Green Party Autumn Conference – 2013

Banking Reform Motion – Background Paper

1. Introduction

This background paper has been produced as a guide and reference document for a motion on banking reform that is proposed for debate at the Green Party Autumn Conference 2013. It sets out evidence in support of a programme of reform to remove the power to create money from private banks, and to fully restore the supply of our national currency to democratic and public control so that it can be issued free of debt and directed to environmentally and socially beneficial areas.

The proposed programme of banking reform builds on and would complement existing Green Party policies on banking and money that call for strict regulation of investment banking activities and their separation from retail banking; limitation on the size of banks; the creation of a Peoples Bank from the currently nationalised banks to provide a guaranteed safe-haven for people's savings; support for mutually owned banks, credit unions and micro-credit schemes; regulatory control of mortgage lending and derivatives; a programme to decentralise banking through the establishment of a network of local, democratically accountable Community Banks; and the promotion and development of local currencies.

The full text of the Monetary Policy section within the Policy for Sustainable Society, showing how it would be amended by the motion, is presented as an Annex to this document.

1.1 Structure of the paper

This document is structured as follows:

1. Introduction
2. The current banking system – making money out of nothing
3. Why the banking system must be reformed
4. How the banking system should be reformed
5. Implementation and benefits of proposed programme of banking reform
6. Cost and revenue impact of banking reform
7. Impact of banking reform on Green Party policy
8. Answers to common concerns about banking reform.

Annex – Full text of the Monetary Policy section within the Policy for Sustainable Society, showing how it would be amended by the Banking Reform motion.

2. The current banking system – making money out of nothing

In the text of new paragraph EC661, the motion describes the context of the proposed programme of banking reform by briefly outlining how money is created in the current banking system.

EC661. The Green Party believes that, as the means of exchanging goods and services, the stock of money is a vital common resource which should be managed in the public interest. Yet only 3% of our money supply currently exists in the form of notes and coins issued by the Government or the Bank of England. 97% of the money circulating in the economy takes the form of credit that is created electronically by private banks through the accounting processes they follow when they make loans.

2.1 Supporting evidence – Banks have created 97% of money circulating in the economy

In modern society, the predominant form of money is electronic – existing as credit in banks' electronic accounting systems. Nearly all payments are settled electronically by the banks making double-entry book-keeping transactions between customer accounts: debiting the payer's current account and crediting the payee's current account by the required amount of the payment. Bank of England Statistics[1] show that money in the form of notes and coin (issued by the Bank of England and the Treasury) represent less than 3% of the total money supply in the UK.

Bank credit[2] - the electronic money that represents more than 97% of the money supply – is created by banks when they make loans. When a bank makes a loan it does not give the borrower money in the form of notes or coin: instead it makes a simple double-entry book-keeping transaction in its electronic accounting records – debiting the borrower's loan account, and crediting the borrower's current account, by the value of the loan. The borrower then uses the newly created credit in his current account to make payments.

The fact that banks can literally make money out of nothing in this way is regularly acknowledged by experts in the field of money and banking. For example:

In a speech on 23rd October 2012, Sir Mervyn King, Governor of the Bank of England said:

> *"When banks extend loans to their customers, they create money by crediting their customer's accounts"*

[1] In March 2013 the total value of notes and coin in circulation was £57.1 billion: 2.7% of a total money supply of £2,084 billion (by the M4 measure). Source - Bank of England Statistics – Table A2.2.1 – Components of M4 Seasonally Adjusted – 30 April 2013.

[2] Bank account credit balances are often referred to as "deposits" – reflecting the historic role of banks as a place where customers would deposit gold, cash and other valuables for safe keeping. However, because the term "deposit" no longer reflects modern banking operations, this document uses the term "credit" instead.

In an article, published in the Financial Times on 9th November 2010, Martin Wolf, the FT's Chief Economics Commentator, wrote:

> *"The essence of the contemporary monetary system is the creation of money, out of nothing, by private bank's often foolish lending."*

Progressive de-regulation of the banking system since the early 1970's has created a situation in which the only constraint on the banks' ability to create money through lending is the willingness of banks to lend. Banks have a powerful profit motive to increase their lending, because they are able to charge interest on the loans they make. This explains the exponential growth in the money supply and level of debt in the UK during the past 50 years – as illustrated by Chart 1 below. In the 6 years from 2004 to 2010 alone, the banks created £1.1 trillion of new money, doubling the total amount of money circulating in the economy.

As in other developed countries, the freedom of banks to create credit has caused growth of the UK money supply to become de-coupled from growth of the nation's real economy. In 1984, the UK money supply (by the M4 measure) was equal to 60% of the UK gross domestic product. However, by 2009, while UK GDP (measured in current prices) had increased more than 4 fold, the UK money supply had grown more than 10 fold to equal 146% of UK GDP.

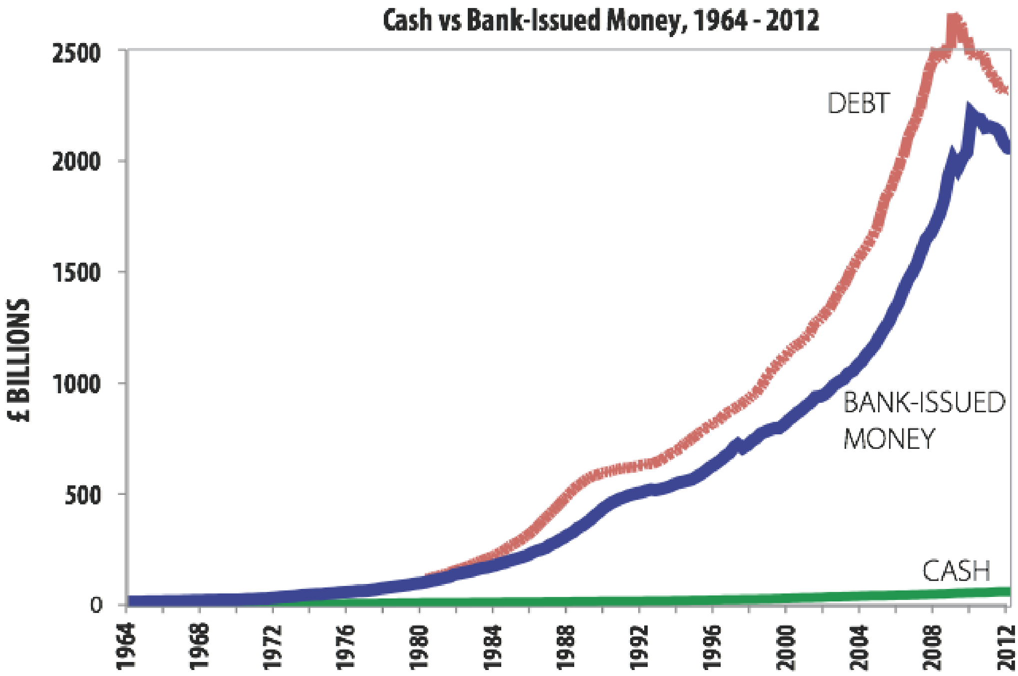

Chart 1 – Growth of Money Supply and Debt in the UK[3]

[3] Chart produced by Positive Money

3. Why the banking system must be reformed

In new paragraph EC662, the motion explains the failings of the current banking system and why it must be reformed.

EC662.The existing banking system is undemocratic, unfair and highly damaging. Banks not only create money, they also decide how it is first used – and have used this power to fund financial speculation and reckless mortgage lending, rather than to finance investment in productive businesses. Through the interest charged on the loans on which all credit is based, the current banking system increases inequality. It also regularly causes economic crises: banks create and lend more and more money until the level of debt becomes unsustainable, boom turns to bust, and the taxpayer bails out banks that are "too big to fail". Finally, the need to service the growing mountain of debt on which our money is based is a key driver of unsustainable economic growth that is destroying the environment.

