

Deficit Panic II

Replacing a chronically unstable system

'We had to struggle with the old enemies of peace—business and financial monopoly, speculation, reckless banking, class antagonism, sectionalism, war profiteering.

They had begun to consider the Government of the United States as a mere appendage to their own affairs. We know now that Government by organized money is just as dangerous as Government by organized mob.'

**Franklin Delano Roosevelt, Madison Square Garden,
31 October 1936**

Introduction

Part 1 argued that panic and hysteria over public deficits and debt is contrived by ruling elites and that budget austerity is part of a 40 year ideological programme of reversing the social protection and redistributive functions of government and the further centralising of economic and political power under the deceptive banner of the 'free market'. This project has been carried out with the complicity of elected politicians and political parties which have been hijacked by what the American economist Michael Hudson calls 'junk,' or free market, economics. The 'free market' is the governing mythⁱ or cover story for this shift in power and the hollowing out of democratic institutions. The financial crisis was the trigger for the public deficit crisis because the collapse and exposure of fraudulent speculative lending shrank the public money supply across the world, the process known as 'the credit crunch'. Economist Henry Liuⁱⁱ describes it succinctly:

*The rush by the rich and powerful to punish the trouble-causing working poor goes against strong evidence that the current sovereign debt crisis is ... caused [not] by high social welfare expenditure, but by a sudden drop in government revenue due to economic recession caused by credit market failure under [the] fraudulent accounting allowed in structured finance **for which [emphasis added] the financial elite are directly and exclusively responsible.***

The Trillion Dollar Failure, 10 June 2010

Frequent crises, recessions, booms, bubbles and similar dysfunctions are inevitable inⁱⁱⁱ a money system based upon interest bearing debt, because a debt-based money system is always inherently insolvent. An economy run on debt must expand exponentially indefinitely which is impossible. A debt free and publicly controlled money supply would cure these problems permanently.

The tragic absurdity of 'austerity' is that it is an entirely unnecessary and self-imposed economic constraint.

The UK Government's Project Merlin^{iv} is a feeble attempt to persuade banks to repeat what caused the disaster in the first place.

The failure – with few exceptions – of professional economists to spot the dangers or even manage a basic understanding of how money works, demonstrates their sheer pointlessness.

(See below)

Part 2 introduces the misunderstandings about money and how economies depend upon an ever expanding money supply. The crisis is not new in the history of capitalism, the financial phase representing the end of a cycle led by the dominant

power within the system, explaining the contribution of derivatives and shadow banking.

The neoliberal revolution has been an illusion built on deception, and its achievements shallow and meretricious. (See below)

An explanation of Government spending and the money supply is followed by a discussion on the nature of government itself and how expanding and centralising economic power is linked to expanding political power, using insights from some of the most eminent Western thinkers including Aristotle, Marx, Arendt, Einstein and Schumpeter. A summary of the measures needed to replace a dysfunctional system accompanies a short discussion on political aspects, noting the utter failure of political and intellectual leadership in contrast to the 1930s.

The nature of money

Almost everything that is understood about money is wrong. Much of the reality is concealed by the mumbo jumbo of mainstream or 'junk' economics as Galbraith senior explains.

The study of money, above all other fields in economics, is the one in which complexity is used to disguise truth or to evade truth, not to reveal it. The process by which banks create money is so simple the mind is repelled. Where something so important is involved, a deeper mystery seems only decent.

J K Galbraith, Money – whence it came, where it went (1975)

For example, it is believed that:

- Governments control the money supply.
- The banking system recycles deposits taken in from savers as loans for productive investment.
- The government has no money of its own and must raise revenue by taxation and borrow from private financial institutions.
- Recessions and the consequent social disruption and suffering are an inevitable part of the economic or 'business' cycle.

When in reality:

- The public money supply is provided by private banks and only a small percentage is issued debt free in the form of notes and coins.
- The banking system creates deposits by issuing interest-bearing loans as electronic entries into bank accounts from nothing, which cost virtually nothing to produce. Much of this lending goes into speculative investment or takeovers and mergers.

- The government spends money which it has created and which tax revenue cancels. Governments do not need to borrow as explained below.
- Recessions and other dysfunctions are a consequence of debt-based money.

Money can be described as a 'ticket system'^v whereby money 'tickets' grant the right to participate in the economy. They function like railway tickets. The demand for a railway ticket offers the management of a railway a clear indication of the transport required. This makes it possible for a programme of transport to be drawn up, enabling the traveller to make appropriate plans. The ticket office is not the place where the measurement of productive capacity should take place. The proper role of the ticket office, or its financial equivalent, the banking system, is to enable the product or service to be distributed in accordance with the wishes of the consumer.

Frances Hutchinson and Brian Burkitt, The Political Economy of Social Credit and Guild Socialism, 1997

Money is not a thing, it is a social relation...a production relation like any other economic relation.

Karl Marx, The Poverty of Philosophy, quoted in Hutchinson and Burkitt (1997, ibid.)

Why do governments feel obliged to spend untold billions rescuing the banks and the financial sector when other businesses are often left to fail? The answer is that the financial sector...embraces a public function, the issue and circulation of money – something that has been appropriated by private capital.

Professor Mary Mellor, The future of money, Red Pepper, May 2010

Mainstream economic theory in effect operates as a system of rules, procedures and assumptions that justifies elite appropriation and manipulation of the material, social and intellectual resources of society through the institutions of the formal economy: property finance and markets.

Frances Hutchinson, Mary Mellor and Wendy Olsen, The Politics of Money: towards sustainability and economic democracy, 2002

Our Republican leaders tell us economic laws – sacred, inviolable, unchangeable – cause panics which no one could prevent. But while they prate of economic laws, men and women are starving. We must lay hold of the fact that economic laws are not made by nature. They are made by human beings.

