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MONETARY POLICY AND FISCAL POLICY (1)

The Question of Credit Creation

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James Robertson is among the growing number of people advocating change in the way non-cash money is created. His paper on "Monetary Policy and Fiscal Policy: The Question of Credit Creation" was published on 27th July in the Report (Vol. II - Evidence, HL Paper 96) of the House of Lords Select Committee which has been examining the work of the Bank of England's Monetary Policy Committee.
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inside this issue

PAGES 57-63
Monetary Policy and Fiscal Policy The Question of Credit Creation

PAGES 64-66
Money in The Ancient World

PAGES 66-67
Towards Social Credit

SUMMARY

This paper discusses
- whether the government could create directly the amount of new credit judged necessary from time to time to increase the money stock without inflationary effects, and
- whether, at the same time, the commercial banking and financial system could be limited to credit-broking and excluded from credit-creating.

It summarises some of the arguments for this, outlines a possible approach to doing it, and touches on some of the implications.

It suggests that making this change could bring important benefits, fiscal and others, and that the repercussions for monetary policy and other aspects of public policy should be manageable without undue difficulty. It also suggests, for further study, a possible way to introduce the change.

It concludes that the feasibility of this change should be examined seriously. Given the professional capability now developed by UK monetary institutions, this should be done before a decision is taken whether or not the UK should join EMU and replace sterling with the euro.

INTRODUCTION

"Government financing policy is fundamentally linked to monetary policy. If the budget deficit could be covered simply by printing money (i.e. at zero interest-rate cost) with no harmful effects on the rest of the economy, it would make sense for the government to use this means. But it is widely accepted that the monetary consequences of such financing would be harmful to the economy." (3)

This paper does not suggest that the government should print money to cover the budget deficit, regardless of how large or small the deficit may be. It accepts that high inflation is harmful. It supports the UK government's decision to make an independent monetary authority operationally responsible for monetary control.

However, it suggests that we ought:
a) to look afresh at the link between government financing policy and monetary policy,
b) to consider if it would make sense to change the present method of issuing new money (creating new credit), and
c) to examine how it might be practicable to do so.

Following the 1998 Bank of England Act, the Bank now has operationally independent responsibility for the conduct of monetary policy. Responsibility for banking supervision (to protect the interests of bank customers and to promote financial stability) has been transferred to the Financial Services Authority. And responsibility for issuing and managing the government's gilt-edged debt (and eventually for the government's day-to-day cash management) has been transferred to a new Debt Management Office under the Treasury. (4) Thus the Bank's attention is now concentrated on monetary policy as never before. Moreover, there has been a marked development in its monetary expertise over the past two decades. This suggests that, if the public interest and the national interest would be served by changing the present method of credit creation, the Bank now has the expert professional capability to advise on the practicalities, and to implement whatever changes are decided.

The present UK government is committed to modernising the country's institutions. The scope for further progress in the field of monetary policy and public finance should be explored before the UK decides whether or not to give up sterling and join the euro – see pp 11-12 below.

THE PRESENT METHOD OF CREDIT CREATION, AND A PROPOSAL FOR CHANGE

At present only a small proportion of the money stock is issued as notes and coins. Government receives "seignorage" revenue from this. The net revenue amounts to the annual increase in the value of notes and coins in circulation minus the cost of producing and putting new ones into circulation and withdrawing old ones. In January 1994 the value of notes and coins in circulation in the UK was £20.5 bn. Five years later, in January 1999 it was £27.7 bn. The increase between January 1998 and January 1999 was £1.3 bn., indicating that the annual net revenue to the government from seignorage is running at about that level. (5)

But more than 95% of the continuing growth of the money stock is "printed" by the commercial banking system and other financial institutions. They put it into circulation as loans to their customers, i.e. as credits issued in the form of interest-bearing debts. (6) In the first quarter of 1994 private sector holdings of broad money (M4) were £543 bn. Five years later, by January 1999, they had risen to £779 bn - an increase of £236 bn. The annual increase from January 1998 to January 1999 was £52.6 bn. This indicates that public revenue foregone from this source – i.e. not collected by the government as seignorage for this increase in the money stock - may be running at an annual level of about £50bn. That would be a significant contribution to total annual government revenue of about £300 bn (£303 bn in 1998 - *Financial Statistics*, March 1999, Table 2.1A).

The change proposed is as follows.

1) The government itself should create the amount of new credit judged necessary from time to time by an independent monetary authority, in order to increase the money stock as required without inflationary effects. The government should "print" it and put it into circulation interest-free as Treasury Credits to public spending programmes.

2) The banking system should no longer put new credit into circulation. In other words, banks (and other financial institutions) should become credit brokers and stop being credit creators.

ARGUMENTS FOR CHANGE

The first argument for the proposed change is that the monetary value of the new credit/money created according to official monetary policy and under official monetary controls should be seen as a "common resource", i.e. a resource created by society. It should be treated as a source of public revenue, as notes and coins now are, not as a source of commercial profit. (7)

"The first argument for the proposed change is that the monetary value of the new credit/money created according to official monetary policy and under official monetary controls should be seen as a 'common resource', i.e. a resource created by society. It should be treated as a source of public revenue, as notes and coins now are, not as a source of commercial profit."

Second, treating additions to the money stock as a source of public revenue will enable governments to increase public spending (as favoured by the traditional Left), or to reduce taxation and public borrowing (as favoured by the traditional Right), or both. At present, by allowing the banking system to create new money/credit instead of creating it directly itself, government has to borrow the money at interest from the banking system. This does not make sense from the point of view of taxpayers and citizens.

