the same time. In other words total community debt must continuously increase. This fact is confirmed by simple observation of such phenomena as continuous inflation, steadily increasing taxation and the increasing numbers of bankruptcies and the failures of businesses of all sizes from the smallest to the largest.

Another topic dealt with in the foregoing article is the question of 'money from overseas' (page 11).

Two statements must be considered together to see their full meaning. These are 'an inflow of money from overseas increases the Reserve Bank's holdings of gold and foreign exchange' and, 'boosts the cash balances of the public and the banking system'. That both these effects are the result of the same transaction is most important.

If the equivalent of one Australian dollar is received from another country and is handed to the Reserve Bank in exchange for one Australian dollar (ignoring any possible fee which may be charged for the service), according to this statement the Reserve Bank then has the equivalent of one Australian dollar in the currency of the other country while someone in Australia also has one extra dollar. It would therefore appear that although the equivalent of the Australian dollar has merely changed hands in the other country, a new Australian dollar has been created here. That such is in fact the case is confirmed by independent correspondence with the Reserve Bank.

Early in the article the author refers to money as 'the means to purchase goods' (page 1), thereby acknowledging that there is, or at least should be, a recognizable relationship between the amount of money available to a community and the price of the real wealth it is intended to purchase. Such a relationship is clearly the only basis on which a community can have confidence in their money, specially because the currency, coins and notes, have little or no intrinsic value.

This need to maintain a recognizable relationship between money and real wealth should be considered in conjunction with the several references in the article to ways in which Governments and banks can and do vary the amount of money available to a community. But there is no mention of real wealth or of how the total of real wealth may change, other than an implication that

exports and imports are associated with at least some 'foreign exchange transactions'.

Under the heading 'MONEY FROM OVERSEAS' (page 11) there are several references to 'foreign exchange' transactions of various types but with the overall provision that any receipts resulting from such transactions must be 'converted' to Australian dollars (page 11). How does the conversion process function? As stated above the foreign money remains in the hands of the Reserve Bank as a credit with a bank in the foreign country, while the equivalent in Australian dollars is created and becomes a credit to the Australian participant in the transaction. By inference the reverse occurs when the transaction involves a payment to an overseas creditor.

Considering any one such transaction involving an export or import of goods which could rightly be included in a list of Australia's real wealth (e.g. a shipload of sugar which was a real asset before it was exported or an aeroplane which would be a real asset after it was imported) it is vitally important to note that while the exported goods leave Australia and are therefore a net loss of real wealth, the transaction results in an increase in Australia's money supply. The opposite occurs with imports.

In the case of the import of the aeroplane, Australia's real wealth is increased by the introduction of the new plane, but there is a corresponding reduction in the supply of money available to the community as a whole. Demands by the airline, through fares charged, for reimbursement of the cost of the aeroplane means that the community is being asked to pay for the aeroplane twice - once by surrendering the original purchase price and again in the fares charged to fly in it. In the second instance, however, they have been deprived of the money with which to meet the demand, resulting in an increase in indebtedness to the banking

system simply because there is no other source of money with which to meet the demand for the additional part of the fares.

If an import and an export exactly match in value, there is no net change in either the total of real wealth in the country or of the amount of money available to the community and the two transactions can be regarded as pure barter as far as the community as a whole is concerned. In all other cases, however, the financial system cannot be correct both before and after the transaction. It is this inability to maintain a relationship between money and real things, and the associated insistence that exports must exceed imports, which gives rise to much of the financial chaos of today. It also is the surest way of developing international tensions, the only outcome of which is war.

### CONCLUSION

The article 'SOURCES OF MONEY' establishes beyond doubt that the banking system is the community's only real source of money; that money only reaches the community as a debt to the banking system; and that total debt can never be repaid. It also leaves some doubt about at least one other major question - the level of expertise of bank officials, typically the author of the article.

If the points raised in this commentary were not understood by the author of the article, and that level of expertise is representative of other bank officials, it is difficult to comprehend how the banking system could become so well organised and united in pursuit of a policy so poorly understood. On the other hand, if the author did understand the points raised it becomes a question of why the article includes so many apparent contradictions.

The reader must assess the evidence and attempt

to decide if the banking system is being sufficiently honest in its dealings with the general community. It is also important to understand that, although those outside the banking system need not be familiar with the details of banking processes and techniques, it is vital to appreciate the fact that no matter how efficient the banking system may be as a business enterprise, if it operates in defiance of sound principles it cannot serve the best interests of the community.

It is up to the reader to decide what action can and should be taken to correct the manifestly serious errors here revealed.

\* \* \* \* \*

NOTE: In the case of the Bank of Portugal v Waterlow and Sons Ltd before the House of Lords and Privy Council (H.L.(E.) 28th April 1932) the judgement included the following:

"A bank note in the hands of the bank . . is just a piece of stationery of paper worth. One test is to see how the notes are to be replaced. [Another] party would have to pay the face value either in currency or services. The bank could replace the notes from their stock at the cost of the printer's bill. If the notes were burnt while in the hands of the bank, they would lose nothing; but the [other] party could not replace the notes except at the cost of the face value".

**RECOMMENDED READING:**

*'The Creation and Control of Money'*

*'Freedom From Debt'* by J. D. Malan

*'Money and the Price System'* by C. H. Douglas

*'The Money Trick'*

*'The Monopoly of Credit'* by C. H. Douglas

*'Natural Cost and the Ownership of Money'* by J. D. Malan

*'The Use of Money'* by C. H. Douglas

These and other books on similar subjects available from:

Heritage Bookshop, 145 Russell Street, MELBOURNE, Victoria, 3000

Book Mailing Service,  
P. O. Box 93, BORONIA PARK, New South Wales, 2111

Heritage Bookshop, 2nd Floor, Princes Building,  
24 Waymouth Street, ADELAIDE, South Australia, 5000

Book Mailing Service, P. O. Box 1035,  
Midland, WESTERN AUSTRALIA, 6056

or

The Conservative Bookshop,  
2nd Floor, McConaghy House,  
460 Ann Street,  
BRISBANE, 4000

(Typeset using the 'Wordpal' Text Processing System)