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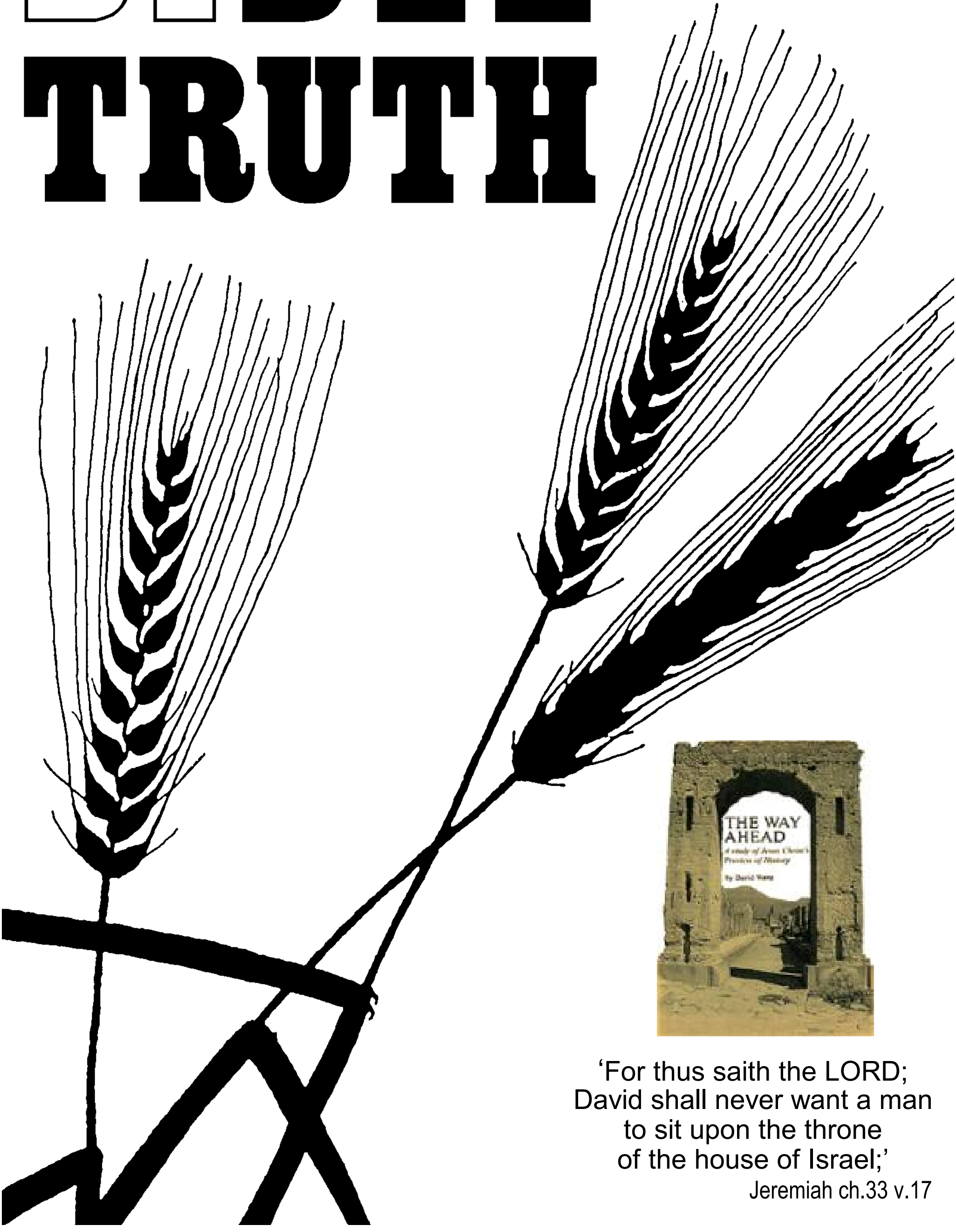

‘For thus saith the LORD;
David shall never want a man
to sit upon the throne
of the house of Israel;’

Jeremiah ch.33 v.17

TINKER BELL FINANCE AND ALICE IN WONDERLAND BANKING

by David Hay

> 'And Abraham hearkened unto Ephron; and Abraham weighed to Ephron the silver, which he had named in the audience of the sons of Heth, **four hundred shekels of silver, current money with the merchant**. And the field of Ephron, which was in Machpelah, which was before Mamre, the field, and the cave which was therein, and all the trees that were in the field, that were in all the borders round about, were made sure Unto Abraham for a possession in the presence of the children of Heth, before all that went in at the gate of his city.'
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> Genesis ch.23 vv 16-18

Editor's note. This Old Testament text is immensely valuable to Bible students because it is an early reference to how trade was done using currency instead of barter or other means. In this case it was a weight of silver and later gold was used. David Hay's article shows the development of money exchange which more often than not became unbiblical in its application.

