Money, Mysteries, Myths and Banking

Compiled by
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A study on the history of money will quickly reveal that over centuries, money has been accepted in many different forms. It has been gold, silver, leather discs, shells, and in early Australian history it was rum. In today's modern world it takes two forms. One is what is known as legal tender, i.e., currency, notes and coins, and the other is bank credit that is used as money when people write cheques.

The latter is extremely important to understand because it is in the area of the use of cheques that people are usually at a loss to accept that it is purely and simply through the system of granting loans or overdrafts that new money is created. To put it another way, money is created by creating a debt.

As the principal banker for the Australian Government, the Reserve Bank in one of its number of activities prints and manages the note issue. As agent for the Commonwealth, the Reserve Bank distributes coins, which are produced by the Australian Government mint. The total value of notes on issue (coins are so small they are not mentioned) circulating as part of the total money supply as at 30 June 1999 was $23 billion. In June 2007 it was $38 billion.[1]

For the purpose of simplicity we will use the Reserve Bank's recognition of what they refer to as Money Aggregates or total money under the term of M3. We need not go into detail as to what this means except to repeat that it is regarded as the total amount of money in the community. At the end of June 1999 their figure was, seasonally adjusted, $403 billion. In June 2007 it was $868 billion.[2]

A simple calculation will show that the amount of currency notes in circulation compared to the total money supply represents 5.7%. The other 94.3% is what is referred to as bank created money. If one wishes to disregard the M3 figure we can take the total of deposits with all banks as recorded in the same Reserve Bank Bulletin. The total of deposits at the end of June 1999 was $363 billion. The value of currency notes in circulation represents still about 6.3%.[3]

To make this clearer let us look at it in the following form because deposits in whatever form, i.e., cash balances or securities held in lieu of cash and repayable in cash still represent or are supposed to be represented by money.

	Billion	Billion	
	Total Deposits in Banks	Legal Tender in Currency Notes	% of Notes in money supply
June 1999	$363	$23	6.3 %
June 2007	$952	$38	4.0 %

Total amount of legal tender money in 1999 created by the Reserve Bank for the government was 6.3% or $23 billion. In 2007 the currency represented 4% of bank deposits.

Total amount of money created in 1999 by private banking companies was 94.3% or $363 billion. In 2007 the amount of money created by the private banks was $952 billion against a currency total of $38 billion.

While monetary policy seeks to influence the volume of money *of which the public's holdings of currency is a part* [emphasis added] there is no restriction on the amount of currency on issue. (*The Australian Currency Issue,* Reserve Bank Bulletin, 1986). To the layman who has never had instruction in how the money supply is effected it is necessary to provide some basic information.

This information is detailed in a Basic Paper No. 10, 1981 distributed through the Parliament of the Commonwealth of Australia by the Legislative Research Service, Department of the Parliamentary Library.[4]

The following information is extracted from the publication to explain how the system works, without including information not relevant to the purpose of this exercise. The excluded information deals with various aspects of monetary policy and functions and responsibilities of the Reserve Bank. Whilst the figures contained here may be regarded as out of date they are still relevant to the explanation of how fractional banking operates. Even an Encyclopaedia is out of date at the time of printing.

Excerpt from Basic Paper No 10. 1981
The Money Supply and an Outline of the Means Available for its Control
Legislative Research Service
Department of the Parliamentary Library:

> **"III. Creation of Money: Liabilities of the Reserve Bank of Australia**
>
> "Accordingly there are two channels through which new money can be created. These are, respectively, any changes in the factors, which influence the ability of the banking system to create deposits (these are examined later) and those factors, which determine the value of the Reserve Bank's outstanding monetary liabilities. The value of the outstanding monetary liabilities of the Reserve Bank can be increased as a result of the following:
>
> "An inflow of foreign currency (a balance of payments surplus or, more correctly, a surplus resulting from private transactions with overseas residents, which results in a net inflow of foreign currency) The Reserve Bank of Australia stands ready to exchange (say) $US for Australian dollars. (Normally the trading banks act as agents for the Reserve Bank in buying and selling foreign currency). Upon receipt of $US an Australian resident will normally wish to exchange the $US for Australian currency. By exchanging the $US for domestic currency the Reserve Bank creates a new liability of value equal to the assets which it buys, namely the $US. By doing so there is an equal increase in the holding of cash by Australian residents."