Third, issuing most new money/credit in the form of debts, as at present, automatically ensures that the total indebtedness of society rises more or less in step with the money stock. This rising indebtedness has damaging economic, social and environmental consequences. Economically, the growing scale of interest payments throughout the economy adds to the cost of everything, including the necessities of life. This is regressive, in that it bears relatively harder on the poor than on the rich. It also has a sustained inflationary effect. Socially it is perverse, in that it systematically accelerates the transfer of money from poor to rich individuals and localities (and countries) and widens the gap between them. (The poor, who have

less money, have a greater need to borrow it and pay interest, while the rich, who have more money, are better placed to lend it and receive interest.) Environmentally, continually growing financial pressure to earn the money needed to pay off interest on ever-increasing levels of debt speeds up the exploitation of natural resources.

Fourth, using the banking system and bank customers as the channel for putting new money/credit into circulation distorts the economy. It means that the new money is used to support activities to which banks and bank borrowers give priority. Channelling public resources towards particular sections of the economy and particular kinds of economic activity is to subsidise them and discriminate against others. Subsidies should be implemented transparently, as an aspect of public expenditure policy, if and when government judges them to be desirable.

PROPOSED NEW ARRANGEMENTS

A new method of issuing new money/credit into circulation thus appears to be desirable which will meet those four arguments. To summarise,

(1) It should treat as a source of public revenue the value of new money/credit put into circulation.

(2) It should thus enable government to increase public spending, or reduce taxation and public borrowing, or both.

(3) By disconnecting the creation of credit from the creation of debt, it should bring to an end the automatic growth of indebtedness in step with the growth of the money stock.

(4) It should stop channelling financial resources (as a hidden subsidy) towards particular sections of society, and bring to an end the economic distortion this causes.

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<u>The first part of the proposal</u> is that all new money/credit should be directly issued by the government. (8)

It should be issued debt-free. It should consist partly of notes and coins put into circulation as at present via the Bank of England and the commercial banks, with the profit (seignorage) continuing to contribute to public revenue. (9) But the greater part of it, corresponding to the credit currently created by the banking and financial system, should be issued directly by the government in the form of Treasury Credits to government spending programmes. (10) Treasury Credits would not be issued to the banking system to be on-lent to bank customers as interest-bearing loans. (11)

The increases in the money stock created as Treasury Credits should be strictly and clearly limited to the amounts judged necessary from the point of view of monetary control. In order to insulate politicians from political pressures to create too much (inflationary) new money in this way, the amount to be created should be decided at regular intervals by an independent money supply authority – as, at present, the Bank of England's Monetary Policy Committee decides whether interest rates should change. In fact, the Monetary Policy Committee could take on this new function.

<u>The second part of the proposal</u> is that the banks (and other financial institutions) should no longer be allowed to issue new money/credit. How are they to be stopped?

One possible way of stopping them would be to make it obligatory for them to match the liquidity of their liabilities (i.e. their obligations to repay customers' deposits and savings) with the liquidity of their assets (i.e. their claims to recover what is owing to them). In other words, sight deposits, overdraft facilities and credit limits which customers can access immediately would have to be matched by assets which banks, etc., can realise immediately, such as cash and their operational deposits with the central bank; whereas savings deposits and other claims which customers can access only after a period of notice would have to be matched by assets which banks, etc., can realise within the same period. The matching deposits held by banks, etc, with the central bank would be held out of circulation and would earn no interest. A bank would pay into and draw out of its operational deposit account with the central bank the net daily increases and decreases in the total value of its customers' sight deposits. (12)

A transitional problem is discussed in the next section. Two other points should be noted here.

- Confining the commercial banks, etc, to credit broking and excluding them from credit creation would probably lead to clearer distinctions than now exist between the payments services, savings services, and loans services which they offer to their customers. For example, they might need to change the basis on which they now provide overdrafts.

• Under the proposed arrangement, monetary regulation of banks and financial institutions and supervision of their solvency and financial stability would be based on the same reserve requirements. This would contribute to administrative effectiveness, especially now that two different agencies – Bank of England and Financial Services Authority - are responsible for monetary regulation and financial supervision.

INTRODUCTION OF THE NEW ARRANGEMENTS

In January 1999, the value of the banks' operational deposits with the Bank of England totalled about £250 million, whereas (in the first Quarter of 1999) the value of non-interest-bearing and interest-bearing sight deposits held with the banks by household and corporate customers totalled about £306 bn. (13) How could the banks raise the value of their deposits with the Bank of England by over £300 bn, in order to match the value of the sight deposits held by their customers? To require them to do this by selling interest-earning assets would be retrospectively punitive and unrealistic.

To avoid that effect, the government might decide to enable the banks to start the new arrangements on a new footing. It might give every affected bank "Transitional Treasury Credits" to the value needed to bring their deposits at the central bank up to, or nearly up to, the new level required. These Transitional Treasury Credits would be "printed" with, so to speak, a stroke of the pen. The banks could use them for no other purpose than to match the sight deposits of bank customers. Their creation would be a one-off measure, based on the sight deposits held by customers with their banks on a specified date, minus the cash and deposits already held by the banks with the central bank on that date.

The feasibility of this needs to be studied. If, in the judgement of banking and monetary experts, it was likely to be a practicable solution, without undesirable consequences, credit creation by the banking and financial system could be brought to an end virtually at once – as a "big bang" – and not have to be phased out gradually over a period of years.

GOVERNMENT BORROWING

The government's ability to issue new money/credit of the order of £50bn a year directly in the form of public expenditure, will no doubt reduce the government's borrowing require-ments. But it will not eliminate them. Not for many years, if ever, will the National Debt be reduced to zero.