How profoundly does finance influence the quality of our lives. It exerts a dictatorship over us greater than almost any other authority we recognise. Not even our conventional religious beliefs dominate our existence as much as our economic condition. It determines our personal and social status from infancy to old age. It determines our educational opportunities and by it the advantages of our children are limited or enlarged. It determines the hour at which we rise in the morning. It commands how every day shall be spent and to what tasks we shall bend our backs, minds or efforts. It dictates the hour at which we shall be released at night and the kind of home we shall return to. It insinuates itself into the most intimate fabric of our being in such a way that there is nothing to which its mastery can be compared. It is as merciless and ruthless as any despotic emperor bent on enslavement of populations. We therefore stand perplexed at the relentless fiscal and economic policies of our present governments but we should not be surprised. They are the policies which inevitably follow the application of a financial system which is fundamentally flawed yet we have become so indoctrinated in its principles that we are blinded to any alternative. In this condition we remain slavish prisoners - even defending it belligerently.

What is wealth? It is not money. Wealth is the sum of the collective goods and services that the community possesses or provides for itself. A community which creates nothing and which provides no services for its members is, by definition, poverty stricken.

What is money? Money is the stuff which is used to exchange the goods and services of a community. It is, therefore, a standard of measurement [of wealth] and must have a standard or fixed value.

Hence, money is that part of the economic system which provides the machinery whereby the exchange of goods and services is effected. Money is essentially a man-devised means of replacing the cumbersome methods of barter so that all goods and services can be exchanged with comparative freedom. It might be described as a ticket or token system.

In effect what happens is that, for example, a farmer produces sheep. He sells them and buys money (a certain number of tokens depending on the value of sheep). If he wants a tractor he sells money and buys a tractor (exchanging a certain number of tokens depending on the value of the machine).

Thus, the purpose of a financial or money system should be the distribution of all the goods and services which the community wishes to provide for itself and any system of finance must be judged on the basis of its ability to achieve this objective.

Therefore, 'money' must be created or be available in proportion to the accumulated 'wealth' of the community, that is, in proportion to the creation of its tradable or exchangeable goods and services. If a person creates 'wealth', this has a certain intrinsic value. If he sells or trades some of his wealth and converts its value into 'money', he may choose to store some of it for future requirements (such as retirement) or to purchase other goods or services which he may desire or require. For this reason the purchasing power of money must not alter or be subject to change in value over a period of time which, in effect, diminishes the value of the effort and expertise expended in the creation of the initial wealth. That is, money cannot be 'devalued' to compensate for 'inflation' - or for any other reason. It is an insult, indeed, a deprivation of the rights of the creator of that contribution (wealth) to diminish its value at any time thereafter its creation.

Consequently, money assumes its proper place and status as a device for wealth measurement and falls into the same category as metres, which measure length, or kilograms which measure weight. Money is, in the final analysis, a valueless system of symbols although there must be a recognisable and stable relationship between the money symbols and the real things it is intended to represent (that is, goods and services). Rigidly controlled relationships are maintained between symbols and reality in the areas of measures, weights and other standards. Similarly, rigid constraints must apply to the relationship between money symbols and reality.

To illustrate the point, a contractor undertakes to supply ten kilometres of road. The council knows (because the metre is a standard and inviolable length) exactly how much road it will get. The standard of measurement (the metre] is freely available in unrestricted and abundant supply to measure the length of road required. Another contractor requires ten tons of steel to construct a building. He knows (because the kilogram is a standard and inviolable weight) exactly how much steel he will get. The standard of measurement (the kilogram) is available in unrestricted and abundant supply to weigh out the material.

The respective contractors would be dumbfounded if they were told that because there was a current shortage of metres or kilograms they could not build a length of road or weigh an amount of steel. The roading contractor would be even more dumbfounded if he were told that before he could build the road he would be required to take out a loan of 10,000 metres from the Metre bank and he would be stupefied it he were then informed that after he had built the road, he would be required to return not only the 10,000 metres which he had borrowed, but because the interest rate on metres was 10% he would need to find another 1000 metres to add to the original. Where would he find the extra metres? Take some from another contractor? Apply the same analogy to the builder and a great philosophical schizophrenia is apparent. Yet, is this not what has happened to our money system?