3.1 Supporting evidence – The existing banking system is undemocratic

Banks not only enjoy the power to create money, they decide how this new money is allocated - giving banks huge power to shape the economy. This power is even greater than that of a democratically elected government: the banking sector can allocate more money via lending than governments can distribute through public spending. In the five years running up to the start of the financial crisis, the UK banking sector's gross lending to households and individuals alone (not including lending to businesses) came to a total of £2.9 trillion – compared to UK government spending in the same period of £2.1 trillion[4]. Debt-based money also weakens democracy and the sovereignty of governments as they too become heavily indebted.

Control of the banks' power is concentrated in the hands of the directors of the five largest banks[5]. As at September 2011, these banks had just a total of 78 board members[6].

The banks do not use their power to shape the economy wisely. Analysis by Positive Money[7] shows that only 13% of the increase in lending from 1997 to 2007 went to non-financial businesses with 87% being used to finance house purchases, loans to other financial institutions, and consumer borrowing. In 2010, the value of loans outstanding to the

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[4] Statistic quoted in P167 of *Modernising Money* by Andrew Jackson and Ben Dyson, published by Positive Money in 2012.

[5] HSBC, Barclays, Santander, RBS Group, Lloyds/HBOS. In 2010, these banks accounted for 85% of the current account market and 61% of the savings account market. (Source HM Treasury, 2011 – statistics quoted in P168 of *Modernising Money*)

[6] Statistic quoted in P168 of *Modernising Money*

[7] Positive Money is a not-for-profit research and campaign group. It works to raise awareness of the connections between our current monetary and banking system and some of the biggest social, economic and environmental challenges that we face today.

productive part of the economy (i.e. those sectors which contribute to GDP) accounted for just 8% of lending in the UK.

By far the greatest proportion of lending is to the property market: in 2010, 45% of the value of total loans outstanding in the UK was for loans to individuals secured on property, with an additional 15% to commercial real estate companies. This, rather than growth in the number of households[8], has fuelled inflation in property prices over the past 60 years – illustrated in Chart 2 below.

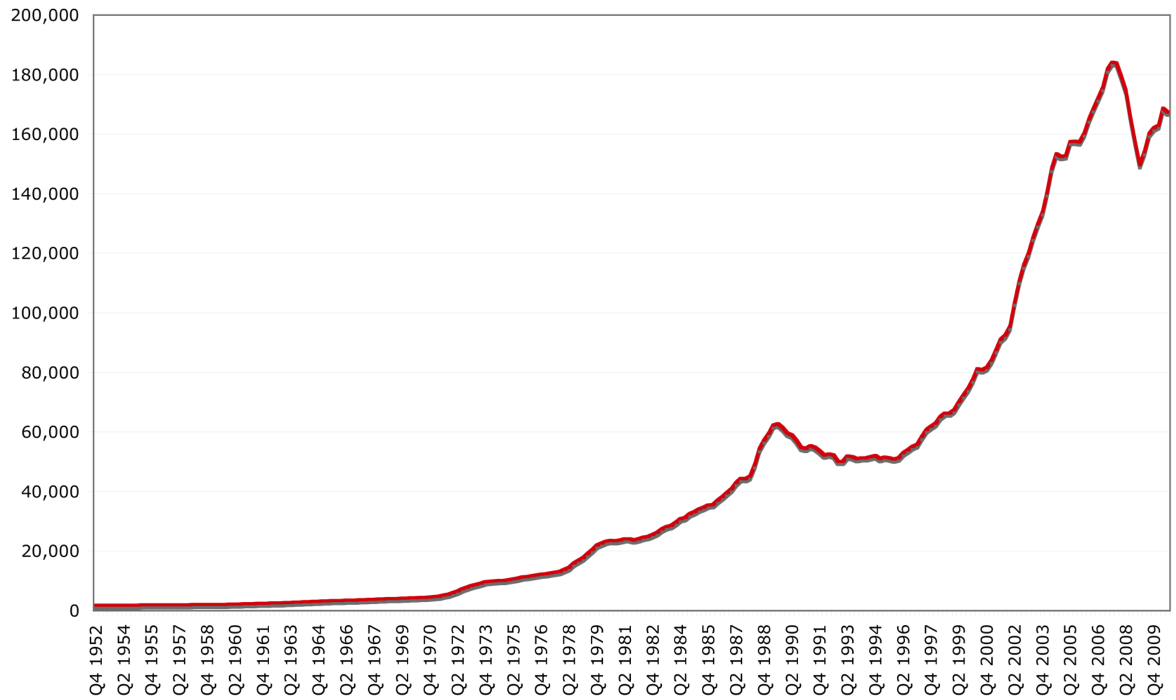

Chart 2 – Increase in UK Average House Prices (£)[9]

3.2 Supporting evidence – The existing banking system increases inequality

The existing banking system systematically transfers wealth to the banking sector from the economy. This is because for there to be a supply of money, there must be debt. In effect, society must rent the money supply it needs from the banks, resulting in a constant transfer of wealth through loan interest payments to banks. Given that the money supply in the UK stands at approximately £2 trillion, and assuming an average interest rate of 8% on bank loans, then simply to keep the money supply at a constant level requires the non-bank sector to transfer the massive sum of £160 billion a year to the banking sector. This charge

[8] In the UK house prices increased threefold between 1995 and 2007 (Nationwide, house price survey 2012) despite the number of housing units increasing by 8% between 1997 and 2007 while the population grew by only 5%. The 206% increase in house prices can largely be attributed to the 370% increase in mortgage lending over its 1997 level. (Figures taken from an analysis of the house price bubble in *Modernising Money*, P144)

[9] Chart produced by Positive Money

- for something that could be provided at almost no cost by the state - is not shared equally among households – as is shown in Chart 3 below.

Chart 3 shows how the banking sector transfers money from the poor to the wealthy. On the vertical axis is the net balance – shown as a percentage of household income – of money either received from or paid out to banks, while the horizontal axis splits households into deciles by income. The black line shows the net burden/benefit of banks on each decile. Bank charges and loan interest payments means that all households bear a net burden. However, this burden falls disproportionately on lower income households; while higher income households disproportionately benefit from income received from banks – in the form of salaries, bonuses, dividends or interest on savings.

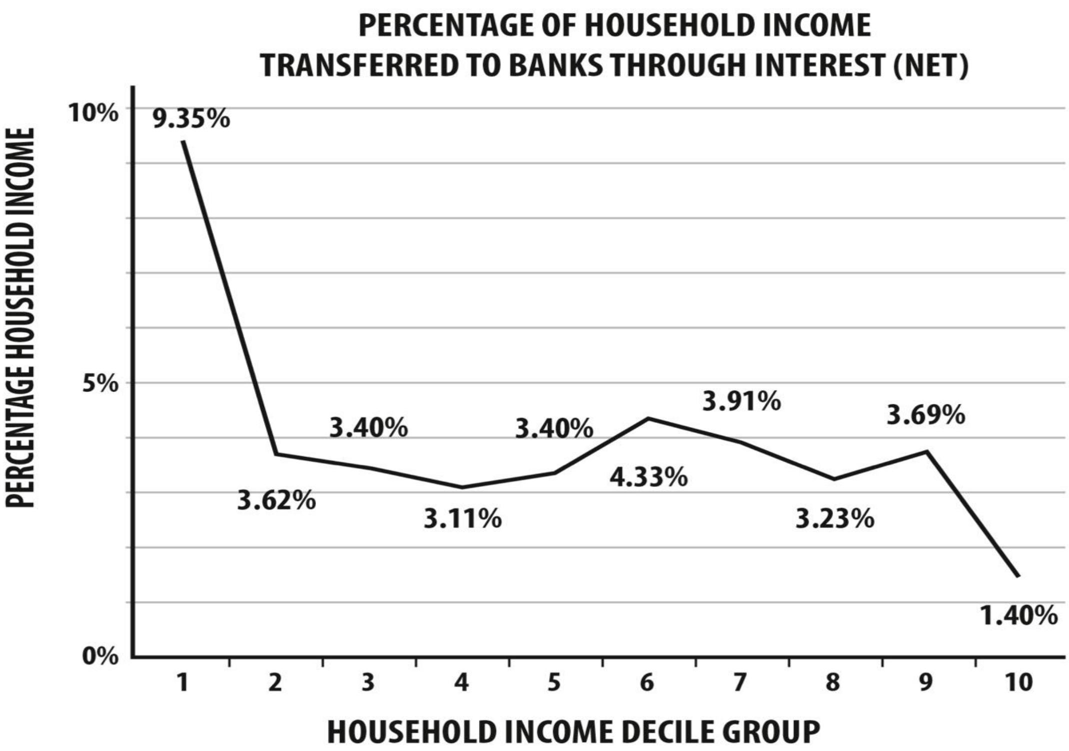

Chart 3 – Banking Burden on Households (2005)[10]