Franklin Delano Roosevelt, Acceptance speech, 1932

The world is being treated to a travesty of liberalism and free markets. The classical idea of a free market was one free from predatory rentier financial and property claims. Today, a "free market" Alan Greenspan and Ayn Rand style is a market free for predators.

Michael Hudson, Europe Sacrifices Labour for Finance, 26 June 2010

In modern economies, almost all of the money supply comprises bank loans and it must expand constantly if economic activity is not to seize up. This is because every loan creates additional obligations in the form of interest and no money is issued to cover those. Unless more money is put into the system, there will be widespread bankruptcies as individuals and companies default on their loans. The solution is for banks to issue more loans, but as this only creates a demand for more loans, the system is constantly chasing its tail. This is a pyramid or ‘Ponzi’^{vi} scheme because it depends upon an infinite capacity for new debt which is impossible. That insolvency is built into the money system has been recognised for centuries. Thus Benjamin Franklin speaking to the directors of the Bank of England in 1764 described the monetary policy of the American colonies:

<p><i>In the colonies we issue our own money....to pay the government’s approved expenses. We make sure it is issued in proper proportions to make the goods pass easily from producers to the consumers...In this manner creating for ourselves our own paper money, we control its purchasing power and we have no interest to pay to no one....a legitimate government can both spend and lend money into circulation, while banks can only lend...Thus when your bankers ...place money into circulation there is always a debt principal to be returned and usury to be paid. The result is that you have always too little credit in circulation to give the workers full employment. You do not have too many workers, you have too little money...all bear[ing] the endless burden of unpayable debt and usury.</i></p>

<p>Benjamin Franklin quoted by the Monetary Reform Policy Working Group of the Green Party of England and Wales^{vii}</p>
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The economy cannot function without millions of people becoming more and more indebted. This expanding debt is the cause of booms, asset price bubbles^{viii}, recessions and depressions. Sooner or later the weight of debt obligations overwhelms the capacity of the real economy and the result is a contraction of the money supply, fiscal deficits, bankruptcies and unemployment. It is necessary to purge the debt overhead of bad loans before any ‘recovery’ can begin. In the extreme circumstances of a depression this includes destruction of real wealth as well as financial wealth, and even war. In Marxist terminology these are periodic ‘crises of accumulation’ or ‘overaccumulation’ when the process of recycling economic surplus known as capital runs up against physical and social limits and breaks down. Marxist geographer David Harvey explains:

As surplus theory tells us, capitalists produce a surplus, which they then have to take a part of, recapitalise it, and reinvest it in expansion.....in the last 30 years an immense amount of the capital surplus has been absorbed into urbanisation: urban restructuring, expansion and speculation. Every city I go to is a huge building site for capitalist surplus absorption. This way of absorbing capital surpluses has got more and more problematic over time. In 1750 the global value of the total output of goods and services was around \$135 billion, in constant values. By 1950, it's \$4 trillion. By 2000, it's \$40 trillion. It's now around \$50 trillion. And if Gordon Brown is right it's going to double over the next 20 years, to \$100 trillion by 2030. Throughout the history of capitalism, the general rate of growth has been close to 2.5 per cent per annum, compound basis. That would mean that in 2030 you'd need to find profitable outlets for \$3 trillion dollars. That's a very tall order. I think there has been a serious problem, particularly since 1970, about how to absorb greater and greater amounts of surplus into real production. Less and less of it is going into real production, and more and more into speculation on asset values, which accounts for the increasing frequency and depth of the financial crises we've been having; they are all crises of asset value.

David Harvey, Their Crisis, Our Challenge, Red Pepper, March 2009^{ix}

Harvey summarises the fundamental dynamic of capitalism which was expounded by Karl Marx over 150 years ago: the structural imperative of a constant expansion of money and its complex interaction with the real producing economy^x. As physical limits to expansion become more intense, more investment goes into speculation in real and then financial or 'fictitious' assets which have no direct relationship to real goods and services. Arrighi^{xi} identifies four long cycles in the 300 year history of capitalism, Genoese, Dutch, British and American. In each case the first half of the cycle is dominated by trade and production and in the second, by finance and debt-financed or 'leveraged' speculation in asset values. If Arrighi's analysis is correct, we are approaching the end of the American cycle which began about 110 years ago, and which entered its financial phase around 1970.

Before 1970, the ability of private banks to create credit was strictly limited by regulation. However, in 1971, President Nixon destabilised the international financial system by removing the ability to exchange US Dollars for gold. Since then there has been a dismantling of controls on credit creation and an explosion in debt across the globe. This has enabled the US to run external and internal government deficits indefinitely and to follow a policy of global military aggression on borrowed money. Governments have abrogated their sovereign power to control money and credit for the benefit of their citizens. Instead a coterie of private bankers has taken control of the world's money supply and currency for their own speculative ends. Engdahl

below explains the origins of the neoliberal revolution, a revolution forced by the beginnings of the decline of American economic supremacy and one which has only hastened it.

The so-called neo-liberal finance model which was espoused by the Thatcher government after 1979 had its origins in a decision by leading Anglo-American financial powers and their circle that it was time to begin a wholesale clawing back of the concessions which they had granted under, as they saw it, duress, during the great depression of the 1930's and in the case of Britain, the post-war economic difficulties.

*The origins of the effort in the United States go back to a seminal little known book by a scion of the vastly wealthy Rockefeller family, the late John D. Rockefeller III, titled *The Second American Revolution*. There, amid soporific rhetoric about creation of a 'humanistic capitalism' he calls for drastic reduction in the role and size of government in the economy. That theme was then propagated through the efficient propaganda apparatus of the Rockefeller imperium, aided by the economist guru of the Rockefellers' University of Chicago, Milton Friedman.*

F William Engdahl, Death Agony of the Thatcher Deregulated Finance Model, Global Research 22 January 2009

The neoliberal revolution has older roots than the latest phase of American decline. Carroll Quigley was a historian who had unprecedented access to the inner circles of the Anglo American financial elite and set out its agenda in a monumental work, *Tragedy and Hope*.