At this point it might be worth explaining that the above operation is in the main a book entry transaction. The $US are not sent to Australia in the form of currency. It is simply a swap transaction but in the process there is an increase in the domestic money supply. Details of capital inflow are explained in a later segment.

An appendix prepared by the Legislative Research service includes the following explanation of the ability of banks to create new money mentioned above in III.

The table illustrated is simply an example of how the banking system can create money through the process of lending. In each case the reserve required is based upon Reserve Bank requirements at any particular time. If the reserves required were 4% then the $8 as illustrated would be $4. This simply means that the banking system is able to lend more than if the reserve requirement was higher.

APPENDIX – The Credit Creation Mechanism

Suppose that trading Bank A suddenly finds itself, for the reasons outlined in the text, with free reserves equal to $100. Suppose also that Bank A lends the $100 to a customer wishing to purchase a bicycle. The customer will pay $100 to the bike shop proprietor who in turn can be expected to deposit the $100 with his own trading Bank, Bank B. Suppose further that trading banks are subject to a 8% reserve requirement. Then, after the deposit of $100, Trading Bank B's balance sheet will show the following adjustments:

Trading Bank B

New Liabilities		New Assets	
Deposits	$100	Required Reserves	$ 8
		Free Reserves	$92
Total	$100	Total	$100

After the deposit of $100 (the bank's liability to its depositor) the bank’s holdings of cash increase by $100 however, $8 must be held as reserves.

As a result of events to this point, Bank B has free reserves of $92. Banks are of course, in the business of making loans. By making loans to the value of $92 the balance sheet of Bank B will now be:

Trading Bank B

New Liabilities		New Assets	
Deposits	\$100	Required Reserves	\$8
		Loans	\$92
Total	\$100	Total	\$100

Now the person(s) who borrowed from Bank B will once again spend their borrowed money and it is assumed that the recipient of those funds deposits them in Bank C. In a similar manner to the process already outlined, Bank C's balance sheet will show the following adjustments with required reserves being 8% of new deposits:

Trading Bank C

New Liabilities		New Assets	
Deposits	\$92	Required Reserves	\$7.36
		Free Reserves	\$84.64
Total	\$92	Total	\$92.00

As before, Bank C has \$84.64 to lend. By extending loans of \$84.64 these, by the same process as outlined earlier, will be received by Bank D whose balance sheet will show the following adjustments:

Trading Bank D

New Liabilities		New Assets	
Deposits	\$84.64	Required Reserve	\$6.77
		Free Reserves	\$77.87
Total	\$84.64	Total	\$84.64

This process can continue almost without limit until ultimately when aggregating over all banks, the following change in the combined balance sheet for all banks is obtained:

All Trading Banks

New liabilities		New Assets	
Deposits	$1250	Required Reserves	$100
		Loans	$1150
Total	$1250	Total	$1250

Basically this procedure demonstrates that loans become deposits, 8% of deposits are required as reserves, 92% is available for loans, which become deposits and so on. Eventually, new deposits are equal to a multiple of the new reserves initially made available, that multiple being the reciprocal of the reserve ratio. Hence, if the reserve ratio had been 20%, the injection of $100 in new reserves could have supported $500 in new deposits.

On the other hand, if there are no required reserves the banks would be free to create whatever they wished – limited only by their own prudential requirements for day to day trading.

It should be pointed out that there might be interruptions to the mechanisms just described. People may wish to hold some of their funds as cash rather than deposits in the banking system. Likewise, the banks may wish to hold some free reserves above the required level and which therefore are not made available to would be borrowers.

However, more complex versions of the credit creation mechanism which take account of these factors still show the same implications, namely that new bank reserves will support a multiplied increase in bank deposits.[5]

The question of reserves is entirely academic now inasmuch as banks are no longer required to hold such reserves. As a matter of fact all of the so-called controls, the LGS, Capital Assets, Prime Assets, Statutory Deposits, etc., were in reality a smoke screen to create the myth that banks only lent their depositors money, which of course was untrue.

Commonwealth Bank of Australia

Under the Commonwealth Bank Act, legislation was enacted by the then Labor Government establishing the Commonwealth Bank in 1911. The Bank was established with the power to raise a capital of $2 million (£1 million) by the sale of debentures based on the security of the national credit. Profits were to be equally divided into two funds – a reserve fund, to meet any liabilities incurred by the Bank, and a redemption fund, to redeem the debentures or other stock issued by the Bank in order to obtain its capital; afterwards, this half of the profits could be used to reduce the National Debt.