Considering the enormous increase in house prices driven by bank lending, these results are not surprising. There has been a corresponding increase in the percentage of household income that needs to be devoted to mortgage payments or rent, with a proportionately larger reduction in disposable income for poorer households that struggle to

[10] Chart produced by Positive Money – shown in P156 of *Modernising Money*. The figures on which the chart is based are drawn from analyses conducted by Positive Money combining statistics on the revenues and expenditures of UK banks (published by the Bank of England) and surveys of the finances of British households and small and medium sized businesses commissioned by UK government departments and held at the UK Data Archive.

meet their accommodation needs, while richer households that can afford to invest in property have benefitted from higher house prices.

The current banking system also tends to redistribute wealth geographically. In the UK the headquarters of the major banks (and thus the high-earning bank employees) are located in London and thus the charging of interest on bank loans not only transfers wealth to the banking sector, it transfers wealth towards London.

3.3 Supporting evidence – The existing banking system regularly causes economic and financial crises

Because the supply of credit depends on the willingness of banks to lend and on the confidence of individuals and businesses to borrow, the existing banking system is prone to cycles of “boom and bust” that regularly causes financial and economic crises.

In the “boom” phase of the cycle, banks accelerate the rate of their lending in order to generate more profits; fuelling an increase in the price of houses and other assets. This causes individuals to feel wealthier and to spend more, which in turn encourages businesses to borrow and add capacity to meet increased demand. Increasing employment and higher earnings leads to even greater consumer confidence, which stimulates yet more borrowing and spending. However, with the growing stock of debt the burden of servicing and repaying loans becomes harder and harder for borrowers to sustain.

At the start of the “bust” phase of the cycle, speculators begin to sell assets in order to repay loans they cannot afford. Other borrowers simply default on their loan payments. This causes house and asset prices to fall, and banks to become more cautious in their lending, which causes further falls in house and asset prices. As confidence starts to wane, consumers spend less and businesses cut back on investment, causing unemployment to rise – driving a downward spiral of further loan defaults, forced asset sales, lower spending and yet higher unemployment. Eventually, the level of loan defaults may threaten the solvency of banks as their capital reserves are written off. At this point the bust has become a full blown financial crisis.

As Lord Adair Turner, former Chairman of the Financial Standards Authority, said in a speech in 2012:

> “The financial crisis of 2007/08 occurred because we failed to constrain the private financial system’s creation of credit and money.”

Academic studies of economic history confirm that in the current banking system, banks are perfectly capable of destroying themselves and the rest of the economy with depressing regularity. In the UK there have been 12 banking crises since 1800, with 4 of these occurring since 1945[11].

[11] This Time is Different: Eight Centuries of Financial Folly – by C.M.Reinhart and K.S.Rogoff, published by Princeton University Press, 2009 – cited in P143 of *Modernising Money*

The inherent instability of the banking system is made worse by Government-backed deposit insurance that removes (or greatly reduces) the incentive for depositors to monitor the riskiness of their banks' lending, as they are protected from losses by the taxpayer. Without the scrutiny of anxious depositors, banks are even less constrained in exercising their power to create credit and money through lending.

This misalignment of risk and reward is usually referred to as "moral hazard". In countries such as the UK, where the size of banks is very high relative to the size of the economy, the sheer scale of the potential losses underwritten by deposit insurance mean that banks have become "too big to fail". This was clearly shown during the financial crisis of 2008, when Governments had to bail out failing financial institutions. The cost of this bailout is not only being paid by the taxpayer, but also by those who depend on public services that have been cut as a result of "austerity" measures to reduce Government borrowing.

3.4 Supporting evidence – The existing banking system is a key driver of unsustainable economic growth that is destroying the environment

In their book *Enough is Enough*[12] Rob Dietz and Dan O'Neill describe how the current debt-based system of creating money is incompatible with the goal of a sustainable, steady-state economy that many environmentalists and the Green Party aspire too. A steady state economy is an economy that aims to maintain a stable level of resource consumption, in which use of materials and energy are kept within finite ecological limits. The current dependency of the global economy on growth means that it will further exceed the "carrying capacity" of our finite planet, and is not sustainable.

The existing banking system drives and depends on unsustainable economic growth in a number of ways:

- Money created by banks has to be repaid by borrowers who then need to engage in economic activity to earn the money required to repay their loans. As loans are repaid, credit is cancelled and banks therefore make new loans to maintain the stock of money in circulation and sustain levels of economic activity.

- However, in addition to the principal of their loans, borrowers have to repay interest. This generates even more economic activity and consequent growth in consumption. To enable borrowers to pay interest as well as the principal of their loans, the stock of money circulating in the economy must increase. The banking system can only met this need by making more loans thereby stimulating economic growth.

- The lending decisions of banks are largely driven by short-term profit considerations. Therefore banks have little incentive to finance social and environmental projects that generate longer-term returns. Banks prefer lending to projects that generate quick returns or are well backed by asset collateral.

[12] See Chapter 8 – "Enough Debt" in *Enough is Enough* – Rob Dietz and Dan O'Neill, Routledge, 2013

- By driving up house prices, the existing banking system increases the cost of living forcing households to borrow more or increase their economic activity to make ends meet – further driving economic growth.

- As money is a claim on wealth, the uncontrolled growth of the stock of money by profit-seeking private banks creates a strong incentive to acquire more real wealth to keep pace. This is reflected in the growth in house prices noted above, but it is also reflected by increases in the growth of extravagant consumption.

- As explained in section 3.2 above, the existing banking system transfers wealth to those with higher incomes. Increasing inequality drives yet more economic growth as people borrow or work harder in an attempt to "keep up with the Jones's".

As well as driving unsustainable economic growth, the stability of the existing banking system depends on it. As explained in section 3.3 above - without the expectation of economic growth, banks lack the confidence to lend, businesses lack the confidence to invest and borrow, and boom turns to bust. In short, tomorrow's growth is collateral for today's debt.

Another way in which the existing banking system has a negative impact on the environment is the tendency of governments to respond to the "bust" phase of the finance driven economic cycle by removing environmental regulations and cutting back on environmentally beneficial initiatives.

During a severe recession, Governments are more open to the argument that environmental regulations represent a cost to business that makes them internationally uncompetitive and less able to deliver growth and higher employment. The long-term environmental benefits of regulation tend to lose out to such short-term political and economic considerations. The current pressure on governments to allow exploitation of marginal sources of non-renewable energy such as shale-oil and gas, regardless of the environmental impact, is a good example of this.

In the aftermath of the most recent financial crisis, Governments across the world have implemented austerity measures, cutting spending on public services to reduce government deficits. The pressure to cut spending may result in environmentally beneficial projects being cut, such as green energy subsidies, or long-term investment in science and technology that the private sector is unable to fund due to the long and uncertain timescale before any payback from such investment.

To achieve a steady state economy we must eliminate the growth imperative that is built into the existing banking system. This requires overhauling the process of money creation.

4. How the banking system should be reformed

Given the failings of the existing, debt-based, banking system, the motion - in new paragraph EC663 - states that the current banking system should be reformed by fully restoring the power to create our national currency to public control, in a way that enables this money to be issued free of debt.