*The influence of financial capitalism and of the international bankers who created it was exercised both on business and on governments, but could have done neither if it had not been able to persuade both these to accept the two 'axioms' of its own ideology. Both of these were based on the assumption that politicians were too weak and too subject to temporary popular pressures to be trusted with control of the money system; accordingly, the sanctity of all values and the soundness of money must be protected in two ways: by basing the value of money on gold and by allowing bankers to control the money supply. **To do this [emphasis added] it was necessary to conceal, or even mislead, both governments and people about the nature and its method of operation.***

Carroll Quigley, *Tragedy & Hope: a history of the world in our time* (1966), p 53.

The powers of financial capitalism had another far reaching aim, nothing less than to create a world system of financial control in private hands able to dominate the political system of each

country and of the world as a whole. This system was to be controlled in a feudalist fashion by the central banks of the world acting in concert, by secret agreements arrived at in frequent meetings and conferences. The apex of the system was the Bank for International Settlements in Basle, Switzerland; a private bank owned and controlled by the world's central banks which were they private corporations. The growth of financial capitalism made possible a centralisation of world economic control and the use of this power for the direct benefit of financiers and the indirect injury of all other economic groups.

Quigley, Ibid., quoted in 'Where's the money to come from?' Monetary Reform Policy Working Group, Green Party of England and Wales (2008)

All this has happened without any public debate and with the complicity of politicians and the mass media. As the Green Party puts it:

It is as if those governments have been placed in a state of hypnosis to surrender without the slightest reward or consideration their most valuable asset.

Monetary Reform Policy Working Group of the Green Party of England and Wales^{xii}

.It is no accident that financial deregulation has brought about increasing instability, coinciding with the severest UK recessions since 1945, in 1980, 1990 and 2008-09; four out of the five biggest stock market falls in the last 100 years in 1975, 1987, 2000-02 and 2008-09; international financial crises in Asia (1997), Russia (1998), Argentina (2001), the LTCM collapse (1998), and the global banking crisis (2007-09) and housing recessions in 1980-82, 1990-93 and 2008 on.

In 1950 the UK government supplied about half the money supply in the form of notes and coins. Now, about 97% of the money supply consists of bank loans. The Heath government expanded banks' ability to create credit in 1971 and triggered a speculative inflationary boom, which was blamed on the 1974-1979 Labour government and 'Keynesian' policies, although it had nothing to do with either. Subsequent financial deregulation came after 1979, with the abandonment of exchange controls and the banking legislation of 1986 and 1996 which triggered an explosive growth of debt of every kind in the UK economy. Every pound in every bank account originates as a loan. If every loan were to be repaid tomorrow, nothing could function without money in circulation. Associated with the growth of debt is inflation of asset prices and prices generally, with the money supply expanding faster than economic output. The economic system depends upon constantly expanding

debt, consumption and asset prices at the expense of investment in real goods and services and infrastructure and the shift to green technologies. Two illusions have been fostered:

- Money or financial assets is deemed to be wealth rather than being simply claims on real goods and services.
- There is an easy way to prosperity by borrowing against the expectation of rising asset prices rather than the much harder tasks of investing in skills, infrastructure and production.

Britain's boom was dependent on the imbalance between the huge trade surpluses of emergent economies and the deficits of the rich countries. Despite the extraordinary growth of the financial sector, its business model did not spread wealth and nor did it create a significant number of jobs. The compact^{xiii} established a banking oligarchy which captured both the financial regulatory system and the political class^{xiv}.

Jon Cruddas and Jonathan Rutherford, in *Crisis and Recovery: ethics, economics and justice* (edited by Rowan Williams and Larry Elliott, 2010)

30 years of 'free markets' has greatly weakened Britain's ability to pay its way in the world and to be self sufficient in critical areas such as food and energy. It runs trade deficits in manufactured goods and an overall current account deficit. It is impossible for countries to run deficits indefinitely but while it is acknowledged this is rarely addressed. The (albeit simplified) theory of 'globalisation' is based on the delusion that China and other countries will make all the manufactured goods the rich countries need and lend them the money to pay for them. As skilled jobs have gone abroad, wages have been depressed and personal debt has increased^{xv}. Private sector debt in the UK is the equivalent of over 4 years' GDP and is the highest in the world (see appendix). Foreign currency reserves are £44bn while UK banks have been allowed - astonishingly – to run up foreign debts of \$4.4trn, twice Britain's GDP^{xvi}. The economic growth and apparent increased prosperity of the last 30 years have been brought into existence almost entirely by borrowing. Every £1 of UK growth has been achieved by adding £2 of debt.^{xvii} The neoliberal revolution has been an illusion built on deception, and its achievements shallow and meretricious.

Securitisation was based in the assumption that a fool was born every minute.

Joseph Stiglitz, October 2008, quoted in Kevin Phillips, Bad Money (2009)

The crash has laid bare many unpleasant truths about the United States. One of the most alarming... is that the finance industry has effectively captured our government - a state of affairs that more typically describes emerging markets, and is at the center of many emerging-market crises. If the IMF's staff could speak freely about the U.S., it would tell us what it tells all countries in this situation; recovery will fail unless we break the financial oligarchy that is blocking essential reform. And if we are to prevent a true depression we're running out of time

Simon Johnson, The Quiet Coup, Atlantic Monthly, May 2009

The shadow banking system has collapsed, not because the market is "frozen" or because investors are in a state of panic after Lehman, but because derivatives and securitization have been exposed as a fraud propped up on insufficient capital. It's snake oil sold by charlatans.

Mike Whitney, Securitization: The Biggest Rip-off Ever, June 2009 "Information Clearing House" June 2009

Deregulation allows the banks to create as much bogus money as they want in the form of credit. When a bank issues a loan to someone who can't repay the debt, it's counterfeiting, which is the same as stealing.