Further, the contractor and the builder would be totally frustrated if, having commenced their work, the length of the metre or the weight of the kilogram were ‘devalued’ so that they were, respectively, only able to build 9 km of road, or erect a building of smaller stature because the metre was suddenly shorter or the kilogram lighter. But is this not what happens in our economy?

Should not 'money', the standard of wealth measurement, be similarly available in unrestricted and abundant supply to measure and exchange the true wealth of our community - the goods and services which we desire and which we provide by our own efforts? It is philosophically and fundamentally wrong that the system of measurement itself, should become a tradable commodity in its own right, that the units of measurement should vary in value from day to day and that that system of measurement should, by some devious act of magic, be able to multiply itself.

How is it, then, that our present money system has been allowed to depart from a fundamentally honest and truthful means of wealth measurement? Why have we allowed every aspect of our lives to be dominated by a system which is nothing more than an evaluation device? Why has the servant become the master? The answer lies in the methods by which banks create and manipulate currency.

THE DEVELOPMENT OF BANKING

The early history of English finance has been little investigated but there seems no good reason to doubt the tradition that before 1640 merchants and moneyed men kept uninvested funds either on their own premises, whence it could be stolen, or in the Tower of London. When King Charles I converted these deposits into a forced loan, this action by the Crown made men distrust the Tower as a place of safe deposit and the practice arose of depositing money in the strong-rooms of the goldsmiths - who subsequently lent it out reserving only sufficient to meet probable calls. The present finance and banking system developed from this time and its origin established many of the principles which are now regarded as sacrosanct economic practice.

In the course of conducting their business, merchants quickly learned that their receipts (the gold certificates issued by the goldsmith to the merchant confirming that he possessed a certain weight and purity of gold or coin and that it was held in safe deposit in the goldsmith's vault) could be used as payment for goods. This arose because of the undoubted inconvenience of the merchant having to take a journey to the goldsmith in order to redeem some of his gold to pay for the goods. The reasoning would be something like this. 'We have agreed on a price for these goods but it is 30 miles to travel to London for me to obtain the gold to pay you. Would you be prepared to accept my goldsmith's certificates as surety of the fact that I have the gold required for payment on deposit in his vault?

When you are next in London, you can present them yourself and he will issue you the gold.'

So, the onus of collecting the money was transferred to the vendor who, likewise, found it equally inconvenient to travel to the goldsmith to redeem the certificates and used the same certificates as payment to another vendor in a separate business deal of his own. In other words a form of payment very similar to the present system of the cheque, was rapidly established. Meanwhile, the gold or coin itself, remained in the goldsmith's vault.

An important point to note at this stage is that although paper certificates were circulating as a form of 'money', they were fully backed by the corresponding value in gold and coin held by the goldsmith. If all the merchants suddenly wanted their deposits back they only had to present their documentation (the gold certificates) to the goldsmiths who could redeem these receipts by returning the merchant's property. Indeed, until the advent of decimal currency in New Zealand all banknotes were printed with the declaration, 'Reserve Bank of New Zealand promises to pay on demand the value (in gold) of ' ... Ten shillings, pounds etc. In other words one could still apply to the Reserve Bank to redeem the promissory note for its value in gold at that time.

It did not take very long, however, for enterprising goldsmiths to realise that at any one time the amount of gold or coin they were required to pay out was only a fraction of the total they had in storage and it was not a large step to the concept - no doubt rationalised as good business practice - of issuing some of the gold held as reserve and of writing additional 'receipts' for other customers who wanted financial loans. The reasoning could have been thus,

'I have in my vault 1000 ounces of gold for which I get only a small storage fee. Last year I noticed that there was never any more than 100 ounces out in circulation at any one time. It seems terrible to leave 900 ounces of good money lying about in my vault doing nothing. It appears that I have a couple of options. I could loan out some of the gold - it would never be missed - and charge interest ! If I loaned out 300 ounces at 10% interest then I could make 30 ounces of gold per year for myself ! That still leaves 600 ounces. I suppose I had better keep 400 ounces just in case one or two of the merchants actually do require more than usual but, even then, there are still 200 ounces to do something with. If I wrote out some more "gold certificates" (which are being accepted as money anyway) I could make more loans to the value of 2000 ounces ! That would mean that the "spare" 200 ounces would go out in cash - since I have noticed that only one tenth of the value of the receipts I previously issued to the merchants is ever required for cash at any one time. I can charge 10% on the new paper "receipts" and earn a further 200 ounces ! What a magnificent profit - not a large risk and all done with someone else's money ! Two hundred and thirty ounces of gold in profit per annum on a 1000 ounces deposit !!!'

