The bad times had arrived with the crash.

In bad times the banks stop lending, businesses and citizens pay down or default on their debts, the quantity of money in the economy shrinks[3] and the lack of spending and investment can cause a recession.

To get the economy growing again, we need to boost spending. This can be done by getting the banks to create new money by issuing loans i.e. for businesses and citizens (the private sector) to borrow more. Another way is for the Government to spend more than it receives in taxes, fiscal expansion, but this is currently being ruled out.

That is why, after the crash, the Chancellor and the Bank of England made every effort to get the banks to increase lending with low interest rates, first-time buyer house down-payment guarantees, Quantitative Easing and so on.

Other more radical ways to stimulate the economy have been

[3] Note 3

proposed, namely QE for people, Green QE etc. but so far the obsession with austerity has ruled out such possibilities.

So for now, without fiscal expansion by the Government, the only way to grow the economy is for the private sector to borrow more, meaning more new money creation through increased bank lending. But, private debt is already very high.

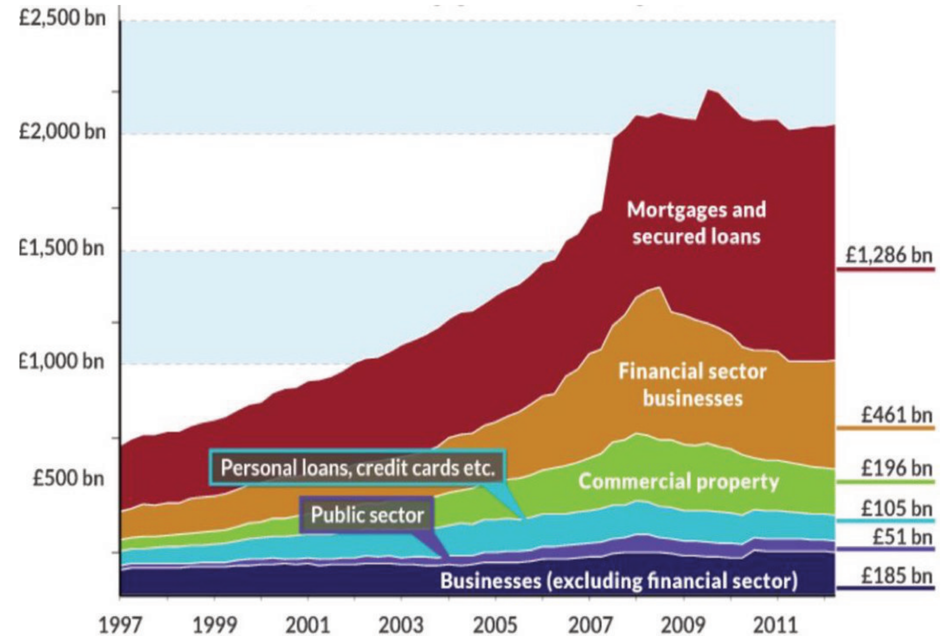
The economy is not working, with asset inflation, growing wealth inequality, stagnant wages, food banks, struggling public services, too much private debt, a trade deficit from de-industrialisation, low productivity and an over-dominant financial sector. At the root is a money creation and banking system which is not serving society.

Positive Money's long term proposal is that all new money should be created debt-free by the state i.e. the Bank of England and not by private commercial banks.

An independent committee, such as that which currently sets interest rates, would decide how much additional money should be added to the economy. The Bank of England would create that money electronically (out of thin air) and credit it to the Government account. The democratically elected Government would decide how to spend that money into the economy e.g. infrastructure and environmental improvements, the NHS, education, law enforcement, public sector wages, or reducing taxes etc.

The detail of how this change could be introduced is set out in the book "Modernising Money", see Books page 13 of this booklet.

Commercial banks would still be able to lend but only money deposited with them The public would have two types of bank account: zero risk non-interest bearing transaction accounts, equivalent to digital cash, ultimately held at the Central Bank; and interest bearing deposit/investment accounts held at commercial



The graph shows where all the newly created money had been going up until the crash. Note how little went into non-financial businesses and the public sector i.e. the real economy, and how much into property and the financial sector, the latter resulting in the crash of 2007/2008.

The crash came because the banks had been creating too much money to make overly risky investments in and loans to the financial markets.

When it became clear that many of these loans and investments were turning bad, the banks froze, trusting no counter-party and they stopped lending, even to each other, a financial meltdown. The Government and taxpayer had to pick up the pieces.

Can it be right that private banks have the power to create and allocate new money and yet are effectively underwritten by the taxpayer?

banks which, in return for interest, would bear risk. So wise account holders would seek transparency on the investments that banks were making with their money.

Short term, Positive Money propose that the Bank of England carries out QE for people. This would be creating new money which the Government can spend into the economy to help stimulate demand and employment.

In its QE program, the Bank of England created £445 billion of new money by typing numbers into a computer. This was injected into the financial markets to strengthen the banking sector and help keep interest rates low, but also with the intention of money working its way into the real economy. Of the first £375 billion QE, equivalent to £6,000 per per person in the UK, Positive Money calculate that only 8p in every £1 reached the real economy. Much of the rest simply inflated house prices and the value of financial assets, widening yet further the gap between the 1% and the 99%.