Mike Whitney, Financial Bubble Alert:: "Backdoor Bailouts" and The Creation of Bogus Money, Global Research, January 2011

Things were being done that were illegal and certainly criminal...fraud creates instability in competitive markets. If you can't trust your counterparty, it won't work.

Alan Greenspan, former Chairman, US Federal Reserve, 9 November 2010

Total debt is only part of the story. The other aspect is the growth of 'shadow banking'^{xviii}, credit creation by 'securitisation' or banks writing IOUs to each other and other financial institutions, and using derivatives contracts to avoid regulation and to conceal risk – in effect a giant inverted credit pyramid:

Securitization--which is the conversion of pools of loans into securities that are sold in the secondary market--provides a means for massive debt-leveraging. The banks use off-balance sheet operations to create securities so they can avoid normal reserve requirements and bothersome regulatory oversight. Oddly enough, the quality of the loan makes no difference at all, since the banks make their money on loan originations and other related fees. What matters is quantity, quantity, quantity; an industrial-scale assembly line of fetid loans dumped on unsuspecting investors to fatten the bottom line.....mortgage-related securities ballooned from \$492.6 billion in 1996 to \$3,071.1 in 2003, while asset backed securities (ABS) jumped from \$168.4 billion in 1996 to \$1,253.1 in 2006. All told, more than \$20 trillion in securitized debt was sold between 1997 to 2007. How much of that debt will turn out to be worthless as foreclosures skyrocket and the banks balance sheets come under greater and greater pressure?^{xix}

Mike Whitney, Securitization: The Biggest Rip-off Ever, June 2009 "Information Clearing House" June 2009

Derivatives contracts globally at the end of 2009 were an estimated \$600trn, swamping global output of about \$50trn^{xx} with a potential exposure of \$14.5 trn^{xxi}. It was the freezing of the shadow banking sector which triggered the financial crisis in August 2007 and it is the losses from speculative and in many cases, as Alan Greenspan acknowledges, fraudulent lending which has been bailed out by governments across the world. And given that trading while insolvent is illegal, the legality as well as the probity of the public support for the insolvent banks must be in serious doubt. A better course would have been to put banks into administration, allow them to continue to trade, separate and liquidate the bad debts as happened in Sweden in the early 1990s.

It is a tragedy that the very financial system that has recently been bailed out by the taxpayer is treated as the arbiter of fiscal policy-using the very deficits and debt that they have foisted on us as the pretext for savage fiscal cuts in recession. Regrettably, I do not agree with the noble Lord, Lord Lawson, that deficit reduction should take precedence over any other policies, but I agree with a famous predecessor of his, Winston Churchill, who, as Chancellor of the Exchequer, said:

"I would rather see finance less proud and industry more content".

Lord Skidelsky, Keynes's biographer, House of Lords, 2 June 2010

The bail outs are a stark illustration of how, in a debt-based economy (known in previous times as usury^{xxii}), all economic and social activity is subordinated to the priorities of finance. In other words, labour and resources can only be mobilised for

production if there is enough money and therefore if, as politicians and commentators are constantly telling us, 'there is no more money', then resources must lie idle.

Common sense tells us that this is preposterous, as Keynes explained in an article he wrote in 1928^{xxiii}. It is 'imbecile', he said, to say that we cannot afford something for lack of money when labour and resources lie idle. **It is the unused productive resources and not the lack of money which is the problem.** Money, as Hutchinson and Burkitt explain, is a token or 'ticket' which mobilises resources. Therefore the supply of money should be commensurate with productive capacity and there is no limit to how much money can be created. To use their railway analogy, it would be ridiculous to halt train services because the train operator had run out of tickets. A lack of money is not like other shortages such as labour or raw materials which have physical and natural constraints. To say there is no money available is both misleading and a way of concealing the priorities of finance over social need.

In order to understand the interaction between money and government spending it is necessary to explain how it actually works.

Government spending^{xxiv}

The conventional view of government spending is that governments have no money of their own, but must raise revenue from taxing their populations ('the taxpayer'), and where there is a shortfall between revenue and spending, then governments borrow from financial markets by issuing marketable securities called bonds. Governments are exactly the same as households in this view, but it is entirely wrong.

Governments have the sovereign power to issue the national currency and raise taxes, in contrast to households which cannot issue currency (counterfeiting is a crime) or raise taxes (extortion is also a crime) and can only have credit with the permission of the banking sector.

When a government spends, it does not wait for tax receipts to reach its bank account; it simply debits its own account and credits other private bank accounts. In other words, by crediting bank accounts electronically, new government-backed money is created.

The government reverses the spending process when it raises tax revenue; it debits private bank accounts and credits its own, cancelling the new money it has issued in spending.

Governments do not spend 'taxpayers' money'. They spend their own money. It follows that a sovereign government in control of its own currency cannot 'run out of money'.

When governments borrow by selling bonds to banks, pension funds, insurance companies and other investors, it is analogous to a bank setting up deposit accounts for savers. These accounts become a liability or debt to the bank which pays interest on those accounts. The other side of the national debt balance sheet is the savings which these represent. You seldom hear any scaremongering about the savings held by banks which represent a liability (debt) on their balance sheets.

When it sells a bond, the government takes cash out of the economy but in exchange issues a bond (a promise to pay at some time in the future) to the investor which carries guaranteed interest payments and also is easily sold if the investor wants cash. Government bonds are therefore a form of money and are supported by the sovereign credit of the government.

There is no difference between a government issuing new money by spending it into the economy (which it always does) and raising a bond, except that the latter carries long term obligations in the form of interest and redemption of the principal. It follows that swapping government money for IOUs to financial institutions is a voluntary limitation on government's capacity to act. There is therefore no need for governments to borrow from private financial institutions.

Quantitative easing provides irrefutable evidence. The Bank of England purchased 30% of the UK national debt in exchange for issuing new money. Effectively almost a third of the public debt has been cancelled and almost all of the 2009/10 borrowing requirement was covered^{xxv}. The government could cancel all existing debt over time in this way.