Short-term fluctuations in the balance between incoming government revenue from taxation and outgoing government expenditure will continue to create short-term revenue deficits that will have to be covered by temporary borrowing. So far as public investment is concerned, the argument that taxpayers of the future should share the costs of long-term public investment projects with the taxpayers of today will support the case for financing at least some of those investments by long-term loans. Issues of government stock and National Savings will continue to have significant roles. Over the course of time, today's scale and patterns of government borrowing will no doubt steadily change. A long-term trend for interest rates to fall could further reduce the costs of government borrowing. But there is no reason to suppose that the conversion of banks, etc, from credit creators into credit brokers will introduce problems that the Treasury's new Debt Management Office and the Bank of England will be unable to handle.

MONETARY CONTROL

"There is no single, ideal structure of monetary policy targets or money market operations... One of the most fundamental issues is to decide which target to adopt: the quantity of money or its price, the rate of interest." (14)

Currently the Monetary Policy Committee of the Bank of England is required to aim for a target annual inflation rate of 2.5%, and to use short-term interest rates as the main instrument for achieving it. Turning the banks, etc, into credit brokers instead of credit creators, and arranging for the government itself to issue increases in the money supply directly in the form of Treasury Credits for public expenditure, will not imply any change in the target – the inflation rate. But it will make it necessary to change the main instrument for achieving it. It will become a question of deciding what increases to make in the money stock, rather than what changes in interest rates. Changes in interest rates will then increasingly be influenced by changes in the money stock, rather than vice versa as now. In other words, the price of money will increasingly be influenced by supply and demand in the market for money, in contrast to the way supply and demand in the market for money are now influenced by administered prices. (There will no doubt remain decisions about interest rates which the central bank will still have to take, e.g. about rates at which it will lend to the commercial banks when they require it to do so. How such decisions on interest rates will interact with decisions on increases in the money stock will be a question that the central bank will have to take into account.)

It must be recognised that the proposal to shift the emphasis from controlling interest rates to controlling increases in the money stock is contrary to the prevailing tendency over the past 25 years. That has been for monetary policy to move away from direct controls to control of interest rates. The Supplementary Special Deposit Scheme (or "Corset"), which reintroduced a form of quantitative control in 1973, was abolished in

1980. In the early 1980s there was extensive debate about whether control of "base money" (the banking system's holdings of balances at the Bank of England, and notes and coin) might enable the authorities to control the money supply. But the authorities were not convinced that this could provide as effective a means of monetary control as was provided by the management of short-term interest rates. Also in the early 1980s it was found that the broad money targets of the Medium Term Financial Strategy gave misleading signals, since the relationship between broad money aggregates (as then compiled) and national income was unstable. Although by the later 1980s broad money and narrow money were both being used as indicators to guide interest-rate policy, the conventional wisdom today is that the most effective practicable form of monetary control is to regulate the demand for money/credit (and therefore the supply of it) by controlling short-term interest rates. Alternatives such as monetary base control, direct controls on lending, and reserve requirements are not thought very useful. (15)

However, today's conventional wisdom necessarily involves accepting that banks, etc, should be allowed to create over 95% of new money/credit as interest-bearing loans. That is what needs to be questioned. The following paragraph suggests that the consequences of questioning it may not raise insuperable difficulties from the viewpoint of monetary control.

In a recent report on "The Transmission Mechanism of Monetary Policy" (16) the Bank of England describes how the interest-rate changes decided by the Monetary Policy Committee feed through the economy and affect various features of it culminating with the inflation rate. It explains (pp 10-11) how, at present, although the money supply plays an important role in the transmission mechanism,

"it is not, under the United Kingdom's monetary arrangements, a policy instrument. It could be a target of policy, but it need not be so. In the United Kingdom it is not, as we have an inflation target, and so monetary aggregates are indicators only. However, for each path of the official rate given by the decisions of the MPC, there is an implied path for the monetary aggregates. And in some circumstances, monetary aggregates might be a better indicator than interest rates of the stance of monetary policy. In the long run, there is a positive relationship between each monetary aggregate and the general level of prices. Sustained increases in prices cannot occur without accompanying increases in the monetary aggregates. It is in this sense that money is the nominal anchor of the system".

So, although control of interest rates is currently preferred to control of increases in the money stock as the main instrument of monetary policy, it appears that this need not rule out a shift of emphasis toward the latter. As the Governor of the Bank of England recently stressed, monetary policy "is a kind of art, not a science; it is an art which can be, more or less, carefully crafted but an art it is, nevertheless". (17) If, in response to arguments such as those at pp 3-4 above, and after careful analysis of the feasibility of the change, the government were to ask the Bank of England's Monetary Policy Committee to use control over increases in the money stock (rather than control over interest rates) as the main instrument of monetary policy, it would surely not find it impossible to develop the carefully crafted art of doing so. (18)

PARALLEL CURRENCIES, QUASI-CURRENCIES AND ELECTRONIC MONEY

An opinion increasingly heard is that various new developments are diminishing the power of governments to control the supply of money and the demand for it, whatever instruments they use. For example, even if the UK does not join the euro, UK citizens are likely to use it for an increasing number of transactions, in the same way as many non-Americans use the $US for overseas transactions, and – within a number of countries – as a parallel currency alongside their own. At the same time, more and more non-banks, including retailers and credit card and debit card companies, are providing banking services. It is suggested that these developments, together with electronic money transmission, electronic money storage (as in electronic "purses"), electronic commerce (internet trading), and the increasing use of non-official currencies and quasi-currencies like Air Miles and LETS units, will increasingly lead to the money supply slipping out of the monetary authorities' control. So, it is asked, will changing the present way of regulating the creation of credit be like trying to shut the stable door when the horse is already half way through it?