EC663. The existing banking system has failed and is no longer fit for purpose. The Green Party believes that the power to create money must be removed from private banks. The supply of our national currency must be fully restored to democratic and public control so that it can be issued free of debt and directed to environmentally and socially beneficial areas such as renewable energy, social housing, or support for community businesses.

(The use of the phrase "supply of our national currency" in the text of the motion is intended to ensure that the proposed programme of reform is consistent with the Green Party's existing policy of establishing a network of local, democratically accountable Community Banks which would have to power to create and manage local currencies that would operate alongside the national currency.)

4.1 Appraisal of options for reform of the banking system

This paper considers three options for reforming the banking system to remove or limit the power of private banks to create money:

- Tighter regulation of the banks – including strict controls on their lending
- Taking banks into public ownership
- Restoring the power to create our national currency to public control.

An appraisal of each option is presented below. The results of the appraisal demonstrate that restoring the power to create our national currency to public control, in a way that enables it to be issued free of debt, is the best option for reforming the banking system.

4.2 Option 1 - Tighter regulation of banks

The existing monetary policy of the Green Party reflects the first option. It calls for "stricter regulation of the banks", and proposes that "their lending power should be reined in, enabling the emphasis of lending to be transferred to sustainable production". In support of these aims existing Green Party monetary policy also sets out a number of measures including regulation of financial instruments, re-introduction of the requirement for banks to maintain minimum fractional reserve ratios, re-establishment of controls on international capital movements, legal separation of retail and investment banking, and maximum limits on the size of banks.

The above measures would indeed be beneficial, and the proposed motion on banking reform leaves them in place as important elements of the Green Party's monetary policy. However, while these measures would go some way to restraining the worst excesses of the existing banking system, they would not achieve the Green Party's objective to "control and re-direct the creation of money towards socially and environmentally sound areas of the economy, and away from unsustainable and consumption- driven areas"[13]. This is because banks would retain the power to decide and set policies for the allocation of new loans (all be it within the constraints of any regulatory limits on different types of lending) and would continue to exercise such power in their own profit-seeking interests. The measures set out in the current Green Party monetary policy would not give a Green Government the power to direct bank lending towards environmentally and socially beneficial areas.

4.3 Option 2 – taking banks into public ownership

The second option – taking banks into public ownership – would bring the banking system under public control. In addition to regulating banking activity, Governments would have the power – as shareholder - to appoint the boards of publicly-owned banks and, if necessary, to direct them to follow socially and environmentally beneficial lending policies. Also, the profits earned from bank lending would accrue to the benefit of the taxpayer.

However, there are a number of significant disadvantages to taking the banks into public ownership:

- ***Cost*** – under international law, governments that nationalise property are obliged to pay appropriate compensation to former owners or shareholders for the value of the property taken.[14] In a recent pamphlet, the Fire Brigades Union estimated that full nationalisation of the big five banks would cost about £55bn at current market rates.[15] While such compensation could be paid in the form of Government Bonds, the servicing of these bonds would be a cost to the taxpayer.

- ***Risk of corruption*** – public ownership would expose bank lending decisions to the risk of malign influence by vote seeking politicians. How would non-green governments be prevented from directing nationalised banks to fuel unsustainable economic booms, or worse, from making loans to fund their pet projects or reward their supporters? Measures could be designed to protect the independence and integrity of banks' lending decisions. However such measures would inevitably limit the ability of a Green Government to direct lending to socially and environmentally beneficial areas, and thus undermine one of the potential benefits of taking the banks into public ownership.

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[13] Paragraph EC661, Monetary policy, Policy for Sustainable Society, Green Party of England and Wales

[14] In 1962, the United Nations General Assembly adopted Resolution 1803, "Permanent Sovereignty over National Resources", which states that in the event of nationalization, the owner "shall be paid appropriate compensation in accordance with international law."

[15] "It's Time to Take over the Banks", Fire Brigades Union, 2012. http://www.fbu.org.uk/wp-content/uploads/2012/11/s-time-to-take-over-the-BanksLR.pdf This estimate is relatively low reflecting the currently depressed level of bank share prices.

- ***Maintains high burden of debt*** – under a debt-based money system, as loans are repaid corresponding amounts of credit (i.e. money) are cancelled. Therefore, even under public ownership, the banking system needs individuals, business or the government itself to take out new loans in order to maintain the supply of money circulating in the economy. Society would continue to bear a heavy burden of debt, and, as discussed in section 3.2 above, households on low-incomes bear a disproportionate share of this burden.

- ***Continues to drive unsustainable growth*** – public ownership would mitigate some of the drivers of unsustainable growth under the existing system – for example, the level of mortgage lending could be limited to avoid inflation in house prices. However, the basic growth imperative of the debt-based money system would remain: borrowers would continue to increase their economic activity in order to pay interest on their loans, driving demand for more loans to expand the supply of money available to pay the interest, thus stimulating further growth in the economy.

4.4 Option 3 - Restoring the power to create our national currency to public control

The final option, set out in the proposed motion on Banking Reform - that the power to create our national currency should be fully restored to public control so that it can be issued free of debt – recognises that the stock of money is a vital common resource which should be managed in the public interest.

Leading green economists such as Herman Daly[16], James Robertson[17], Mary Mellor[18] and Molly Scott-Catto[19] have proposed that private banks should be prohibited from issuing debt-based money and that the power to issue a debt-free national currency is instead vested in a public authority. The current practice of banks creating money out of thin air through book-keeping entries should be made illegal just as counterfeiting is.

The 3% of the UK money supply that takes the form of notes and coin (issued by the Government through the Bank of England and the Treasury - see section 2.1. above) is already under public control. The Government earns a profit – known as seigniorage – between the face value of the notes and coins and the cost of producing them. Between,

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[16] See pages 252-254 of *Ecological Economics: Principles and Applications*, by Herman Daly and Joshua Farley, published by Island Press, Washington D.C., 2003

[17] *Creating New Money: A Monetary Reform for the Information Age*, by Joseph Huber and James Robertson, published by New Economics Foundation, London, 2000, and *Future Money: Breakdown or Breakthrough?*, by James Robertson, published by Green Books Limited, Totnes, 2012

[18] *The Future of Money: From Financial Crisis to Public Resource*, by Mary Mellor, published by Pluto Press, 2010

[19] Policy proposal presented by Molly Scott-Catto and Mary Mellor to "Workshop 4: Money and the Financial System" at the Steady State Economy Conference, Leeds, June 2010. http://steadystate.org/wp-content/uploads/WS4_Proposal_Money.pdf

2000 and 2009 the value of this seigniorage to the UK Government has been estimated at saving the public £18 billion in taxes[20].

The seigniorage on the 97% of the UK money supply that takes the form of bank credit is effectively enjoyed by the banks. As noted in section 2.1 above, between 2004 and 2010 the banks created banks £1.1 trillion of new money. Had the Government been able to create this money instead, then it would have been have been able to repay 80% of national debt of the UK Government[21].

In the UK, there is historical precedent for restoring the power to create money to public control. In the early 19th century, during the industrial revolution, the banking sector had expanded to finance the growth of trade and industry. A shortage of silver and copper coinage led to the practice of privately owned banks creating money through the issue of bank notes that were nominally backed by their holdings of gold and coins. However, a wave of speculation in company start-ups led to increasingly reckless lending and, inevitably, to a series of bank failures and financial crises from 1825 to 1839. In response to these crises the Conservative government of the day passed the 1844 Bank Charter Act, which curtailed and then phased out altogether, the right of private banks to issue bank notes. Henceforth, the power to issue bank notes was vested solely in the Bank of England.[22]

However, the Bank Charter Act did not address other substitutes for money – such as the use of cheques to transfer credit between accounts held in bank's accounting records. So, over time, the banks were able to recover their power to create money to the extent that, in the modern age of light touch regulation and electronic banking, credit created by private banks accounts for 97% of the money that circulates in the UK economy.