General banking business was commenced by the bank on January 20, 1913, simultaneously at the following points: Head office, Sydney, and branches at Canberra, Melbourne, Brisbane, Townsville, Adelaide, Perth, Hobart and London. The bank was then fully established.

It might be worth considering at this point that the Commonwealth Bank did provide $700 million (£350 million) to finance the 1914-18 war. It also provided the major portion of the finance for the construction of the Transcontinental Railway, which was completed without any debt or interest charges. (See *Hansard*, Vol. 129, P. 1930).

It did a lot more. It financed jam and fruit pools, it provided $8 million (£4 million) for Australian homes, plus finance for local government bodies, construction of roads, tramways, harbours, gasworks, and electric power plants.

In June, 1924, the Bruce-Page Government brought in a Bill to amend the Commonwealth Bank Act by taking the control of the Commonwealth Bank out of the hands of the new Governor, and placing it in the hands of a directorate consisting of the Governor of the Bank, the Secretary of the Treasury, and six persons actively engaged in agriculture, commerce, finance, and industry.

From this time on it was a matter of gradual undermining the operation of what was the People's Bank, to one, which is today a private corporation.

It is no longer a Peoples' Bank. The Commonwealth Bank gradually assumed the role of a Central Bank and in 1959 this role was terminated with the introduction of the Reserve Bank Act of 1959, which saw the establishment of The Reserve Bank. Historical revisionists tend to confuse the action of the two banks. During World War 11 the Commonwealth Bank was given emergency powers to administer exchange controls and mobilise Australia's gold and overseas funds. It was also given wide powers of control over the banking system including authority to determine advance policy and interest rates and to require the private banks to lodge funds with it in Special Accounts.

The central banking responsibilities and powers which had evolved were consolidated in 1945 in the Commonwealth Bank Act and the Banking Act and in *separated form* are now in the Reserve Bank Act 1959 and the Bank Act 1959.

This last action virtually concluded the demise of the Commonwealth Bank as the People's Bank and a further nail was put into the coffin when the Commonwealth Government decided to sell off part of the Commonwealth Bank. The Prospectus was dated 5 July, 1991, and was issued on that day, and was also lodged with and registered by the Australian Securities Commission on the same day. This was preceded by The Commonwealth Banks Restructuring Act 1990, which, among other things amended the 1959 Act to provide for the conversion of the Commonwealth into a public company.

It is interesting to note the various Acts 1953, 1984, and 1987 as well as that of 1990. For example, one of the requirements of the 1984 Act was to lower the percentage of net profits to be paid to the Commonwealth of Australia in the form of a dividend.[6] This was obviously mentioned in the Prospectus to draw attention to the dividends, which could be expected, to a willing investor.

The Investigating Accountants' Report which incorporated certain adjustments made for the purpose of comparability differed from the figures shown in the Discussion of Operating Results that show the Operating profit and extraordinary items in millions after income tax attributable to the group.[7]

Million

1986	$364.6
1987	$321.7
1988	$452.9
1989	$557.8
1990	$524.8

In the four years from 1986 to 1990 the profit increase was $160 million. In the 17 years between 1990 and 2007 the profit increased by $4.07 billion.

2007	$4.6 Billion

Some may argue that because it is privatized that it is much more efficient and therefore reaping greater profits for the shareholders who now own shares. If it can be achieved under privatization it could have been achieved as it was originally established and the profits could have been distributed to the original shareholders – the people of Australia.

Without going into the intricacies of other figures contained in the accounts it is sufficient to show the trend and the extent of the change from 1912. The thing to keep in mind is not only was the Commonwealth Bank making profits but this is different from the actions of the Bank when it was originally established in 1912 up to 1924 and it made finance available through the very operation of credit creation.

One may well ask the question, whether the change in the operations of the Commonwealth Bank was due to political ignorance in the field of finance, or whether there has been a deliberate undermining of its potential through a policy generated outside the political sphere. It is ironical to hear that the reason for the privatisation of the Commonwealth Bank was to give the public the opportunity to have a share in it.