If the Bank of England can create money to rescue the City, why not create money to help the real economy?

Whilst by treaty law, currently the Bank of England cannot fund the Government directly, it can, as with QE, create new money to fund, for example a Green Investment Bank.

Positive Money and others such as Lord Adair Turner have proposed that the Government sell bonds with perpetual life and pay zero interest, which are purchased by the Bank of England via the open market. (Search: Positive Money Guide to Public Money Creation)

People's QE is a short term solution to stimulate the economy, but what we really need is a reform of banking which Positive Money believes must include a change in how money is created. Educating the public as to the current system is a good start, but we still have a long way to go. A survey in 2017 found that 70% of MPs still did not understand

of the 21st Century, with cheap imports and low wage growth, inflation was kept low. Thus interest rates were also kept low, borrowing cheap, and the banks kept on lending (creating new money). This increased the money supply.

The rate of growth in the money supply was approximately three times real economic growth. So rather than growing the economy, the new money was going into inflating the value of existing assets and into financial markets, thus increasing wealth inequality.

Lending against houses, with the property as security, is low risk. Rising property prices make such loans appear even safer, lenders offering easier terms and creating new money for ever larger mortgages, so house prices keep on rising.

Creating new money, both to lend and speculate on their own account in rising financial markets, can also be very profitable for banks, at least for a period.

– out of thin air, is the correct answer!

Commercial Banks do not have to have the money to make a loan[1], they just have to decide whether the borrower will have the ability to repay the loan and pay the interest, the more risky the loan the higher the rate of interest charged. The loan is new money which did not exist before and is created by typing a few digits into a computer.[2]

Around 97% of all new money is created this way by commercial banks when they make loans, though exceptional money creation by the Bank of England in the form of QE has reduced this to 80% over the recent past.

In the good times banks create lots of new money, expanding (inflating) the money supply. The Bank of England attempts to control inflation by varying the interest rate using cost of living indices as their guide. But these indices do not include the costs of property or the price of stocks and shares and other financial investments. So, at the start

[1] Note 1 [2] Note 2

how money is created. Find out how much your MP knows about the current system and discuss what changes they would support. Insist that their party's manifesto includes the setting up of a commission to investigate the whole business of money creation and banking.

Meanwhile, talk to your family and friends and don't presume economics is for the experts only. Follow some of the economists on the recommended list (Page 13) and links from them. They don't all agree with Positive Money's solution for money creation, but they fully support the need for banking reform - join the conversation and welcome to

Positivemoney.org

Notes

1) Whilst it is correct that banks don't have to have the money to make loans, they are required to have sufficient shareholders' funds (equity) to cover any losses from bad debts. Prior to the crash the book value of shareholders' funds was typically no more than 3% and then suddenly turned negative needing a bailout. Regulators are now pushing for a figure closer to 10%.

Banks are also required to hold central bank money, reserves and easily sold (liquid) assets like government bonds to cover sudden withdrawals by depositors. In practice the Bank of England will always provide the necessary funds, reserves.

2) For those interested in double entry bookkeeping, the loan i.e. the borrower's promise to repay in the future, is added to the asset side of the balance sheet and the money loaned added to the liabilities side as a deposit which the borrower can draw on.

3) Just as banks create new money when they make loans, so when loans are repaid to banks the money is destroyed. This is quite different to a non-bank making a loan e.g. if you lend someone £100, you lose the use of the money whilst the borrower has use of it. When they repay the loan, you again have use of the £100 and they don't. So throughout the transaction there is no change in the money circulating in the economy. Bank loans being created and repaid increase and decrease the money in the economy. This is a critical role played by banks that is too often ignored by economists.

When Banks make loans, from where do they get the money?

1) Savers' deposits.

or

2) The Bank of England.

or

3) Out of thin air.

Informative links

Search (Google) - Bank of England Money Money Creation

twitter.com/positivemoneyuk   facebook.com/positivemoney

positivemoney.org

Books

Where Does Money Come From, Josh Ryan-Collins, Tony Greenham, Richard Werner & Andrew Jackson

Modernising Money, Andrew Jackson & Ben Dyson

Some Economists to follow

Professor Steve Keen - Kingston University

Lord Adair Turner - Institute of New Economic Thinking

Professor Richard Werner - Southampton University

Martin Wolf - Financial Times

Ann Pettifor - Primeeconomics.org

Rethinking Economics   www.rethinkingeconomics.org

New Economics Foundation   www.neweconomics.org

- Positive Money is a movement to democratise money and banking so that it works for society and not against it.
- Right now the money and banking system causes house price bubbles, high levels of debt and rising inequality. It lays the foundations for financial crises and it harms our environment. To deal with the big social, economic and environmental challenges we're facing today, we need to reform our money and banking system.
- **Since 2010, through research, education and our growing UK and international network, we've been campaigning for a money and banking system that enables a fair, sustainable economy**
- Please join the campaign: positivemoney.org

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How is money created?