Government spending and the money supply

The tragic absurdity of 'austerity' is that it is an entirely unnecessary and self-imposed economic constraint. The UK money supply is £2,200 bn, to support an accumulated debt overhead of £4,000 bn including interbank lending. Household debt has probably reached its limit of 103% of GDP as households are now net savers through paying off debt, which has the effect of reducing the money supply. The money supply will contract further with the £110 bn net reductions (including tax increases) in government spending over the next few years. Even when the economy is growing in 'normal' circumstances, the money supply is not large enough to enable

debtors to service and pay off their loans – about £350 bn of new borrowing is needed annually just to stand still^{xxvi}. The solution is quite simple; the government can issue new debt free money to replace the shortfall arising from a shrinking money supply and to gradually phase out the reliance on interest bearing debt. But austerity only holds the prospect of falling economic activity and more unemployment, house repossessions and business failures. Only if the real and hidden objective of austerity is to increase further the power of the banking sector over government and the economy, does it makes any sense. This raises the questions of

- what is government for?
- and in whose interests should it be run?

the subject of the next section.

The nature of government

For twelve years this Nation was afflicted with hear-nothing, see-nothing, do-nothing Government. The Nation looked to that Government but that Government looked away. Nine mocking years with the golden calf and three long years of the scourge! Nine crazy years at the ticker and three long years in the breadlines! Nine mad years of mirage and three long years of despair! Powerful influences strive today to restore that kind of government with its doctrine that that Government is best which is most indifferent.

We had to struggle with the old enemies of peace—business and financial monopoly, speculation, reckless banking, class antagonism, sectionalism, war profiteering.

They had begun to consider the Government of the United States as a mere appendage to their own affairs. We know now that Government by organized money is just as dangerous as Government by organized mob.

President Roosevelt, Campaign speech, Madison Square Garden, 31 October 1936

The neoliberal revolution has been accompanied by strident populist anti government propaganda. ‘The problem is government’ said Ronald Reagan on taking office. ‘Big government’ is routinely denounced and ‘small government’ praised, although it is never made clear what these terms mean. ‘Big government’ as a term does not apply to military and security establishments. Government is depicted as variously incompetent, corrupt, inefficient, and untrustworthy; public servants are motivated solely by their own vested interests. This is accompanied by hostility to politics^{xxvii}, synonymous with double dealing, betrayal and chicanery.

However, no advanced society can function without effective government or a political system. Government is the shorthand for the institutional expression of the collective public power of a society; ‘institutional’ in the Weberian^{xxviii} sense of a set of

rules and procedures; 'collective public power' is the ability to act on common matters – public infrastructure and services, laws and taxation, security, environmental and other regulation – in ways which are binding on all members of the political community who come under its authority.

Advocates of 'smaller government' are disingenuous. Since a society's collective public power is always present the only question is how should it be used and in whose interests? 'Smaller government' or 'rolling back the state' are phrases designed to conceal the hijacking and centralising of collective public power with a tiny elite.

Money is the clearest expression of collective public power because without it, it is impossible for any advanced economy to function. And without this collective public power, a money system is not possible. Money itself has no intrinsic value but derives its value from the legal authority of the state from being accepted as in payment for taxes and services. It rests upon a combination of authority and trust. The conventional division of the state and market in the disciplines of political and economic science conceals this important connection between government and money. The 'state' or government is a network of institutions which do not in liberal political thought sit somehow above and beyond the economy or society but are embedded in other social relationships.

The public money supply is not a technical matter. Nor is it an impersonal structural force independent of human agency. To cede control of the public money supply is to hand over the power of government and economic planning. All economies are planned. The only question is who will plan and according to whose priorities. The choice of state planning or the free market is a false one. The 'free market' is cover story for handing over the planning and the control of the economy and planning to an elite and reducing elected politicians to the role of actors^{xxix}. This how Austrian economist Joseph Schumpeter^{xxx} described it

All plans and outlooks for the future in the economic system affect [the money market], all conditions of the national life, all political, economic, and natural events....The money market is always, as it were, the headquarters of the capitalist system from which orders go out to its individual divisions, and that which is debated and decided there is always in essence the settlement of plans for future development.

Joseph Schumpeter, The Theory of Economic Development, 1961^{xxxi}

Talk about centralisation! The credit system which has its focus in the so-called national banks and the big money lenders and usurers surrounding them constitutes enormous centralisation and gives this class of parasites the fabulous power not only to periodically

despoil industrial capitalists but also to interfere in actual production in a most dangerous manner – and this gang knows nothing about production and has nothing to do with it.

Karl Marx, Capital Vol III, pp 544-545, cited by Steve Keen, DebtWatch 31, Feb 2009

It is as Hannah Arendt, one of the most original political theorists of the last century, explains below, political. The expansion of money is inseparable from an expansion (and centralisation) of power.^{xxxii} So what we have is a highly unstable system which poses a threat to democratic institutions because it hijacks society's collective public power to the unending centralising of political and economic power in fewer and fewer hands. The consequences are a misallocation of resources and environmental damage, imperialism and war, high levels of inequality, and the hollowing out of the liberal democratic state. Another of the twentieth century's most brilliant thinkers, Albert Einstein, recognised this danger in 1949 (below). Wolin (2008)^{xxxiii} and Sassen (2006) have in different ways suggested that the Western liberal state system is now evolving into a new form which Wolin describes as 'inverted totalitarianism'. There is nothing new about this, only the scale on which it is happening. The dangers of oligarchy (see Aristotle below) were recognised 2,500 years ago.

Hobbes's insistence on power as the motor of all things human...sprang from the theoretically indisputable proposition that a never-ending accumulation of property must be based on a never-ending accumulation of power....The limitless process of capital accumulation needs the political structure of so "unlimited a power" that it can protect growing property by constantly growing more powerful...This process of never-ending accumulation of power necessary for the protection of a never-ending accumulation determined the "progressive" ideology of the late nineteenth century and foreshadowed the rise of imperialism.