Yet, if we are to believe that the Commonwealth Government is an administrative body acting on behalf of the Australian people and owned the Commonwealth Bank, then the Bank was already owned by the people. Included in the prospectus of 1991[8] was a letter from the Commonwealth Treasurer, J. C. Kerin, M.P., which said in part:

> "The Government is proud of the record of the Commonwealth Bank as a wholly owned Commonwealth Government business enterprise and looks forward to the Commonwealth of Australia continuing as a major shareholder. The Commonwealth Banks Restructuring Act 1990 requires the Government to maintain a shareholding of at least 70 per cent of the total voting shares issued by the bank. The Government has no plans to reverse or modify this position".

Like Bruce, Page, Menzies, Hawke, and Keating, Mr. Kerin has passed into history. Mr. Howard and Mr. Costello will go down in history as the two who completed the coffin. In 1993 the Commonwealth Banks Amendments Act provided the means whereby the Commonwealth Government could reduce its share holding in the Commonwealth with the second issue of shares. The position then allowed the Commonwealth Government to hold only a 50.1 % shareholding.[9]

The final chapter in this saga has been written. The final nail has been driven into the coffin and any reference to a living "Peoples" Bank has passed a use by date. It is dead and buried with the final action by the Keating government and completed under the Howard government.

The balance of 50.1%, like the 100% to 70% to 50.01%, has now gone to 0%. So much for the truth.

These concluding actions conclude the on-going story of removing any semblance of a Peoples' Bank, which was established to provide a benefit for the people of Australia. This story commenced in 1912 and finishes in 1996.

The beginning of the end was related in a lecture delivered in 1931 and continued in pamphlet form being updated by its author D. J. Amos, F.C.I.S. In his preface to the twelfth edition of the *Story of the Commonwealth Bank* in February, 1948 he said:

> "In the present (twelfth) edition, the story is brought to its final conclusion, in the surrender by Australia of its control over its own currency to the International Monetary Fund and Bank. In future (the Commonwealth Bank being again reduced to servitude) these two great foreign institutions will be free to deal with our people and our living standards as they see fit".

As we know, that was not the final conclusion but only the beginning of the final conclusion. The stage had been set for complete foreign control but the dismantling of the Commonwealth Bank had to be definitive to ensure that it could not be raised like Lazarus. The sale of the remainder of the Commonwealth Bank has guaranteed this.

The Story of the Commonwealth Bank as told by Mr. Amos should be read for a full and detailed account of the transition from a Peoples' Bank to just another private bank. This leaves no doubt as to the control that is exerted on governments, by and through the efforts, of persons who are serving interests other than those of the people whom governments are elected to serve.

The gradual removal from what was once described as the only true Peoples' Bank in the world to what it is today is one of the great tragedies that can only be assessed as incompetence on the part of politicians or as a deliberate plan to remove an obstacle to the financiers who control the policy of the banking systems in the world.

The Reserve Bank

The Reserve Bank published a booklet called, Reserve Bank of Australia – Functions and Operations. In this publication it states in relation to its history:

> "In 1911, legislation established the Commonwealth Bank of Australia.

"Originally, the main functions of this bank were to carry on the general business of banking and the business as a savings bank. Central banking functions developed gradually until the Second World War when wide powers were conferred in areas such as exchange control and the administration of monetary and banking policy. The functions and powers were formalised in 1945 in the Commonwealth Bank Act and the Banking Act. Legislation in 1959 preserved the original corporate body under the new name of the Reserve Bank of Australia to carry on the central banking functions of the Commonwealth Bank. The Reserve Bank Act took effect from 14 January 1960; since that date, the Reserve Bank has been Australia's central bank with its own Board, governor and staff.

"With the elected Labor Government under Mr. Hawke the deregulation of the banking system saw changes that have escaped the notice of many people. Prior arrangements with respect to the creation of money by private banking institutions encompassed an agreement that banks would not allow their reserves to drop below 18%.

"Should this occur the banks were obliged to borrow from the Reserve Bank, usually at a high rate of interest to bring their reserves back into line. The controls that then existed on the amount of money creation involved the maintaining of liquid assets in the form of legal tender and government securities plus a deposit with the Reserve bank entitled Statutory Reserve Deposits. The liquid assets ratio, i.e., liquid assets held against the deposit liabilities was usually maintained at about 20%. This in effect allowed banks to create money at a rate of $5 for every extra $1 increase in their liquid assets.

"In 1984/5 discussions with the banks resulted in a change, which came into effect on 29 May 1985. This change was from the LGS Convention to a 'Prime Assets Ratio'. This change meant a lowering of liquid assets, which in turn meant banks, could create more money against lower holdings of liquid assets, i.e., legal tender and government securities that could be quickly converted into legal tender."