Innovations in the monetary, banking and financial system will obviously continue to affect the way money is used, and its supply and velocity. Decisions on how much the money stock should be increased will require understanding of these changes and their consequences, just as decisions on short-term interest rates do. But, for the foreseeable future, two things seem certain. First, governments will generally continue to be responsible for the official currency, for monetary policy and for public finance. Second, demand deposit accounts denominated in the official currency will continue to provide the ultimate source and destination for the majority of payment transactions for many years to come. In other words, the need to manage the creation of new money/credit denominated in official currencies has not been overtaken by the new developments. So the case for changing the present way of managing it is not invalidated by them.

IMPLICATIONS FOR EXCHANGE RATE POLICY

The proposed change in the present methods of credit creation is likely to bring about a long-term reduction in the growth of (and probably the actual levels of) government debt and of indebtedness in the economy as a whole. This could be a factor tending to reduce the level of domestic interest rates. That, in turn, would have an effect on the exchange rate. (19)

However, this does not seem likely to prompt a need to change the present approach of government and central bank toward exchange-rate policy and external financial flows. There may be other arguments for making regulatory changes in those areas. But those do not appear to affect the proposals about credit creation which are the subject of discussion here.

THE MAASTRICHT AND AMSTERDAM TREATIES

In the EU, central bank financing of the government is prohibited: central banks are not allowed to provide direct credits to their governments, nor to purchase government securities in the primary market. Might this rule out the proposal that the government itself should create Treasury Credits as a direct contribution to public expenditure (up to a limit independently authorised as an acceptable increase to the money supply)? The provision in question is Article 101 of the Amsterdam Treaty, previously Article 104 of the Maastricht Treaty. Whatever its intention, its wording does not appear to relate to any such proposal. It is as follows:

> "Overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States (hereinafter referred to as enational central banks') in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments."

It says nothing about the direct creation of Treasury Credits by the government itself.

A PROPOSAL FOR BRITAIN OR FOR EMU?

If Britain – as a member of the European Monetary Union (EMU) – was now replacing sterling with the euro, a proposal for changing the present method of creating new money/credit would have to be addressed to the institutions of the European Union (EU) and the European Central Bank (ECB). Is the likelihood of Britain joining EMU within the next few years so great that that is the right course to take now?

The professional competence of monetary institutions, as an element of democratic government, is not yet as highly developed in the EU and ECB as it is now in Britain. A current member of the Bank of England's Monetary Policy Committee discusses it in a recent paper on prospects for the euro.

> "The lack of openness, transparency and accountability written into the statutes of the ECB and reinforced by the ECB's own operating procedures could yet undermine the viability of the whole enterprise. From this perspective, it is a pity indeed that the UK is not among the founding members of EMU. The British 'common law' genius for pragmatic institutional design and adaptation, and the example of openness and transparency set by the Bank of England since its independence in June 1997, would have provided a welcome counterpoint to the continental 'statute law' approach and the enduring continental tradition of opaqueness and secrecy in monetary arrangements and procedures." (20)

This suggests that, far from putting the matter off until a decision on joining the euro has been taken, the UK should examine the desirability and the practicalities of a new approach to credit creation, while we have the monetary independence to do so. If study shows the new approach to be desirable and feasible in the public and national interest, we would then have two options. If we continued to stay out of EMU, we would be in a position to make the change ourselves. If, on the other hand, we joined EMU, we would be in a stronger position to support the new approach to credit creation in EMU as a whole. (21)

CONCLUSIONS

This paper has suggested that the government could itself create directly the amount of new credit judged necessary from time to time to increase the money supply without inflationary effects, and that the commercial banking system would then no longer create it. It has summarised some of the arguments in favour of this. It has proposed changes that could bring it about, and discussed some of their implications.

It concludes that the advantages of the changes might significantly outweigh any disadvantages and difficulties, and that their repercussions for monetary policy and other aspects of public policy could probably be handled without undue problems. It might be possible to introduce them as a "big bang", rather than as a gradually phased-in programme.

It also concludes that the desirability and feasibility of this approach should be seriously studied and discussed before a decision is taken whether the UK should join EMU and replace sterling with the euro.

James Robertson May 1999

Notes:

(1) Unless otherwise stated, this paper is concerned with the situation in the UK. But the same principles can be applied elsewhere too.

(2) James Robertson worked in the Cabinet Office (1960-1963), directed the Inter-Bank Research Organisation (1968-1973), and was specialist adviser to the House of Commons Procedure Committee's 1969 enquiry on parliamentary control of public expenditure. He is currently an independent writer and lecturer.

(3) Bank of England, Centre for Central Banking Studies, Handbooks in Central Banking No. 5, May 1996, on "The Management of Government Debt", first paragraph of Section 3, on "Co-ordination with Monetary Policy".

(4) An account of these changes is in Bank of England, *Report and Accounts*, 1998.

(5) For these figures, and those in the following paragraph, see *Financial Statistics*, March 1999, Tables 3.1C and 3.1D

(6) The money involved in every new bank loan soon returns to the banking system as a new deposit - made either by the borrower or by someone to whom the borrower has paid it. The banking system then has the basis for making a further loan. And so on. This is how the total money stock continually increases. (Those who argue that this is not how it happens, find it difficult to explain how it does.)

