

Money As Debt

Monday 24th September 2007

As notes and coin dwindle to 3% of money in circulation, so dwindles the portion of money issued free of interest.

Most money now is issued (created) by banks in forms of loans, mortgages, overdrafts etc. All this money enters the economy with interest. So what? We may ask, we expect to pay for products and services – including financial ones. It seems normal. But we perhaps do not think of money itself as carrying this debt burden – the medium of exchange; the unit of account; the lifeblood of the economy; the oil in the machine. Even if one thinks of it as a store of value, IOU or promissory note ‘to pay the bearer ...’ it seems neutral, unencumbered.

‘Money as Debt’ by Paul Grignon

In a departure from the club’s customary format, the subject was introduced via a short film by Canadian political artist Paul Grignon. See at www.moneyasdebt.com. In an entertaining polemic on the nature of money and banking, the film focuses on how, long since freed from ties to gold or other valuable commodity, money now is created by private banks out of nothing but the borrower’s undertaking to pay.

An urbane and slightly sinister banker drops the mortgagee’s signed promise into his deep top hat and pulls out a dollar bill. The vault in the background remains unopened.

To economists it should beg the question: what are the costs of production for which interest is the price?

Broadly allegorical history of banking

In the film a mediaeval goldsmith has a safe place, the vault, to keep his gold stock. Other townfolk rent space in it to keep their own gold. But they rarely come back to collect because in the market place the goldsmith’s receipt becomes as good as the gold itself – and less cumbersome to carry around.

Another branch of his business was lending. But as the paper chits for depositors became so effective, loans too could be issued in similar form. Initially his loans were backed by his own gold. But what was to stop him backing them with his depositors’ gold as well?

And later – why have the gold there at all? The system relies on faith in the gold being there but more so on faith in the bank, faith in the money – now government fiat currency – faith in the government, reflecting a sort of general faith in society itself.

Northern Rock

The subject was rendered topical – and seemingly a little prescient – by the sudden run on Newcastle-based bank, Northern Rock. Some are calling it the first such run in 140 years. We were delighted therefore to have with us David Nicholls, bringing 35 years of experience in banking. As well as a moderate and level-headed assessment, which one might expect of a banker, David maintains an active interest in development economics; so he was well placed to respond with some sensitivity on questions relating money supply to a broad range of issues – such as growth and sustainability.

David traced bank failure ultimately to loan default, that is, imprudent lending somewhere. Northern Rock were financing a rapid expansion on speculative investments and part of their portfolio turns out to be in the US sub-prime mortgage market. Did they know what they were buying? David says they did, but believed it to be ‘good’ debt – and respected credit rating agencies had endorsed it. So the problem was endemic.

Northern Rock were in real trouble only when depositors believed they might be and started queuing for withdrawals. The faith was shaken and the story underlines the ultimate dependence on the borrower’s ability to pay back with interest – that is, even when sustained low interest levels start climbing again.

Comparisons with 3rd world debt

That crisis, David argued, remains much worse than this. Of course US and UK ‘sub-prime’ borrowers enjoy the protection of bankruptcy laws that wipe the slate mostly clean. 3rd world governments do not. So the even-less-prime people they represent are tied into endless compounding of unpayable debt.

Filling the pool

Paul Grignon looks at the entire pool of money and asks how much of it is interest-bearing debt and what money will be used to pay the interest? He provides a graphic illustration of two swimming pools, one 10% longer than the other. A man with a fat hose is filling the longer pool from the shorter.

Inevitable failure of I/(P+I)

It appears inevitable that, for the portion of interest to be paid out of a limited pool, a similar portion of loans cannot be redeemed. There will be a portion of defaults, foreclosures, of business failures. It is somehow shocking that the system might have that built into it.



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Debt driving growth

Paul Grignon argues that only the time lag between debt creation and redemption keeps the parasite from outgrowing and devouring its host. Of course, the compensating force is the capacity of the ‘real’ economy to constantly innovate and grow; to generate more production and consumption to keep pace with the growing debt. But apart from the pressure that places on family, social and economic life it has another significant drawback.

Sustainable growth at 3%?

What we innocuously term ‘a steady rate of growth’ at ‘a modest 2.5 to 3% annually’ is not what it seems. It sounds linear but due to the compounding effect, becomes exponential. 3% per annum in 50 years is a four-fold increase, nearly 20-fold in 100 years. Of course if value growth were in quality rather than quantity, in maintenance rather than replacement, then the ecological impact could be relatively benign. But is it?

Hence monetary reformers have become environmentalists. The earth presents the ultimate limit if she cannot sustain such growth levels in extractions and emissions. Ardent campaigner for legislative reform, Sabine McNeill, said ‘Limits to Growth’ had been published in 1972 but little notice is being taken.

Canon Peter Challen, chairman of the Christian Council for Monetary Justice, emphasised injunctions against usury in the major religions and that all people of good faith should look for reform. It was not a personal conspiracy but acquires the pervasive character of what he termed a ‘cold evil’, creating social disease. But the important thing was to focus on remedies. Government should realise its responsibility to issue debt-free money into the economy. See www.ccmj.org

Enthusiasts may tend to imply that debt is the only driver of growth and cause of business failure – which it clearly is not. Nevertheless, one gets a glimpse of an enormous reach to this phenomenon and a vital challenge for reformers: to communicate the salient arguments dispassionately and unencumbered.