Hannah Arendt, The Origins of Totalitarianism, p 143

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*Private capital tends to become concentrated in few hands, partly because competition among the capitalists, and partly because technological development and the increasing division of labor encourage the formation of larger units of production at the expense of smaller ones. **The result of these developments is an oligarchy of private capital the enormous power of which cannot be effectively checked even by a democratically organised political society [emphasis added].***

Albert Einstein, May 1949^{xxxv}

*A democracy exists whenever those who are free and not well-off, being in the majority, are in sovereign control of the government, **an oligarchy when control lies with the rich and better-born, these being few.***

Aristotle, The Politics (IV iv)

The point of the analysis is not just to understand the system but, as Marx said, to change it.

Replacing a dysfunctional system

We say in our platform that we believe that the right to coin and issue money is a function of government. We believe it. We believe that it is a part of sovereignty, and can no more with safety be delegated to private individuals than we could afford to delegate to private individuals the power to make penal statutes or levy taxes.

William Jennings Bryan, US Presidential candidate acceptance speech, 1896

This is preeminently the time to speak the truth, the whole truth, frankly and boldly.

Franklin Delano Roosevelt, Inaugural Address 4 March 1933

And finally, in our progress towards a resumption of work, we require two safeguards against a return to the evils of the old order. There must be strict supervision of all banking and credits and investments. There must be an end to speculation with other people's money. And there must be provision for an adequate but sound currency.

Franklin Delano Roosevelt, Inaugural Address 4 March 1933

Of all the many ways of organising banking, the worst is the one we have today.

Mervyn King, Governor of the Bank of England, October 2010

The essence of the contemporary monetary system is the creation of money out of nothing, by private banks' often foolish lending. Why is such privatisation of a public function right and proper, but action by the central bank to meet pressing public need a road to catastrophe?

Martin Wolf, Financial Times, 9 November 2010^{xxxvi}

A household is somewhere where life is lived in common; and housekeeping is guaranteeing that this common life has some stability about it that allows the members of the household to grow and flourish and act in useful ways.

Rowan Williams, Archbishop of Canterbury, 2010^{xxxvii}

We would never put up with unsafe transport systems where planes fell inexplicably out of the skies or cars constantly broke down because the engineers who design them did not understand how they work. Why should we put up with a dysfunctional banking and monetary system which constantly disrupt the economy? The world pays a heavy price for handing control of its destiny to a predatory elite. And yet the solution is simple in principle and not difficult to implement: that is to give government control of the money supply as the sole issuer of debt free money. Modelling of a debt free money supply by Kaoru Yamaguchi, of Doshisha University shows higher

GDP, no inflation and the elimination of all public debt.^{xxxviii} In this way, government can be used for its proper purpose, public benefit.

The measures required.

The role of government

The power to issue new money and its economic benefit must rest exclusively with the government.

Government spending will primarily be financed by the use of debt-free money spent directly into the economy, offset by taxation. Government debt will be phased out by the gradual purchase of all existing bonds in exchange for new money.

All public infrastructure to be financed by government-issued and debt-free money.

A public Green Investment Bank to be initially capitalised with new money for specific projects promoting green technologies, energy self-sufficiency and efficiency.

The power within specified limits for the devolved assemblies in Scotland Wales and N Ireland to have money creation powers and to set up public development banks with the power to capitalise these. Also to devolve 90% of land value revenues to the assemblies with total discretion over tax rates.

Tax and capital flows

The existing system of taxation must be phased out and replaced by taxation of economic rent^{xxxix} such as land values, the use of natural resources, and concentrations of wealth or unearned income, and financial transactions.

The reintroduction of controls on capital movements including foreign exchange^{xl}.

The phasing out of tax havens and ‘offshore centres’ and an end to banking secrecy starting with British territories.

Banking

Banks must maintain full reserves and not be able to create money in the form of bank credit, created as accounting entries out of nothing.

Banks must not be able to borrow from other banks either directly or by the process known as ‘securitisation’.

Bank liabilities must not exceed 5% of GDP for each bank and no more than 50% for the whole sector.

To qualify for a banking license, banks must be constituted as either not for profit mutuals or publicly owned utility banks dedicated to maximising value not for

shareholders but their members and the wider society, adhering to social and good governance principles.

No banking licence should be awarded to a financial institution engaged in speculative activity such as derivatives or currency trading except to promote real economic activity or a social purpose.

The systematic and thorough restructuring of bank balance sheets by identifying, isolating and writing off unpayable or 'toxic' debts.

A general 'debt jubilee', write down of unrepayable debt, through the whole UK.

Corporate debt to be swapped for equity stakes as alternative to insolvency procedures.

An immediate end to home repossessions as a solution to mortgage arrears.

Asset price speculation (the following proposals to dampen asset price bubbles have been put forward by Steve Keen)

Secured loans on properties to be capped at a maximum of ten times the annual rental.

Traded shares to expire to zero value after 50 years.

In order to implement the programme of replacing a dangerously dysfunctional system, it has not only to be shown that it is practicable but also the legitimacy of the present system must be destroyed. Once it is realised that money rests on the fragile foundations of debt and deception and private monopoly, the whole system will fall. The ruling elite will not voluntarily give up its powers and privileges but sections of them are being persuaded of the need for change. Most, however, still have the attitude satirised by Dickens:

Mr Podsnap was well-to-do and stood very high in Mr Podsnap's opinion. Beginning with a good inheritance, he had married a good inheritance, and had thriven exceedingly in the Marine Insurance way, and was quite satisfied. He never could make out why everybody was not quite satisfied, and he felt conscious that he set a brilliant social example in being particularly well satisfied with most things, and, above all other things, with himself.