(7) This reflects a general principle that monetary values created by the activities and decisions of society at large, and by the processes of nature, should be a source of public revenue, whereas monetary values created by the work and skill and enterprise of individuals and corporate organisations should be respected as legitimate private earnings and commercial profit. This principle supports shifting taxes away from incomes, profits and value added towards higher taxes (or charges) on energy, resources and pollution and the site-value of land. This is relevant to, though not the subject of, the proposals discussed in this paper.

(8) This refers to new money/credit denominated in the official currency - i.e. sterling in the UK. The question of parallel currencies and quasi-currencies is briefly discussed on p 10 below.

(9) Although banknotes say "I promise to pay...", issuing them does not in practice increase the total indebtedness of society.

(10) It is not necessary to discuss in this paper whether one form of public expenditure or another will be most appropriately financed by Treasury Credits – e.g. to reduce the national debt, to contribute to capital or recurrent spending, to contribute to this particular government programme or that, or to help to finance a citizen's income.

(11) The possible issue of Transitional Treasury Credits to the banking system would be for a different purpose - see p6 below.

(12) A proposal on these lines is sometimes referred to as "100% Banking".

(13) Bank of England: Monetary and Financial Statistics, April 1999, Tables 1 and 7.

(14) Bank of England, Centre for Central Banking Studies, Handbooks in Central Banking No. 10, September 1996, "Introduction to Monetary Operations", page 40.

(15) The Bank of England's August 1998 Fact Sheet on "Monetary Policy in the United Kingdom" provides a useful account of how the system now works and of some of the major developments over the last 25 years.

(16) Report of 29 April 1999 prepared for the The Treasury Committee of the House of Commons and the House of Lords Select Committee on the Monetary Policy Committee of the Bank of England.

(17) Answer to Question 54, Minutes of Evidence of the House of Commons Select Committee on the Treasury, meeting of Tuesday 23 February 1999.

(18) The Bank appears to be up to the task technically. For example (see <www.res.org.uk/media/barnett.htm >), former Federal Reserve Board member Professor William Barnett, writing in the latest issue of the Economic Journal, claims that, as a general rule, monetary policy could be based on more competently produced aggregate data, and that most central banks are using data produced in accordance with naive and simplistic accounting procedures that have been obsolete within the economics profession for over 70 years. But he cites the Bank of England as "an honourable exception with its published Divisia aggregates". (These are to be found in Bank of England, *Monetary and Financial Statistics*, April 1999, Table 7.)

(19) For relevant background see Handbooks in Central Banking No. 2, May 1996, on "The Choice of Exchange Rate Regime", from the Bank of England's Centre for Central Banking Studies.

(20) Willem H. Buiter, "Alice in Euroland" (page 4), revised text (on the Bank of England's website) of the Journal of Common Market Studies Annual Lecture given on 15 December 1998 at South Bank University. To be published in the Journal of Common Market Studies, 1999.

(21) Although Willem Buiter (see above) regrets that Britain is not a founding member of EMU, it may be more realistic to see the difference between the present state of the art of monetary policy in Britain and Euroland as a reason, along with others, for Britain to stay out of EMU at least for the time being.

TOWARDS SOCIAL CREDIT

Frances Hutchinson

In September the British Government sponsored the largest ever Arms Fair to be held in the UK. Over 600 private companies exhibited their wares at Chertsey in Surrey and on eight warships berthed at West India Docks in the London borough of Tower Hamlets. Was this a good thing or a bad thing? There are two opposing schools of thought on the matter. First, with all the violence and unrest in the world today, the international trade in arms merely fuels the flames. Len Aldis, Chairman of Tower Hamlets Against Docklands Arms Fair, speaks out against the Fair "We believe that the money wasted on the arms trade around the globe would be much better spent on valuable public services such as hospitals and schools. The arms trade bolsters the power of repressive regimes in the world and has served to promote wars over many decades." Through their press releases, Len Aldis, Campaign Against the Arms Trade and other peace organisations seek to persuade the government to cancel arms fairs of this kind.

On the other hand, supporters of the government's sponsorship of the Arms Fair can claim a superior understanding of the economy. Arms exporting firms create employment, and hence make the money available with which to purchase schools, hospitals and the basic necessities of life. In 1997 the UK military spent £3,360 million, employing 150,000 people directly. The manufacture of military equipment provides further employment in the form of research and development, manufacture, marketing and many forms of component supply.

If we want welfare, we must create employment through all means available, since that is the only way to generate incomes which can be taxed to provide welfare services. If the market says people want armaments, there is nothing more to be said.

So – who is right? Could the government create money in some other way, so that it would no longer be necessary to produce and export armaments in order to give people incomes and welfare? James Robertson's suggestion that, on the advice of an "independent monetary authority" the government should 'print' money "and put it into circulation interest-free as Treasury Credits to public spending programmes" carries welcome echoes of the Social Credit debate of the 1920s and 1930s (1) Robertson regards new credit (money) creation as a "common resource, i.e. a resource created by society" which "should be treated as a source of public revenue, as notes and coins are now, not as a source of commercial profit". In words which could have been taken straight out of Social Credit, The Control and Distribution of Production or almost any other of the Douglas publications, he concludes that the "banking system should no longer put new credit into circulation. In other words, banks (and other financial institutions) should become credit brokers and stop being credit creators". This is not a new debate.

Unfortunately, the revived debate may well flounder for exactly the same reason as did the earlier Social Credit movement: it failed to engage the interest of academic economists. It is said that an economist is an expert who will know tomorrow why things he predicted yesterday didn't happen today! On the other hand, an economist can be defined as someone who sees something working in practice and asks whether it would work in principle! Whatever the case, all humour carries an element of truth, and the truth is that through the decades of the twentieth century economists have largely abandoned the study of political economy in favour of production of models, statistics and analyses in support of growth economics.