What has happened so far?

1. The goldsmith has issued receipts (gold certificates) to the true value of the gold and coin deposited in his vault by his merchant customers (OK).
2. Some of those certificates have been circulated by the merchants as a form of payment instead of gold or coin. That is, 'paper' has started to become accepted as real currency (NOT OK).
3. A relatively small amount of the gold and coin has remained in circulation as a means of payment for goods and services (OK).
4. Deception.
    a. The goldsmith has added to the money supply by the amount of 300 ounces of gold taken from the merchant's deposits and recirculated it as a new loan (THEFT).
    b. He has also 'created' money by issuing additional paper to the value of 2000 ounces of gold based on only a 200 ounce reserve (FRAUD).
    c. He has added insult to injury by placing an interest charge on loans which he has spuriously made with someone else's property (WORSE).
5. Result.
    d. The money supply has been artificially expanded.
    e. The goldsmith does not have enough gold in his vault to back up the value of his circulating gold certificates.
    f. The statutory right of the Crown to mint the coin of the realm has been subverted and taken over by the goldsmiths.

6. Faults.
   a. Fault one - lay with the merchants for substituting a 'receipt' for payment in lieu of the official coin of the Realm.
   b. Fault two - occurred when 'paper' - certificates / receipts - became accepted as bone fide money, which led to
   c. Fault three - goldsmiths realising that the bulk of their gold deposits were not being used and motivated by greed,
   d. Loaned out some of the metal - at interest.
   e. Printed more paper loans - at interest.
7. Consequences.
   a. If the merchants (depositors) suddenly wanted their money back, the goldsmith did not have enough in reserve to pay all the withdrawal demands. Indeed, McCaulay quotes from a pamphlet published in 1695 saying, 'No goldsmith had in his vaults guineas and crowns to the full value of his paper'.
   b. Depositors could be defrauded of their deposit because the goldsmith could become insolvent.
   c. Those to whom the money was loaned and on whom the added burden of the interest payment was loaded became 'prisoners of the goldsmith' because of the contract to repay the total debt.
8. Notwithstanding, it is upon these foundations that the modern system of finance and banking has arisen. Fractional Reserve Banking, by its very definition, is a system under which bankers keep in their vaults as reserves only a fraction of the funds they hold on deposit.

Three important features have consequently emerged today.

- First, by getting deposits at zero interest and then lending some of the deposit at positive interest rates, goldsmiths made a profit. Banks remain in business to make profits and now return a small proportion of their overall profit to depositors as interest on the deposit (which is taxed by the Government at the current overall earning rate of the depositor !)
- Second, when goldsmiths decided they could get along by keeping only a fraction of their deposits in reserve and lending out the balance, they acquired the ability to 'create money'. As long as they kept 100% of the deposits, each gold certificate represented one ounce of gold. So, whether people decided to

carry their money around with them or leave it with the goldsmith, the money supply was balanced. But with the advent of fractional reserve banking, new paper certificates were added whenever goldsmiths lent out some of the gold they had on deposit. The loans, in effect, created new money and in this way the total amount of money came to depend on the amount of gold each goldsmith felt compelled to maintain in reserve. That is, the lower the reserves kept, the more loans could be made and therefore the more money there would be - a paradoxically inverse relationship. It may be noticed that in recent times Ministers of Finance have constantly emphasised the need for the public to save much more than they are doing. Somehow it is very bad for people to actually spend the money that they have earned ! It is very clear that the subtle purpose of the admonition is so that the banks will be able issue more loans and so create more money on the basis of the increased deposits. In other words, the introduction of money into circulation became separated from an increase in the volume of goods and services, becoming a matter of money manipulation rather than maintaining a balance between the amount of currency available and the goods and services available. At the present time, although gold is no longer used to back up our money the principle remains that bankers' business decisions influence the supply of money.

- Third, a goldsmith who kept 100% of his reserves never had to worry about a 'run' on his vault. Even though all his clients showed up at the same time he always had enough to return their deposits. As soon as the first goldsmith decided to get by with only a fractional reserve there arose the potential problem that if a large number of his customers appeared and wanted to withdraw their deposits, there would be insufficient funds in the goldsmith's vault to cover the withdrawal demands. Such problems have worried bankers for centuries and consequently the danger of a 'run on the bank', that is, a situation when many customers withdraw their cash simultaneously, has induced bankers to at least keep prudent reserves and to lend out money carefully. To cover this possibility, banks have set up the following.
  - Central Banks - to monetize the shortfall,
  - Their loans have provisions for the bank, at its discretion, to call up any loan at short notice.

To be continued