The language used by the Reserve Bank in many of its notices and Press Releases alternated between the purposes for the change, such as supervision, prudential management, monetary policy.

The following is an extract from Press Release 24 June, 1985 – Reserve Bank of Australia:

> "TRADING BANK PRIME ASSETS RATIO
>
> "The Reserve Bank has informed trading banks that they may reduce the minimum volume of 'prime assets' that they hold under the transition from the LGS Convention to the 'Prime Assets Ratio' (PAR) arrangements which came into effect on 29 May, 1985.
>
> "When the PAR arrangements are fully operating, each trading bank will hold at all times at least *12 per cent* [emphasis added to draw attention to the reduction from previous requirements of 18% under the LGS convention] of its total liabilities (other than shareholders' funds) in prescribed high quality, readily liquidated assets.
>
> "At 29 May, banks' holdings of these assets, in fact *exceeded* [our emphasis] 12 per cent and banks undertook not to let holdings drop below the LGS requirement at 29 May without the agreement of the Reserve Bank. The intention is that the *reduction* [our emphasis] take place over time, as conditions permit.
>
> "It has been decided, therefore, to allow trading banks to reduce the excess level of their prime assets by an aggregate $140 million on Friday, 28 June. This amount is equal to about 16 per cent of the amount by which present required holdings exceed the base figure of 12 per cent of total liabilities, or about 0.2 per cent of trading bank liabilities.
>
> "The change will mean that banks will be required to hold a slightly smaller proportion of their total assets as prime assets. The Reserve bank appreciates that the reduction is, in effect, a freeing of a quantum of liquid assets held by banks and this could have consequences on the market".[10]

In simple terms what they were saying was that they were allowing the banks to create more money but they would have to watch the effect on inflation, which could result, and therefore it had to be done in small doses.

An attachment with explanatory notes to their introduction of the Prime Assets Ratio was that, "This would be primarily for prudential purposes whereas the LGS ratio served mainly monetary policy ends". The details of the whole Explanatory Notes concentrated on the "Supervision of the Adequacy of Liquidity of Trading Banks". Whether it was for supervision of liquidity, or prudential management by the banks, it is of little consequence. What is important is that the private banks were being provided the means to increase their ability to create more money.

An interesting occurrence was the conflicting comments from the Reserve Bank concerning the change. In a Press Release 19 February, 1986, the Bank said, ". . . as a carryover from the LGS convention, which the PAR *replaces* [emphasis added]." In the previous mentioned Explanatory Notes they also said, "The Reserve Bank wishes banks to continue to hold a substantial tranche of high quality liquefiable assets (prime assets) after the LGS convention has been terminated".

In response to a letter to the Reserve Bank querying the figures in the *Reserve Bank Bulletin* which did not calculate according to their own information, the advice received said, "It is not possible to verify the PAR ratios in table C10 of the *Bulletin* because data on shareholders funds, which are collected on a confidential basis by the Reserve Bank are not published".

Compare this also with the explanation of the Reserve Bank on what comprised the prime assets ratio:

> "After consultation with trading banks, the Reserve Bank has decided that a prime assets ratio should replace the present LGS arrangements.

"The numerator of this ratio will comprise:

"Notes and coin
Balances with the reserve Bank Treasury Notes
Other Commonwealth Government securities
Loans to authorised money market dealers secured against
Commonwealth Government Securities

"These assets correspond with the present definition of LGS assets. The denominator will comprise total liabilities in Australian currency (other than shareholders' funds) within Australia".

A press release 28 September, 1989 saw a further change in requirements whereby the Statutory Reserve Deposit which was set at up to 3 percent of a trading bank's deposits.[11]

"Last year agreement was reached with the banks to phase out statutory reserve deposits (SRDs) and to hold in their stead non-callable deposits (NCDs) with the Reserve Bank". The *Reserve Bank Bulletin* March, 1998 shows that at the end of January, 1998 non-callable deposits stood at $4,511 million and total deposits at $328,945 million. This represents 1.2 per cent.