In this scenario, any kind of activity which adds to gross domestic product (GDP) is regarded as desirable. It has been estimated that the OJ Simpson trial added $200 million to America's GDP, in the form of lawyer's fees, court costs and hotel bills for the press and so on. Similarly, oil spills and other environmental disasters, normally regarded as undesirable, register as *additions* to GDP, in the form of clean-up costs, insurance, health bills and so on. Poverty, famine, environ-mental destruction and other perceived social ills are regarded by economists as the inevitable result of market forces. In the view of most economists, any deliberate attempt to interfere in the economy for ideological reasons will only make matters worse.

Douglas' original proposals were based on study of the relationship between credit creation and the economy during World War I. In 1914 the UK government needed money to conduct the war, and it had none. Nevertheless, the necessary weapons, munitions and supplies for the armed forces were produced by private firms and paid for by the government. At that time, the country was on the gold standard, and it was accepted practice that the government would balance its budget by raising taxation for such products and services. Aware that such taxation would cripple the economy, the government abandoned the gold standard. Throughout the course of the war the government allowed financial institutions to create the necessary money by raising the national debt from £660 million in 1914 to £7,700 million by 1919. The fictitious 'loans' (in the sense that they were wholly unrelated to savings) which increased the national debt did

not represent consumption foregone, still less an active contribution of savings to the war effort. Curiously, at the outset of the war, poverty and unemployment were rife, yet as the war ended, despite the vast carnage and destruction, people were better off. The finance generated by the war effort brought necessities on to the market, increasing the standard of living and general welfare. Although Douglas and the early social crediters argued cogently for government control of credit creation, their arguments were disregarded, and the attempt to return to the gold standard in 1925 proved socially disastrous. Keynes picked up on some aspects of Douglas' work, but the social credit model of the economy, so strikingly echoed by Robertson, was largely ignored by economists concerned with conventional definitions of growth.

Although the government receives "seigniorage" revenue from the money stock it creates as notes and coins, the vast bulk of the money stock (95%) is 'printed' by the commercial banking system and other financial institutions" as interest-bearing debt. In this, Robertson is in accord with Douglas. However, Douglas is more specific about the connection between debt-creation, investment, production and income distribution. Although there is not space here to enlarge upon these issues (we will do so in subsequent editions of TSC), note that the production of armaments is highly profitable. They are the ultimate in built-in obsolescence: when used they have to be replaced, and opposing sides can be encouraged to update their arsenals, creating demand for more debt-created finance. Similarly, profitable obsolescence is built into food processing, packaging, transportation, energy production, the medical 'industry', genetically modified organisms (GMOs) and the patenting of life forms themselves.

All forms of 'production' present opportunity for profitable investment, necessitating a constant expansion of the money supply. However, the provision of financial services has become the most profitable of all forms of 'investment'. According to the New Internationalist in October 1998 the daily flows of currency exchanges were running at $1,300 billion, with only 5% of this movement related to real trade. The rest, 95%, is merely speculative. It is not clear how Robertson's proposals would relate to this reality.

The "independent authority" envisaged by Robertson would need to know exactly how their control of the money stock would influence investment, employment and economic activity in general. If the total effect were to be neutral, there would be little point in advocating change. After all, despite its imperfections, the present system is familiar and works after a fashion. If real change is anticipated, then the predicted outcomes need to be spelled out more clearly by reformers.

Social Credit remains remarkably robust as a series of theoretically linked, complementary proposals capable of addressing present concerns. Its philosophy rests on recognition of the vital role of sharing and co-operation within the real-life economy. If greed and self-interest were truly the sole motives for participation in the real-life economy, as most economists believe, the very fabric of society would disintegrate overnight. Sadly, in later years Douglas' monetary reform proposals were often debated in isolation from the underlying social philosophy of Social Credit.

It is now time to turn again to this well-rounded economics of sufficiency based on notions of 'good work', equity, and respect for others and the environment. Advocating neither violent revolution nor unrealistic changes to human nature, Douglas shows how the economy could be transformed to become socially and environmentally sustainable. Detailed study may be necessary to follow Douglas' explanation of the reasons why the present system forces people to produce arms in order to put bread on their tables. Such study takes time, but it is time well spent.

(1) Quotes taken from Robertson's "Monetary and Fiscal policy".

MONEY IN THE ANCIENT WORLD

Michael Joyce

The malign effects of the debt-money system in human affairs has, of course, been understood and made clear in many texts over millennia. This short article, reprinted from "The New Age" of 5th October 1933, (pp 271-272) adds some interesting historical context and justification to the very important and more robust arguments and proposals for change advanced in James Robertson's paper.

The history of Greece up to the time of, say, Alexander the Great, has these two claims, among others, upon our interest: one, that here we can see things happening for the first time, in Europe at any rate: and two, that the principles involved are as vast as the scale on which they are applied is small. It seems likely, then, that Greek history will have something to teach us about money: the following sketch is elementary and non-controversial, and I hope it will inspire someone who is better equipped than I am to go into the question more deeply. My chief authorities are Plutarch's life of Solon, Mr. E.S.G. Robinson's article on money in that admirable book of reference, "*A Companion to Greek*

Studies", Mr. A.E.Zimmern's "*The Greek Common-wealth*", and Bury's "*History of Greece*". I have quoted at some length to show that I have not twisted History to suit my own ideas.