Recently published research by IMF economists[23] has corroborated the potential benefits of restoring the supply of money to public control so that it can be issued free of debt. The researchers used a comprehensive and carefully calibrated model of the banking system within the U.S. economy, to examine claims, made by the economist Irving Fisher in 1936, of the benefits from implementation of Full Reserve Banking, in which commercial bank deposits would have to be backed 100% by reserves of government issued money. They found support for all four of the benefits claimed by Fisher, to quote the paper:

- "Much better control of a major source of business cycle fluctuations, due to the avoidance of sudden increases and contractions of bank credit and of the supply of bank-created money

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[20] Estimate quoted in p160 of *Modernising Money*

[21] As of Q4 2012 the national debt amounted to £1,347.4 billion, or 88.7% of total GDP. http://ec.europa.eu/economy_finance/publications/european_economy/2012/pdf/ee-2012-7_en.pdf

[22] Description of these events taken from P40, *Modernising Money*

[23] Working paper - "The Chicago Plan Revisited", by Jaromir Benes and Michael Kumhof, published by the IMF Research Department in August 2012.

- Complete elimination of bank runs
- Dramatic reduction of the (net) public debt
- Dramatic reduction of private debt, as money creation no longer requires simultaneous debt creation."

The IMF researchers also found that the reform produced output gains approaching 10 percent, and that steady state inflation could drop to zero without posing problems for the conduct of monetary policy.

4.5 Conclusion

The updating of the Bank Charter Act to reflect the reality of banking practices in the modern age is long overdue. Compared to the options of tighter regulation or nationalisation of the banks, a programme of reform to restore the power of the state to issue money free of debt has compelling advantages:

- The seigniorage from creating money would be for public benefit not private profit.
- How and where new money should be spent would be a matter of public choice, rather than being decided by the boards of a handful of banks.
- The replacement of debt-based money with money created by the state – money that is free of debt and interest charges - would enable the heavy burden of debt to be reduced, would reduce inequality, and would eliminate the growth imperative that is built into the existing banking system.
- There would be greater economic stability – the severe recessions caused by financial crises could be avoided because the supply of money would no longer be subject to "boom and bust" cycle of bank lending.

This paper next considers how banking reform to restore the power of the state to issue money free of debt could be implemented.

5. Implementation and benefits of proposed programme of banking reform

The text of the motion – in new paragraph EC664 - describes how reform of the banking system should be implemented to fully restore the power to create money to democratic and public control.

EC664. A Green Government will therefore develop and implement a programme of banking reform based on the following principles:

a) All national currency (both in cash and electronic form) will be created, free of any associated debt, by a National Monetary Authority (NMA) that is accountable to Parliament;

b) The 1844 Bank Charter Act will be updated to prohibit banks from creating national currency in the form of electronic credit. To finance their lending, investment or proprietary trading activities, banks will have to borrow or raise the necessary national currency from savers and investors;

c) The NMA will be mandated by law to manage the stock of national currency so that it is sufficient to support full employment, while avoiding general inflation in prices, and taking into account the development of local currencies (Ref. paragraph EC 678);

d) Any new money created by the NMA will be credited to the account of the Government as additional revenue, to be spent into circulation in the economy in accordance with the budget approved by Parliament;

e) The members of the NMA will be appointed – for fixed terms - by a Select Committee of Parliament;

f) The independence and integrity of the NMA will be assured by law requiring NMA members and staff to be free of any conflict of interest; mandating full transparency of NMA decisions; and prohibiting lobbying or undue influence of NMA members or staff by government, financial institutions, corporations or any other private interest.

5.1 Feasibility of implementing banking reform

By setting out principles of reform, the motion leaves open, for future planning, the specific mechanics of the new monetary system, the timing of implementation, and design of transitional measures to ensure that financial and economic stability is maintained during the period of transition from the current monetary and banking arrangements.

The feasibility of implementing reform of the UK banking system, following the principles set out above, has been demonstrated by the pressure group Positive Money. In their recent book, *Modernising Money*, Andrew Jackson and Ben Dyson of Positive Money describe a detailed programme of measures, based on Full Reserve Banking:

- The first step would be to convert all existing bank current accounts into Transaction Accounts that are 100% backed by national currency held (in electronic form) at the Bank of England. The aggregate value of current account liabilities that exist on each bank's balance sheet would be replaced by a "conversion liability" owed to the Bank of England that would be repayable in national currency.

- Repayment by the banks of their conversion liabilities to the Bank of England would be based on repayment schedules that reflected the maturity profile of their respective loan books. So, as existing borrowers repaid their loans with national currency, banks would use this money to repay their conversion liabilities.

- As the conversion liabilities were repaid (probably over a period of 10-20 years), national currency would be recycled by the Bank of England as necessary to maintain the required stock of national currency in circulation. To recycle national currency the Bank of England would credit it to the account of the Government as additional revenue to be spent into circulation in accordance with spending plans approved by Parliament. An alternative to such recycling, would be a structured programme of debt-relief to reduce the burden of unsustainable household debt.

- To raise funds for new lending, banks would offer Investment Accounts in which customers could save by lending their national currency to the bank for a maturity term (or withdrawal notice period) of not less than (say) 28 days. To avoid moral hazard, Positive Money proposes that balances held in Investment Accounts would not be guaranteed by the Government or any public body.

- The balances of customer Investment Accounts would be shown as liabilities on banks' balance sheets, and the national currency deposited in these accounts would be held in banks Investment Pool accounts at the Bank of England, The balances of the Investment Pools would be shown as assets of the banks' on their balance sheets.

- To make new loans, banks could only use national currency held in their Investment Pool accounts or Operating Accounts at the Bank of England. Banks would be prohibited by law from using national currency deposited in Transaction Accounts to fund (or to provide security for) lending, investment or speculation activity. Banks would receive repayments of loans into their Investment Pools, and would use the national currency held in these to either make new loans or repay customers who wished to withdraw savings from their Investment Accounts. The banks would hold national currency that represented their own capital and their accumulated profits in the Operating Accounts out of which they would pay their expenses and receive income in the form of service charges or interest on loans.

- Positive Money's proposals include a measure that would give the Bank of England the power, during the transition period, to create and lend new national currency to the banks if this was necessary to provide banks with the necessary liquidity to meet the demand for loans. The Bank of England would charge the banks interest on such loans.

- Positive Money's proposals also include detailed measures to govern the appointment of the NMA[24], and to protect the independence and integrity of its decisions to and manage the supply of national currency. Indeed, Positive Money has drafted a bill for Parliament to put these measures into law.[25]

5.2 Benefits of proposed programme of banking reform

The benefits of restoring the supply of money to public control so that it can be issued free of debt were listed in sub-section 4.5 above, but are repeated here again for ease of reference:

- The seigniorage from creating money would be for public benefit not private profit.

- How and where new money should be spent would be a matter of public choice, rather than being decided by the boards of a handful of banks.

- The replacement of debt-based money with money created by the state – money that is free of debt and interest charges - would enable the heavy burden of debt to be reduced, would reduce inequality, and would eliminate the growth imperative that is built into the existing banking system.

- There would be greater economic stability – the severe recessions caused by financial crises could be avoided because the supply of money would no longer be subject to "boom and bust" cycle of bank lending.

The additional benefits of implementing this reform in accordance with the principles set out in the banking reform motion are described below:

- ***Independence and integrity*** – the measures (set out in EC664 sub-paragraph f) are designed to ensure that decisions on increasing or decreasing the amount of money circulating in the economy are made free of any influence by either private interests or vote-seeking politicians.

- ***Public Accountability*** – the independence and integrity of the NMA is further reinforced by:

    a) Its legal obligation to operate within its statutory mandate to support full-employment while avoiding general price inflation (EC664 sub-paragraph c)

    b) Appointment of its members by a Select Committee of Parliament, and not by the Government (EC664 sub-paragraph e)

    c) Ongoing requirement that the NMA will be accountable to Parliament (EC664 sub-paragraph a) meaning that the members of the NMA could be called at

[24] Under Positive Money's proposals , the Monetary Policy Committee of the Bank of England would act as the National Monetary Authority

[25] *Bank of England (Creation of Currency) Bill*, third draft dated 4th May 2011, published by Positive Money

any time to appear before a Select Committee to explain their policies and decisions.