In response to a further query to the Reserve Bank, an extract of the following answer was elicited:

"You may also be aware that the Bank has not replaced the LGS requirement with the PAR requirement. The latter is not an instrument of monetary policy *but relates to the Bank's prudential supervision of the banking system* [emphasis added.][12]

There have been many changes in the operation of the banking system as required by the Reserve Bank. These changes have seen the emphasis from the Liquid and Government Securities (LGS) Ratio and then operating gentleman's agreement not to let this ratio drop below 18%, which in effect restricted the banks to a ratio of lending against increases in reserves to approximately 5 to 1.

That is for every $1 increase in their reserves they could lend out $5 out of thin air. This ratio was based on the amount of cash and government securities (LGS) against Deposits (Liabilities). In 2007 we have reached the situation where there are no reserves the banking system can create practically 100 %.

That is for every $1 increase in their cash holdings they can create just about $100. All of this of course comes into being as a debt through the lending process.

Also in operation was a Statutory Reserve Deposit requirement where banks had to have a certain proportion of their cash on deposit with the Reserve Bank. This was a measure to control the flow and quantity of money being created by the banks. This has long been abandoned.

The introduction of the Prime Assets Ratio saw a change from the LGS deposit liabilities to assets. This change was in effect Prime Assets that were basically cash and government securities, and loans to authorised money market dealers, which in turn were secured against Commonwealth Government Securities. Thus prime Assets corresponded with the then (LGS) assets.

The denominator for the Prime Assets Ratio (PAR) was extended beyond deposit liabilities to include all liabilities within Australia in Australian currency other than shareholders funds. The denominator of the LGS ratio was deposits repayable in Australia.

Initially the PAR was set at 12 per cent. Of course much of what was provided in explanation was the necessity for prudential control of the banks but nevertheless it did provide an opportunity for banks to increase their money creation ability. The Prime Assets Ratio at November as revealed in the Reserve Bank Bulletin January 1999 was 5.6 per cent.

As stated in the Reserve Bank's Report some major changes were effected in 1997/98. These structural changes included two major ones; the creation of the Australian Prudential Regulation Authority (APRA) and the full implementation of the real-time gross settlement (RTGS) system. Those interested can follow this up at their leisure. However it is basically a move towards privatisation. On 1 July 1998 the note printing became the responsibility of Note printing Authority (NPA), which was formally corporatised as a wholly owned subsidiary of the Reserve Bank. As explained by the Reserve Bank (this), "further emphasised its commercial autonomy. During the year NPA won an important new export order to print the entire note issue of New Zealand on polymer".

It is probable that some people in the Reserve Bank and the government may regard this as mind-blowing stuff, but how long will it be before NPA is sold off. Not that it matters much as the value of notes on issue at November 1998 was $4.089 million compared to total deposits in all banks repayable in Australia at November 1998 was $351,346 million. This represents a ratio of notes to deposits at approximately 1.16 per cent, or for every dollar note created by the Reserve Bank, the private banks created approximately $86.

"Under the new regulatory structure, the Reserve Bank no longer has an obligation to protect the interests of depositors and it will not supervise any individual transactions". (*Reserve Bank Report,* 1998).

In keeping with the continual trend of freedom for the banking industry the following media release adds a further dimension to that freedom.

Media Releases

Banks' Liquidity Policies and the Prime Assets Requirement Monday, 16 August 1999, No. 99.14— For Immediate Release

> "Effective today, banks will no longer be required to observe the Prime Assets Requirement (PAR). Each bank will manage its liquidity according to policies agreed individually with APRA.

> "Under PAR, banks were required to hold a minimum level of high quality liquid assets, in the form of Commonwealth Government securities, State Government securities, notes and coins, and balances with the Reserve Bank. The requirement was introduced to help banks cope with emergency demands on their liquidity. The ratio had been reduced in stages, reflecting the reduced availability of Government securities, and had been 3 per cent since June 1997. It was noted at the time of the last reduction that new prudential guidelines would be put in place to deal with liquidity management by banks.
>
> "A new Prudential Statement on Liquidity Management was issued in April 1998. It places greater emphasis on banks' internal management practices and requires banks to have systems in place to manage liquidity under different scenarios, including normal day-to-day operations and a bank-specific ("name") crisis. In particular, banks must be able to demonstrate that they would have sufficient liquidity to keep operating for at least five business days under a 'name' crisis.
>
> "Banks can use a range of strategies to manage liquidity, including holding liquid assets, setting limits on maturity mismatches, diversifying liability sources and developing asset sale strategies.
>
> "It was foreshadowed at the time of release of the new prudential statement that PAR would be removed when each bank's liquidity management policies had been agreed individually with APRA."