Thus happily acquainted with his own merit and importance, Mr Podsnap settled that whatever he put behind him he put out of existence. There was a dignified conclusiveness – not to add a grand convenience – in this way of getting rid of disagreeables, which had done much towards establishing Mr Podsnap in his lofty place in Mr Podsnap's satisfaction. 'I don't want to know about it; I don't choose to discuss it; I don't admit it!' Mr Podsnap had even acquired a peculiar flourish of his right arm in often clearing the world of its most difficult

problems, by sweeping them behind him (and consequently sheer away) with those words and a flushed face. For they affronted him.

Charles Dickens, Our Mutual Friend.

Dickens' satire of the self-satisfied and complacent Victorian elite through the character of Podsnap resonates even today 140 years later. It accurately conveys a wilful reluctance to confront uncomfortable truths. But it has to be remembered that elite power ultimately rests on nothing but the acquiescence of populations. Once democratic collective power is harnessed to changing our money system and taking back and revitalising our institutions, it will collapse. And even without that push, the system will collapse in any case.

It requires strong popular movements, and leaders to demonstrate the vision of Franklin Roosevelt in March 1933. Castigating his predecessors, he said, *Faced by failure of credit, they have proposed only the lending of more money*^{xli}. And what do governments propose as a solution? Incredibly enough, following the example of the mediocrities who ran Prohibition-era America by lending more money. The UK Government's Project Merlin^{xlii} is a feeble attempt to persuade banks to repeat what caused the disaster in the first place. Almost 80 years on, governments' futile banking bailouts represent an unprecedented failure of the basic duties to protect citizens and to investigate and prosecute crime. The failure – with few exceptions – of the 'engineers' of the system, the professional economists, to spot the dangers or even manage a basic understanding of how money works, demonstrates their sheer pointlessness other than as propagandists to the 'government by organised money' which President Roosevelt likened to a crime syndicate..

Faced by a failure of credit, they have proposed only the lending of more money.

Stripped of the lure of profit by which to induce our people to follow their false leadership, they have resorted to exhortations, pleading tearfully for restored confidence. They only know the rules of a generation of self-seekers. They have no vision, and when there is no vision the people perish.

Yes, the money changers have fled from their high seats in the temple of our civilization. We may now restore that temple to the ancient truths. The measure of that restoration lies in the extent to which we apply social values more noble than mere monetary profit.'

**Franklin Delano Roosevelt, Inaugural Address 4
March 1933**

ⁱ See Galbraith, *The Predator State*, 2008

ⁱⁱ <http://henryckliu.com/page230.html>

ⁱⁱⁱ For example, 140 financial crises in developing countries in the past 40 years according to Stiglitz, *Freefall*, 2010

^{iv} <http://www.telegraph.co.uk/finance/comment/kamal-ahmed/8181314/Project-Merlin-is-not-looking-so-magical.html>

'British banking's big idea faces failure before it has been put into practice'.

^v The now largely unknown concept of Clifford Hugh Douglas whose ideas were widely read and debated in the 1920s and 30s.

^{vi} After Charles Ponzi, an Italian American fraudster in the 1920s who promised fabulous returns but simply paid off the original investors with the proceeds from new investors, relying on an infinite supply of new investors to make the scheme work.

^{vii} Quoted in *It's Our Money*, Feb 2008

^{viii} A bubble occurs where the price far exceeds its economic value. For example, a housing bubble causes prices to rise far ahead of earnings, making the basic requirement of shelter unattainable for many and locking others into large mortgages.

^{ix} See also www.davidharvey.org

^x This is the process known as capital. A capitalist economy is one which is dominated by constant monetary expansion through the appropriation and reinvestment of economic surplus by an elite.

^{xi} Giovanni Arrighi, *The Long Twentieth Century*, 1994.

^{xii} See above note v.

^{xiii} 'In the name of a property-owning democracy, a popular compact between the individual and the market took shape, [aligning] home ownership with the profit-seeking of finance capital.[which] began to displace the old social welfare contract.' Jon Cruddas and Jonathan Rutherford in *Crisis and Recovery: ethics, economics and recovery*, edited by Rowan Williams and Larry Elliott (2010) p 56.

^{xiv} *Ibid*, p 56

^{xv} Graham Turner, *The Credit Crunch* (2008) and *No Way To Run An Economy* (2009).

^{xvi} http://www.telegraph.co.uk/finance/comment/ambroseevans_pritchard/4299883/UK-cannot-take-Iceland-soft-option.html

^{xvii} See note v above and also Larry Elliott and Dan Atkinson, *Fantasy Island* (2007).

^{xviii} The **shadow banking system** or the **shadow financial system** consists of non-depository banks and other financial entities (e.g., investment banks, hedge funds, and money market funds) that grew in size dramatically after the year 2000 and play an increasingly critical role in lending businesses the money necessary to operate. By June 2008, the U.S. shadow banking system was approximately the same size as the U.S. traditional depository banking system. The equivalent of a bank run occurred within the shadow banking system during 2007-2008, when investors stopped providing funds to (or through) many entities in the system. Disruption in the shadow banking system is a key component of the ongoing subprime mortgage crisis

http://en.wikipedia.org/wiki/Shadow_banking_system

^{xix} *Securitization: The Biggest Rip-off Ever*, Mike Whitney, Information Clearing House, 5/6/09.

To understand securitization, one must think like a banker. Bankers believe that profits are constrained by reserve requirements. So, what they really want is to expand credit with no reserves; the equivalent of spinning flax into gold. Securitization and derivatives contracts achieve that objective. They create a confusing netherworld of odd-sounding instruments and

bizarre processes which obscure the simple fact that they are creating money out of thin air. That's what securitization really is; undercapitalized junk masquerading as precious jewels. Here's how economist Henry CK Liu sums it up in his article "Mark-to-Market vs. Mark-to-Model":

"The shadow banking system has deviously evaded the reserve requirements of the traditional regulated banking regime and institutions and has promoted a chain-letter-like inverted pyramid scheme of escalating leverage, based in many cases on nonexistent reserve cushion. This was revealed by the AIG collapse in 2008 caused by its insurance on financial derivatives known as credit default swaps (CDS)....."