It is generally agreed that money was first coined in Lydia, in Asia Minor, at the end of the eighth century B.C., or the beginning of the seventh. The use of precious metals in commerce had long superseded crude barter and the reckoning of wealth in terms of cattle; but the seller had to check the weight and purity of the metal offered in exchange for his goods, until the Lydians saw how much time and trouble would be saved by stamping the bits of metal intended for circulation. "As Aristotle says the stamp was to show that the weight was true and to dispense with the continual use of the balance". (Robinson). By the end of the seventh century the idea had spread to Greece, and during the next hundred years it reached Italy and Sicily. "Every city of importance wished to issue its own money (to do so was a sign of autonomy) and the resulting coins are a characteristically varied reflection of Hellenic life... At first the type was stamped on one side only of the coin, the obverse, while the other, the reverse, showed a sinking or incuse, the mark of the punch which drove the metal into the engraved die. In the later sixth and fifth centuries it became usual to engrave a design on the punch as well, and thus the coin reaches its final form. The earliest types were probably the badges of individuals, perhaps Lydian Kings or tyrants of cities, or even mere private merchants...

"*All Greek gold, electrum (an alloy of gold and silver) and silver coins are "value" coins, that is, the nominal value of the coin coincides in theory with its value as mere metal. The earliest coins were of the denominations representing considerable purchasing power, but the growth of trade produced an increasing demand for small change, and coins in the same metals representing small fractions came more and more into use. The inconvenience of such tiny coins led to the introduction of larger bronze coins of the same or even lower values. These were "token" coins, that is their face value was considerably greater than their value as mere metal, and their acceptance depended solely upon convenience backed by the authority of the State.*" (Robinson)

From which point it is not such a very far cry to the fourth century B.C., when ***Demosthenes remarked that if you didn't know that credit was the most important factor in making money, there wasn't much you did know***. The word I translate as "credit" is n****, which is used in the New Testament for Faith.

By all accounts the invention of Money gave almost as great an opportunity for concentration of power as the growth of the modern credit system.

"*For consider what the change means in the life of a peasant who is living from hand to mouth on his yearly harvests. He used to take his stuff to market and exchange it for goods he needed - wool for the wife to spin, children's shoes for the winter, or tiles to mend the roof; or he would pay the smith and the joiner in kind for repairing his plough or his cart. But now most of them will not accept his corn and wine until he has turned it into money. How much is it worth? He has not the least idea; for it depends on factors outside his range and which he has no means of controlling. He takes what the middleman gives him; and the middleman makes a living on his commission. At the end of the first year he is alarmed to find he has not as much margin in hand as usual. When the inevitable lean year comes he has no margin at all. In fact, he cannot see his way to get through the winter without help. His only resource is to borrow.*" (Zimmern)

The only people who have any money are the nobles, and he is forced to go to one of them and raise money on the land, which was his father's before him. The aristocratic money-lender "sets up an eyesore pillar, with letters on it, in full view of the house. He (the peasant) cannot read the letters, but he supposes they are used to keep him in mind of his bargain". (Zimmern) In short, as the great liberator, Solon, said, the black earth was enslaved. Unless the farmer's luck changes he cannot repay the loan next year, and the money-lender takes the property in lieu of payment, leaving the former owner in possession as tenant, on condition that he pays one-sixth of the value of his produce a rent. And as Plutarch tells us, those who couldn't pay their sixth:

"*were by the law delivered to their creditors, who kept them as bondsmen and slaves in their houses, (or, of course, on the original farm) or else they sent them to strange countries to be sold: and many even for very poverty were forced to sell their own children (for there was no law to forbid this remedy) or else to forsake their city or country, for the extreme cruelty and hard dealings of these abominable usurers their creditors*".

Those who have read their poets know what expatriation meant to the Greeks; Homer makes Athene say of her favourite, Odysseus, that "in his yearning to see if it were but the smoke leaping upwards from his own land, he longs for death." Zimmern suggests that similar sufferings are reflected in the complaints of Amos and Hosea; and there certainly an aptness in Amos's imprecation on those who have "sold the righteous for silver, and the poor for a pair of shoes". An interesting parallel might also be drawn between the reforms of Solon, which we are about to consider, and the liberation of bondmen and the return of land to its original owners in the jubilee year, as laid down in Leviticus.

The growing jealousy between rich and poor all over Greece led to the establishment of "tyrannies", or dictatorships, as we would call them. The easiest way to become a dictator was to take up the people's cause against the nobles at the critical moment; and there is the famous case of the rising politician who rushed into the market place one morning, covered with blood, and informed the populace that the nobles had shown their resentment of his popular sympathies by trying to assassinate him. The people were so touched that they voted him a bodyguard on the spot, and that was goodbye to their democratic hopes. But autocratic government was never congenial to

the Greek, and the next period was that of the great law-givers, of whom the greatest, probably, was Solon of Athens (born about 639 B.C.); at any rate we know more about him than any of the others. He is famous for his democratic reforms in the Constitution, which were far-reaching in their results; but here we are concerned with his handling of the economic crisis. He was an aristocrat by birth, a moderate liberal by conviction, apparently he commanded the respect of both parties, and as everyone realised that revolution was imminent he was elected archon with extraordinary powers in the year 594B.C. There is some obscurity as to the nature of his reforms, but apparently he decreed the complete cancellation of all mortgages on land, freed all the farmers who had been enslaved, and made it illegal to borrow money on the security of the borrower's person, his decree went down to history as the n*** that is, the shaking off of burdens.