Meanwhile the creation of the nation's money continues to be created by private banks.

Trading Banks

Trading banks' ability to create the major portion of the nation's money supply is not even a question for debate. That they do can be verified by reference to any major textbook on economics and statements by many other reputable authorities.

The money supply as determined by the Reserve Bank's own figures under their term of M3 has increased from $403 billion in June 1999 to $868 billion in January 2007.[13] This is an increase of $465 billion in a period of approximately 416 weeks or an average of approximately $1 billion per week or 1 thousand million in round figures. The increase in legal tender, i.e., currency notes on issue, over the same period is $23 billion in June 1999 to $38 billion in June 2007.[14] This is a total increase of $15 billion or an average of approximately $36 million per week. The difference of $964 million per week, or $4,177 million per month was created by the private banks in the process of lending out as a debt and charging interest on the money created out of nothing.

Currency has increased from $23 billion to $38 billion from 1999 to 2007 or $15 billion over 8 years. This is an average increase per year of $1.875 billion. At the same time M3 has increased from $403 billion to $868 billion or an average increase per year of $5.8 billion.

There is not only a moral question involved but also a philosophical question. To whom does the credit of a nation belong – private banking institutions or the people?

State Banking

Part V. Powers of Parliament in the Constitution of the Commonwealth of Australia in Section 51. states:

The parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to:

(xiii) Banking, other than State banking; also State banking extending beyond the limits of the State concerned, the incorporation of banks, and the issue of paper money.[15]

> "State banks are not subject to the provisions in the Banking Act relating to the carrying on of banking business. State banks are not subject to the powers of the Reserve Bank in their domestic operations, as these powers derive from Commonwealth legislation".[16]

The Queensland Parliament does have a legal and Constitutional power to establish a State Bank.

If the Constitution is not clear enough for some to interpret, it is worth noting the affirmation by the High Court.

The High Court of Australia in the State Banking Case, in "City of Melbourne v Commonwealth of Australia" (1947) 74 C.L.R., pp. 77-78, wherein the High Court stated:

> "The exception of state banking means that a general law of the Commonwealth governing the business of banking cannot affect the operations of a State Bank within the State concerned. The express inclusion in the federal legislative power of State banking extending beyond the limits of the State concerned gives added point to the exception. For it shows that State banking was contemplated as a possible function of government which should be excluded from the operation of federal law within the territorial limits of the authority of the government concerned".

What would be the purpose of establishing a State Bank? Moreover, the question could be asked if there exists any legal-constitutional financial power to prevent such a Queensland State Bank from using the established "credit creating-advancement" techniques, of the Australian Reserve Bank and Private Trading Banks. Could such techniques be used for the purpose of financing Intra-State and Local government either with interest-free Loans and grants, or non-repayable Loans, etc., thereby completely eliminating the necessity of State imposed taxes?

The problem that exists, is not whether this can be achieved but whether people understand that it can. Because of the lack of education in the area of finance and money and its creation people have come to believe that banks can only lend out the money deposited with them. This is patently and legally untrue, and can be verified by reference to economic textbooks and many other statements by reputable sources.

Verifiable References and Statements

1. One time Governor of the Commonwealth Bank in an address to the then E. S. & A. Bank Limited Research Address at the Queensland University, on 15th September 1954, Dr. H. C. "Nugget" Coombs, stated unequivocally on page 4 of that printed Address:

"Any given piece of expenditure can be financed from one of four sources (or a combination of those sources)— New savings, Accumulated reserves, Money borrowed other than [from] a bank, Money borrowed from a bank.

"The last source differs from the first three because when a bank lends money it passes into the hands of the person who borrows it without anybody having less. Whenever a bank lends money there is, therefore, an increase in the total amount of money available".

2. The Judicial Committee of the Privy Council in its decisions in the Bank Nationalisation Case gave an authoritative definition. It appears on pp. 632-633 of the 79th Volume of the *Commonwealth Law Reports* on Privy Council decisions, and it reads:

"The business of banking, consisting of the creation and transfer of credit, and making loans, the purchase and disposal of investments and other kindred activities is a part of the trade, commerce and intercourse of a modern society . . .".