- ***Democratic control over how new money is used*** – the publicly accountable NMA would have sole authority to create new money, but all decisions on how to spend or allocate any new money would be made by the democratically elected Government of the day, and would be subject to the approval and scrutiny of Parliament (EC664 sub-paragraph d).

- ***Reduced moral hazard*** – the motion does not rule out state guarantees of deposits where these would be appropriate – for example savings placed in low-risk accounts at a state-owned "People's Bank" (Ref EC 669). However, the requirement that banks would have to borrow or raise national currency from savers or investors to fund their lending, investing or proprietary trading activities (EC664 sub-paragraph b), is intended to introduce a taut relationship between the reward that banks depositors receive and the level of risk they choose to be exposed to. The aim of this provision is that banks' commercial policies, practices and judgement would be subject to both the discipline of the market and the robust scrutiny of their customers.

6. Cost and revenue impact of banking reform

6.1 Cost – No additional public expenditure

The programme of banking reform proposed in the motion would not have any significant impact on public expenditure:

- **Insignificant legislative cost** – the proposed programme of reform would require primary legislation, thus incurring costs of research and planning, political briefing, public consultation, responding to stakeholder lobbying and representation, and administration of parliamentary procedures. In financial terms, these costs would not be significant: a generous estimate would be in the order of only £30-50 million[26]. This could be funded within the existing budgets of the relevant Government departments and regulatory authorities.

- **The banking industry would bear its own costs** – implementation of the proposed reforms would require commercial banks to make changes to their accounting systems, and to their regulatory compliance procedures. However, as these changes would be necessary to enable banks to comply with relevant law, they would arise in the normal course of business and the banks would thus bear the cost. By way of comparison, banks have borne considerable costs arising from recent reforms of the regulation of financial advisers, which have required banks to re-train their advisory staff to ensure their accreditation under the new rules.

- **No requirement for compensation for loss of property or other legal rights** – It is generally accepted that the legal right to create currency is one of the fundamental powers of a sovereign state. Banks have usurped this power. Banks have no right in law to create money through their accounting processes. This practice has simply arisen over time. Therefore the question of compensation for updating banking legislation to prevent this practice does not arise.

- **No additional ongoing regulatory costs** – over and above the impact of existing Green Party monetary policy, the proposed reforms should not require any significant addition to the administrative capacity and infrastructure that already exists within HM Treasury, the Bank of England and the Financial Conduct Authority to regulate banks and to record and manage and financial transactions between the Bank of England and commercial banks.

[26] The legislative cost of implementing the proposed reform is roughly estimated to be £30-50 million. This estimate is based on the following assumptions. A special policy project team of about 50 people would be appointed in HM Treasury (including secondees from the Bank of England) and that the team would remain in place for the duration of a Parliament - 5 years. (The number of staff in the team would rise and fall during this period - but we can assume that this will average 50 for the duration of the team's existence.) Assuming an average employment cost of say £60,000 per annum, gives a cost of £15 million over 5 years. Adding 100% to allow for the cost of office accommodation, IT, communications, publicity and external advice - gives a total estimated cost of £30 million. Allowing a further margin for optimism bias gives a top range of the cost estimate at £50 million.

- **No additional ongoing public expenditure** – there would be no requirement for recurring public expenditure arising from the proposed programme of banking reform.

6.2 Revenue – potential £1,000 Billion seigniorage revenue

As described in section 4.5 above, the restoration of the power to create money to pubic control, would mean that the public purse would benefit from the seigniorage from creating money. Under the proposed programme of banking reform, this seigniorage would be realised when any new money created by the NMA is credited to the account of the Government as additional revenue. Assuming that the stock of money in circulation would be maintained at its current level, then as banks repay their conversion liability during the transition period (as described in sub-section 5.1 above) national currency would be recycled into the economy through additional public expenditure or reduced taxation.

Positive Money have estimated that the potential value of the seigniorage arising from the reforms would be in the order of £1,000 billion[27] over a period of around 20 years.

Therefore, during the transition period public revenues would increase by about £50 billion per year. This would be sufficient to fund – without incurring any Government debt - each year:

- A social dividend of approximately £2,000 for each household in the UK, or
- Half of the annual state education budget, or
- Construction of 100 hospitals providing 100,000 patient beds – roughly equal to three-quarters of the hospital capacity of the NHS in England, or
- The HS2 High-Speed rail network (allowing for a 50% mark-up for cost overruns on current cost estimates), or
- Construction of 50,000 Megawatts of wind power generation capacity – equivalent to 50 wind farms the size of the London Array off-shore facility in the Thames estuary – or enough capacity to generate electricity for 35-40 million homes[28], or
- Build 250,000 new homes.

[27] Estimate based on the value of the total stock of demand deposit liabilities, which would be converted to national currency under Positive Money's proposals. As at Sept 2012, the total value of demand deposits - representing about half of the M4 measure – was £1,041 billion, according to Table B1.4 of the Bank of England's BankStats publication. Pages 228, 234 - *Modernising Money*

[28] There are just 24 million households in the UK

7. Impact of banking reform on Green Party policy

Restoring the power to create money to public control would complement and build on existing Green Party policies on banking and money, and would create a more favourable environment for the implementation of Green Party policies more generally.

7.1 Implications for existing Green Party policy on banking and money

The proposed programme of banking reform would complement and build on existing Green Party policies on banking and money that call for:

- Strict regulation of investment banking activities and their separation from retail banking
- Limitation on the size of banks
- Creation of a Peoples Bank from the currently nationalised banks to provide a guaranteed safe-haven for people's savings
- Support for mutually owned banks, credit unions and micro-credit schemes
- Regulatory control of mortgage lending and derivatives
- A programme to decentralise banking through the establishment of a network of local, democratically accountable Community Banks
- The promotion and development of local currencies.

The banking reform motion includes a number of minor amendments to existing policies on Community banks, and on the management of the money supply and interest rates to ensure that these are consistent with the proposed banking reform:

- Paragraphs EC665, EC676, and EC677 are amended so that policies regarding the re-introduction of minimum reserves, and the role played by the Bank of England in managing the money supply and interest rates within the existing banking system are described as interim measures pending the introduction of the proposed programme of banking reform.
- Paragraphs EC 678 and EC512 are amended to remove statements that Community Banks would have the power to create credit in the same way as commercial banks currently do. Such power would be inconsistent with the proposed programme of banking reform. Community banks would instead be able to create credit through the issue of local currencies.

As noted above, the banking reform motion leaves in place existing policy – set out in paragraphs EC678 and EC512 – that Community Banks would be empowered to create their own local currencies, to operate alongside the national currency, where this is supported by the local community, and that the Green Party would research the best use of local currencies and encourage their adoption. The motion also recognises local currencies in proposed new paragraph EC664, which states that the NMA would be required to take into account the development of local currencies in managing the stock of national currency.

7.2 Implications for wider Green Party policies

The proposed programme of banking reform would create a more favourable environment for the implementation of the Green Party's policies for a sustainable and just society:

- Removing the growth imperative that is inherent in the existing banking system, would support the development of a steady-state economy.

- The issue of money free of debt and interest would enable a significant reduction in the burden of debt and thus remove a major driver of inequality.

- The seigniorage from state created money would provide funding for public expenditure on socially and environmentally beneficial projects such as renewable energy sources, sustainable transport infrastructure, modernisation of health care facilities, or provision of affordable housing.

- Restoring the power to decide how money is first used to democratic and public control would avoid the misdirection of credit towards financial speculation, the property market and other non-productive activity.

- The end of lending driven booms and busts, leading to greater financial and economic stability – would make it easier for governments to resist lobbying by business for the repeal of environmental legislation on the grounds that this would reduce business costs.