"*Howbeit some write*," says Plutarch, "*that the poor were contented that the interest only for usury should be moderated, without taking away the whole debt: and that Solon called this easy and gentle discharge, Seisachtleia, with crying up the value of money. For he raised the pound of silver, being before but three score and thirteen drachluns, full up to an hundred: so they which were to pay great sums of money, paid tale as much as they ought, but with less number of pieces than the debt would have been paid when it was borrowed. And so the debtors gained much, and the creditors lost nothing.*

"*Nevertheless the greater part of them which have written the same, say, that this crying up of money, was a general discharge of all debts, conditions, and covenants upon the same; whereto the very poems themselves which Solon wrote, do seem to agree. For he glorieth, and breaketh forth in his verses, that he had taken away all bawks and marks that separated men's lands through the country of Attica (I fancy this refers to the mortgage-pillars described above), and that now he had set at liberty, that which before was in bondage. And that of the citizens of Athens, which for lack of payment of their debts had been condemned for slaves to their creditors, he had brought many home out of strange countries, where they had been so long, that they had forgotten to speak their natural tongue, and other which remained at home in captivity, he had now set them all at good liberty.*"

No doubt these reforms represented a compromise,

"*For Where,*" Plutarch tells us, "*the mischief was tolerable, he did not straight pluck it up by the roots; neither did he so change the State as he might have done, lest if he should have attempted to turn upside down the whole government, he might afterwards never been able to settle and establish the same again.*

Therefore he only altered that, which he thought by reason he could persuade his citizens unto, or else by force he ought to compel them to accept, mingling as he said, sour with sweet, and force with justice. And herewith agreeth his answer that he made afterwards unto one that asked him, if he had made the best of laws he could for the the Athenians? Yea sure, saith he, such as they were to receive."

Like so many compromises, Solon's settlement was not altogether acceptable to either party, and there were still some awkward corners to be turned before Athens reached the height of her prosperity. But it seems to have been an honest and fairly effective attempt to return to the former state of peasant ownership. Later on, of course, Athens became more and more an industrial and trading centre, and by the fourth century at any rate - witness the activities of Pasion - something of a banking centre too. And of course the slave population was much greater in the age of Pericles than in that of Solon, though the old idea that the greatness of Athens was based entirely on slavery is quite discredited; slaves and free labourers worked on the Parthenon side by side.

As her trade increased Athens became more and more dependent upon wheat imported from the area round the Black Sea; so much so that at the opening of the great war with Sparta Pericles succeeded in persuading the populace that so long as they could hold the famous Long Walls which connected the city of Athens with her harbours, it would pay them to let the Spartan armies ravage the rest of Attica, and get all their food by sea. It was Lysander's defeat of the Athenian navy at Aegospotomi in the Dardanelles, and the consequent loss of her most vital trade route, that led to the final surrender to the Spartans.

In conclusion, I must quote a passage from Plutarch, which shows how little the sixth century Greek had to learn from the modern financier.

"For [Solon] *having fixed an edict for clearing of all debts, and lacking only a little to grace it with words, and to give it some pretty preface, that otherwise was ready to be proclaimed; he opened himself somewhat to certain of his familiars whom he trusted and told them how he would not meddle with lands and possessions, but would only clear and cut off all manner of debts. These men before the proclamation came out, went presently to the money men, and borrowed great sums of money of them, and laid it straight out upon land. So when the proclamation came out, they kept the lands they had purchased, but restored not the money they had borrowed. This foul part of theirs made Solon very ill-spoken of, and wrongfully blamed; as if he had not only suffered, but had been partaker of this wrong and injustice. Notwithstanding he cleared himself of this slanderous report, losing five talents by his own law. For it was well known that so much was due unto him, and he was the first that following his proclamation, did clearly release his debtors of the same.*"

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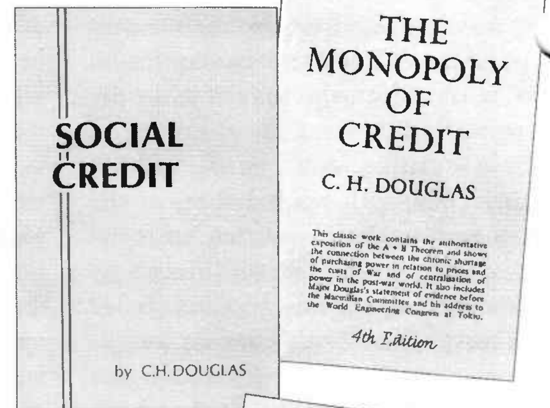

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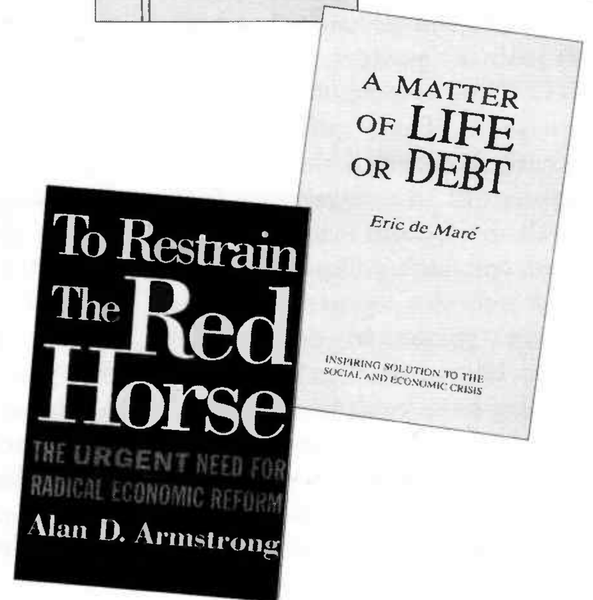

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