Quite clearly the creation and transfer of credit means that banks can and do create credit and in the process of transferring this credit, it is used as money. In other words banks create their own form of money over and above the legal money printed and coined by the Reserve Bank of Australia and the Commonwealth parliament, and lend that Bank created money to approved borrowers.[17]

3. In a booklet *Reserve Bank and the Australian Financial System* by Graeme Thompson, Chief of Financial System Division the author wrote:

"Commercial banks are the creators of money through their deposit liabilities; they are the depository of public savings . . .".[18]

The first part of his statement is true, commercial banks are the creators of money. The second part is an example of the perpetuated myth that they lend out their deposits. Although there is a careful use of words in that he did not say deposits but rather deposit liabilities, the impression given is that the banks only lend from their depositors' money. The depository savings can only come from money that has been created by lending in the first instance.

4. The Economic Research Council, London produced a booklet in 1981 titled *Government Debt and Credit Creation*[19], and although its emphasis was on the British economy the following statement is also relevant to Australia.

> "**The Creation of Credit:** Most of our money today is in the form of credit rather than cash and it is created through the operations of the banking system. It is the method by which this credit money comes into existence, which is worth examination in some detail. Under our present system it comes into existence as an interest-bearing debt and most of the present problems in the monetary sphere arise from this fact. In his book *Economics*, Professor Paul Samuelson explains in detail how 'the banking system as a whole can do what the small bank cannot do; it can expand its loans and investments many times the new reserves of cash created for it'. Or, as the Radcliffe Committee on credit and currency put it, 'the credit creating capacity of the joint stock banks are today their effective credit base; an increase in the amount of liquid assets in the banking system may therefore make possible an increase in the banks' lending to the public'. For many years the banks denied that the banking system could 'create credit', but today there is no shadow of doubt that they can do so as long as there are credit-worthy borrowers requiring loans".

There exists a common belief that the profits of banks come from the difference between the interest they earn on loans and the interest they pay to depositors plus income from other investments. This is patently not correct.

Banks, in making loans of any large nature require some collateral against the loan so that if the borrower defaults the bank can sell the item held as collateral and recover its money.

Whilst this may have provided some support for the bank it does not negate the fact that banks created the money they have lent. In fact, with consumer credit cards and the astronomical debt that has arisen since its inception, it is without any dispute that banks do not receive any collateral to cover those credit card loans. They just create the money.

The truth regarding the profits of the banks which also have risen to astronomical heights, is that the profits consist almost exclusively by creating and issuing credit far in excess of the legal tender that the bank may hold. Any bank which issued credit only in exchange for money has not the slightest possibility of making a profit. It is able to make profits only when credit is issued in exchange for debts which are payable at some time in the future.

5. Probably one of the most quoted statements relating to the Australian situation was that contained in the *Report of the Royal Commission* appointed to inquire into the Monetary and Banking Systems at present in operation in Australia. This Report covered:

CHAPTER 1 – The Australian Economy
CHAPTER 11 –The Monetary and Banking System, 1901-1936
CHAPTER 111 – The Capital Reserves and Profits of the Australian Trading Banks, 1893-1936. Savings and State Banks. Bank Failures.
CHAPTER IV – The Financial System in 1936.

The relevant section appeared under the heading of: "Central Bank Credit":

> "503. The central bank in the Australian system is the Commonwealth Bank of Australia. This bank is a public institution engaged in the discharge of a public trust. As the central bank, its special function is to regulate the volume of credit in the national interest, and its distinctive attribute is its control of the note issue. Within the limits prescribed by law, it has the power to print and issue notes as legal tender money, and every obligation undertaken by the Commonwealth Bank is backed by this power of creating the money with which to discharge it.
>
> "504. Because of this power, the Commonwealth Bank is able to increase the cash of the trading banks in the ways we have pointed out above.
>
> Because of this power, too, the Commonwealth Bank can increase the cash reserves of the trading banks; for example, it can buy securities or other property, it can lend to the government or to others in a variety of ways, and it can even make money available to Governments or to others free of any charge".[20]

One could not expect to find a better authority than The Chairman of the U.S. Federal Reserve Board who in a speech on "Central Banking and Global Finance", January 14, 1997 said:

> "Let me begin with the fundamental observation, that a nation's sovereign credit rating lies at the base of its current fiscal, monetary, and, indirectly, regulatory policy.
>
> "When there is confidence in the integrity of government, monetary authorities – the central bank and the finance ministry – can issue unlimited claims denominated in their own currencies and can guarantee or stand ready to guarantee the obligations of private issuers as they see fit.