8. Answers to common concerns about banking reform

In this final section, the paper considers a number of concerns that have been expressed about banking reform based on Full Reserve Banking (FRB).

8.1 Could the UK operate a Full Reserve Banking model within the foreign exchange markets?

UK national currency issued by the NMA, under a full reserve banking (FRB) system, could still be exchanged for foreign currencies and traded on international currency markets.

Under a FRB model, the mechanics of exchanging UK national currency with foreign currencies could continue to operate much as they do now.[29] To settle, through the banking system, any trade or exchange of foreign currency with UK national currency, a customer must have an account with a bank that has access to the UK payments system that is managed by the Bank of England. So all the UK national currency denominated accounts that are used to settle the foreign currency trading and exchange transactions of foreign customers are already within the jurisdiction of the Bank of England and could therefore become subject to the same 100% reserve requirement as domestic customers' current accounts.

Arguably, a currency that is created under a FRB system would hold its value (compared to currencies that remain debt-based) well on the foreign exchange markets as its supply would be stable and not subject to the "boom and bust" lending practices of the commercial banks.

8.2 Wouldn't the introduction of FRB be another state "bailout" of the banks?

Creation of the national currency (in electronic form) required to provide 100% "reserve" backing of existing current accounts would not be another state "bailout" for the banks.

As noted in sub-section 5.1 above, provision of the necessary reserves of national currency would be balanced by new Conversion Liabilities (which, in aggregate, would equal the total value of the national currency reserves created) owed to the Bank of England by the commercial banks. As the commercial banks repaid these loans over time (using national currency that the banks receive from their own borrowers as they repay existing commercial bank loans) the Bank of England would recycle the national currency it receives by crediting it to the account of the Government to fund public expenditure or repay public debt. This recycling would enable supply of money circulating in the economy to be kept at a stable level. An alternative to such recycling, would be a structured programme of debt-relief to reduce the burden of unsustainable household debt.

So far from being a bail-out for the banks, the introduction of full-reserve banking would enable a massive reduction in the burden of debt that is currently acting as a major drag on economic recovery.

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[29] An excellent description of how the currency markets currently function in the UK is provided in Appendix 4 of *Where Does Money Come From*, by Josh Ryan-Collins, Tony Greenham, Richard Werner and Andrew Jackson - published by the New Economics Foundation, September 2011

8.3 *Would stopping the banks from creating money result in a shortage of credit?*

The removal of the commercial banks power to create money should not result in a shortage of credit for business and for house-buying.

It has been argued that under a FRB regime – such as the one proposed by Positive Money - savers would not be willing to take the risk of placing their money in Investment Accounts (i.e. savings accounts) that were no longer guaranteed by the state, but would prefer to hoard it in Transaction Accounts (i.e. current accounts) which would be 100% backed by national currency. This would mean that there would be insufficient funds for banks to make loans to businesses that wished to expand or to households that wished to purchase homes or other major assets.

This objection ignores the following ways in which savers and banks are likely to respond to the introduction of banking reform based on FRB:

- The majority of commercial bank customer credit balances are held in time-deposit accounts[30] – £1.5 trillion - 58% of all deposit account balances as at Sept 2011[31]. It is unlikely that all of these funds would be shifted to Transaction/current accounts following the introduction of reform based on FRB.

- Households will still need to save (e.g. for deposits to buy housing or for major purchases) and would likely accept exposure to the low risk of investment/savings accounts in return for the opportunity to earn interest on their savings and thus mitigate the threat of the value of their savings being eroded by rise in the cost of living.

- The commercial banks would adopt more transparent and prudent lending policies to reduce the level of perceived risk and persuade households to entrust their savings with them.

- Market forces will operate and banks will offer the rates of return (at given maturity terms) that are necessary to attract the level of savings required to meet demand for lending.

Also, Positive Money's proposals include a measure that would allow the Bank of England, if it proved to be necessary during a transition period, to create and lend national currency to commercial banks to provide them with funding for business and mortgage lending. (This would be similar to the Bank of England's current "Funding for Lending" scheme.) Other measures to discourage hoarding and encourage the use of savings accounts could include

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[30] In the existing banking system, Time-deposit accounts are equivalent to Investment Accounts in that money has to be deposited for a given minimum term, or withdrawal notice period.

[31] Analysis by Positive Money – p 265-266, *Modernising Money*

the levy by the Bank of England of a "demurrage" charge on national currency reserves that commercial banks would then have to pass on to their current account customers.

8.4 Would allowing the state to create money lead to inflation?

The proposed programme of reform avoids the risk of reckless, vote-seeking, politicians causing inflation by ordering excessive money creation. It does so by vesting the power to create money in an independent and publicly accountable National Monetary Authority, which would have a clear mandate to ensure economic stability and avoid general inflation of prices. The proposed reforms include measures to strengthen the independence of the NMA from government influence - e.g. by giving a Select Committee of Parliament the power to appoint the NMA, and to hold it to account.

In any event, the proposed reforms could only improve on the performance of the existing banking system that has generated an exponential increase in the money supply, fuelled inflation in house prices, caused other asset price "bubbles", and financed a massive expansion of speculative trading in financial markets to the extent that this is now a constant threat to the stability of the economy.

Annex

Text of the Policy for Sustainable Society, Economy Chapter, Section 7 - Monetary Policy – as amended

The full text of the Monetary Policy section, within the Economy chapter of the Policy for Sustainable Society, showing how it would be amended by the Banking Reform motion, is presented below

Monetary Policy

EC660 In a Green society the informal sector will eventually gain in significance so that formal transactions and money generally will have a lesser role than at present. There is however no reason why a financial system cannot be made to work in the interests of the community. Practical decentralisation of banking and monetary policy will therefore be linked with a programme of political devolution.

~~EC661 The world money supply has increased over the medium to long term. Almost all is created by commercial lending institutions. The resultant debts are an important promoter of economic growth and consumption, as well as instability. The emphasis in monetary policy will be to control and redirect the creation of money towards socially and environmentally sound areas of the economy, and away from unsustainable and consumption-driven areas.~~

~~EC662 Greed driven lending and financial engineering lead to the accumulation of debts, derivatives and other securities based on debt, and so to financial crises. In particular we aim to avoid:~~

~~1. Excessive economic dependence on private debt;~~

~~2. The reliance of banks on inter-bank lending rather than customer deposits;~~

~~3. Excessive lending on mortgages and for consumption;~~

~~4. Complex and opaque financial instruments, which managers of financial institutions and regulators themselves do not understand;~~

~~5. Lack of transparency on financial markets, and lax and inadequate official regulation.~~

~~EC663 The current economic system enables commercial banks and other financial institutions to exert an unacceptably large influence on the economy. Their lending power should be reined in, enabling the emphasis of lending to be transferred to sustainable production.~~

~~EC664 We will introduce strict controls on the financial sector to ensure that it serves the purposes of a sustainable economy. To ensure stability, we will regulate all financial instruments firmly and permit only those that are transparent, that offer limited risk of financial destabilisation and are clearly beneficial. We will ensure there is stricter regulation of the banks, limiting them principally to the on-lending of customer deposits and enforcing fractional reserve ratios. We will require transparency in all financial trading, including that undertaken by private investment funds.~~

EC661. The Green Party believes that, as the means of exchanging goods and services, the stock of money is a vital common resource which should be managed in the public interest. Yet only 3% of our money supply currently exists in the form of notes and coins issued by the Government or the Bank of England. 97% of the money circulating in the economy takes the form of credit that is created electronically by private banks through the accounting processes they follow when they make loans.

EC662. The existing banking system is undemocratic, unfair and highly damaging. Banks not only create money, they also decide how it is first used – and have used this power to fund financial speculation and reckless mortgage lending, rather than to finance investment in productive businesses. Through the interest charged on the loans on which all credit is based, the current banking system increases inequality. It also regularly causes economic crises: banks create and lend more and more money until the level of debt becomes unsustainable, boom turns to bust, and the taxpayer bails out banks that are "too big to fail". Finally, the need to service the growing mountain of debt on which our money is based is a key driver of unsustainable economic growth that is destroying the environment.

EC663. The existing banking system has failed and is no longer fit for purpose. The Green Party believes that the power to create money must be removed from private banks. The supply of our national currency must be fully restored to democratic and public control so that it can be issued free of debt and directed to environmentally and socially beneficial areas such as renewable energy, social housing, or support for community businesses.

EC664. A Green Government will therefore develop and implement a programme of banking reform based on the following principles:

a) All national currency (both in cash and electronic form) will be created, free of any associated debt, by a National Monetary Authority (NMA) that is accountable to Parliament;

b) The 1844 Bank Charter Act will be updated to prohibit banks from creating national currency in the form of electronic credit. To finance their lending, investment or proprietary trading activities, banks will have to borrow or raise the necessary national currency from savers and investors;

c) The NMA will be mandated by law to manage the stock of national currency so that it is sufficient to support full employment, while avoiding general inflation in prices, and taking into account the development of local currencies (Ref. paragraph EC 678);

d) Any new money created by the NMA will be credited to the account of the Government as additional revenue, to be spent into circulation in the economy in accordance with the budget approved by Parliament;

e) The members of the NMA will be appointed – for fixed terms - by a Select Committee of Parliament;

f) The independence and integrity of the NMA will be assured by law requiring NMA members and staff to be free of any conflict of interest; mandating full transparency of NMA decisions; and prohibiting lobbying or undue influence of NMA members or staff by government, financial institutions, corporations or any other private interest.

EC665 As an interim measure, before the programme of reform described in EC 664 has been implemented, ~~V~~variable reserves and other macro-prudential controls should be reintroduced as instruments of monetary policy, permitting greater flexibility than the present reliance on interest rates alone. A Green government would work in Europe and globally to re-establish controls on international capital movements, in order to restore financial stability and regain control over the macro- economy.

EC666 Banks should be required to limit their role to taking deposits and making loans that facilitate economic activity. We would immediately legislate to separate retail and investment banking. Institutions would not be permitted to operate in both markets simultaneously. Retail banks should be required to limit their role to taking deposits and making loans that facilitate economic activity. Investment banks should take the form of partnerships rather than limited companies.

EC667 A Green government would restore strict divisions between different kinds of financial activity, such as banking, brokerage, commodities trading, and futures and derivatives transactions. No bank will be permitted, either directly or indirectly through affiliates and subsidiaries, to engage in brokerage, to trade on their own account, create or own hedge funds or undertake private equity transactions. In all fields we would subject the 'shadow' banking sector, such as hedge funds and money market funds, to similar regulations to those affecting the banks.

EC668 We would introduce limits on the sizes of banks: no bank operating in the UK would be permitted to have access to more than 10% of the domestic market or 5% of the global market. Since the worst failures in the banking crisis of 2007-08 were associated with 'wholesale' interbank funding, while mutual banks and others that mainly rely on customer deposits were relatively unharmed, we would tightly reduce the permitted scope of interbank transactions, both in lending and financial derivatives.

EC669 A Green government would create a permanent and genuinely national bank out of one or more of the currently 'nationalised' banks. This People's Bank would form an exception to the percentage-based size-restriction specified in EC668: it would be available as a guaranteed safe-haven to deposit money in for any and all citizens. Most citizens seek safety for their money, not a risky high rate of return, and the People's Bank would offer this in perpetuity. The People's Bank would offer current accounts and all other basic banking services, thus complementing National Savings and Investments. In terms of its lending and other policies, it would act as a non-profit, seeking where necessary to restrict or to relax credit in the national interest. It would in effect be a high street branch of the Bank of England. Its raison d'etre above all would be to act prudently in the interests of all its depositors, to ensure that there was no risk of a bank-run ever endangering their money. This would be achieved by the People's Bank being constitutionally limited to low-risk activities, and by the fact that it would be owned and guaranteed by the state.

EC670 Mutual financial institutions are preferable to those owned by shareholders, since they are more likely to serve customer interests. The Green Party would provide financial incentives for governments at all levels to use mutually owned banks and financial intermediaries for their own business, and to encourage citizens to do the same.

EC671 In the interests of economic and financial stability, strict controls should be placed on lending by all banks, including lending to individuals. For example, mortgage loans should be at fixed rates throughout their terms (as is required in certain European countries), in order to place interest- rate risks on the lender, not the borrower; there should be ceilings on the percentages of a property's value and borrower's income that may be lent on mortgage; and strict limits on the issue and use of credit cards, such as already apply in numerous European countries.

EC672 The derivatives markets should be strictly controlled, with specific approval required for each derivative product. The onus will lie on the product's originator to demonstrate that it is beneficial and there is no alternative way of achieving the same purpose. All derivatives must be transparently traded on public exchanges with approved clearing arrangements. Banks and shadow banks will not be permitted to engage in any futures trades except as clients of approved brokers on a public exchange. Swaps and securitisation instruments will have to be specifically approved, as just described. They must be included in the bank's or shadow bank's balance sheet.

EC673 All banks will be required to observe a fiduciary duty towards their clients, which can only be varied for specific ethical reasons agreed with a client. All banks will have to take direct responsibility for their own credit assessments rather than relying on fallible external rating agencies.

EC674 All banks and shadow banks that are found to be in breach of these market restrictions should be liable to lose their licences and not be permitted to reapply for them for a period of up to ten years.

EC675 In the longer term the banking system should be largely brought under democratic control, preferably at a local level. This will allow the process to work in the best interests of the community as a whole, rather than principally in the interests of commercial banks and their shareholders.

EC676 ~~Since these restrictions on bank lending will severely restrict the money supply~~ As an interim measure, before the programme of reform described in EC 664 has been implemented, the Monetary Policy Committee of the Bank of England will be instructed to monitor the need for increase (or decrease) in the money supply, based initially on maintaining the amount of money existing at the time of implementation of these measures. Criteria will be developed in the light of experience, aiming to avoid both inflation and deflation. It will accordingly instruct the Bank of England to create any supplement needed, on a monthly basis, and credit it to the Treasury to be spent by the government on projects that help society and environment. If the occasion arises that a surplus is threatening to cause inflation, the Bank of England will receive back and cancel an appropriate amount of money.

EC677 As an interim measure, before the programme of reform described in EC 664 has been implemented, t~~T~~he Bank of England will continue to be the institution for the regulation of the national currency and the setting of base interest rates. However, it will not focus on narrow economic indicators such as the rate of inflation, but instead will take a broader view on the impact of its decisions on the economy as a whole. Final decisions on the setting of base interest rates will be made by a democratically accountable committee made up of representatives selected from the different regions of the country.

EC678 In order to help bring about the democratisation of the banking system, and in pursuit of our policies to support the growth of local economies, a network of local Community Banks will be established. These will be democratically accountable non-profit-making trusts, which will be able to provide low-cost finance both at district and regional levels. Any operating surplus arising from these Community Banks will be reinvested in their local communities. ~~Community Banks will be empowered to create credit in the same way that commercial banks currently do, and will be given favourable conditions for doing so by the central bank.~~ They will also be able to create their own local currencies, to operate alongside the national currency, where this is supported by the local community.

EC679 In order to bring about a more socially equitable society, it is important that poorer citizens have access to affordable credit, which can give them an opportunity to increase their basic living standards. Alongside Community Banks, measures to help facilitate this will include the promotion and support of credit unions and micro-credit schemes in which small groups of people cooperate to provide guaranteed small loans to each other.

EC512 Policies to increase local investment and the circulation of local finance within the community, include the development of democratically accountable Community Banks, designed to encourage local people to invest in local economic activity, ~~and empowered to create credit at interest rates sufficient only to cover administration when~~ channelling local savings into economically and environmentally sound community enterprises. They should include removal, where necessary, of national restrictions. We will promote Credit Unions and skills exchange schemes, along with researching the best use of local currencies and encouraging their adoption. (see EC678)