^{xx} Kevin Phillips, *Bad Money* (2009) p xxvi

^{xxi} *Ibid* p xxvi. The possible loss if banks underwriting these bets had to pay out.

^{xxii} The world's great religions including Judaism, Christianity and Islam have forbidden usury. Aristotle regarded usury, making money out of money as unnatural.

^{xxiii} Robert Skidelsky, *John Maynard Keynes: philosopher, economist, statesman* (2004)

^{xxiv} See <http://www.netrootsmass.net/fiscal-sustainability-teach-in-and-counter-conference/stephanie-kelton-are-there-spending-constraints-on-governments-sovereign-in-their-currency/> from which almost all of this section is derived.

^{xxv} Lloyds TSB Corporate Markets, gilt market outlook, February 2010. *'As a result of these purchases the Bank of England has almost fully funded the central government's 2009/10 borrowing requirement.'*

^{xxvi} See <http://www.moneyreformparty.org.uk/>

^{xxvii} See Hannah Arendt, *The Human Condition* for a definition of politics as action in a public space and the distinctive expression of human diversity and plurality.

^{xxviii} <http://www.humanities.mq.edu.au/Ockham/y64l09.html>

^{xxix} There is a revealing moment in Michael Moore's film, *Capitalism a love story*, where Ronald Reagan is interrupted in his victory speech in 1980 by Wall Street banker Don Regan telling him brusquely to 'speed it up'. Those seconds tell us more about the Reagan phenomenon than all the books that have been written about him.

^{xxx} http://en.wikipedia.org/wiki/Joseph_Schumpeter

^{xxxi} Quoted in Giovanni Arrighi, *Adam Smith in Beijing* (2007) p 89.

^{xxxii} Arendt, *The Origins of Totalitarianism*.

^{xxxiii} Wolin, *Democracy Inc.* (2008)

^{xxxiv} *Ibid.* p 228.

^{xxxv} *Why Socialism?* Monthly Review, May 1949, published at www.globalresearch.ca, January 2011

^{xxxvi} Quoted in *Towards a Twenty-First Century Banking and Monetary system*, joint submission to the independent banking commission by Positive Money, New Economics Foundation and Southampton University.

^{xxxvii} *Knowing Our Limits, from Crisis and Recovery: ethics, economics and justice*, ed. Williams & Elliott (2010)

^{xxxviii} <http://www.systemdynamics.org/conferences/2010/proceed/papers/P1061.pdf>

On the liquidation of government debt under a debt-free money system – modelling the American Monetary Act.

^{xxxix} Economic rent refers to that part of economic output which has no cost of production associated with it.

Appendix 1 - Debt as a percentage of GDP for the most indebted countries

	Countries	Government	Nonfinancial business	Households	Financial Institutions	Totals
1	Japan (2009)	197%	95%	69%	110%	471%
2	United Kingdom (2009)	59%	110%	103%	194%	466%
3	Spain (2009)	56%	141%	87%	82%	366%
4	South Korea (2009)	31%	116%	78%	107%	333%
5	France (2009)	80%	114%	44%	84%	323%
6	Italy (2009)	109%	83%	41%	82%	315%
7	Switzerland (2007)	37%	75%	118%	84%	313%
8	United States* (2009)	67%	79%	97%	53%	296%
9	Germany (2009)	73%	69%	64%	80%	285%
10	Canada (2009)	65%	56%	88%	50%	259%
11	China (2008)	32%	96%	12%	18%	159%
12	Brazil (2008)	66%	30%	13%	33%	142%
13	India (2008)	66%	42%	10%	11%	129%
14	Russia (2008)	5%	40%	10%	16%	71%

Source: <http://www.qfmag.com/tools/global-database/economic-data/10403-total-debt-to-gdp.html>

Appendix 2: Spending without borrowing

Governments choose not to tax the things which would both yield secure revenues and at the same time encourage economic activity; instead they tax economic activity, penalising work and discouraging savings and enterprise, which has the effect of reducing tax revenues.

The biggest and most valuable resource is land. Taxing land values is advocated by Green Party and the Cooperative Party, and two commentators, Larry Elliott, economics editor of the Guardian and Philippe Legrain of the London School of Economics. Currently the government chooses not to tax land values and the unearned gains accruing to landowners. Land tax is easy to collect and impossible to avoid. It is hard to argue that your 6,000 acre estate in the Scottish Highlands is actually in Bermuda. It is fair to share gains from rising land values throughout the community. A tiny 0.3% of the population owns 69% of all land^{xxxix} and enjoys fortuitous unearned gains from land value appreciation. Taxing land values would give an incentive to government to invest in transport infrastructure such as light rail because of the increase in land values, financing it from its own source of interest free credit. It would also help prevent the destructive bubbles in property.

How spending without borrowing might work

Tax	Annual revenue/expenditure (£ bn)
Land Value Tax ^{xxxix}	341
Removal of avoidance, evasion and uncollected tax ^{xxxix}	130

Financial transactions levy of 0.05% (foreign exchange & derivatives) ^{xxxix}	10
Financial wealth levy of 5% ^{xxxix}	50
Super tax on annual incomes over £100,000 of 10% ^{xxxix}	10
Excise duties ^{xxxix}	46
Corporation tax ^{xxxix}	42
Green taxes ^{xxxix}	49
Total	678
Budgeted spending for 2010/11 ^{xxxix}	704
Less savings from debt interest	(43)
Surplus	17

Note

This illustration does not take into account the transition to the new tax system and does not include the benefits of seigniorage, the revenue accruing to government as a result of its taking control of the issue of money. It is not an alternative budget. LVT yield is an order of magnitude estimate only. The recovery of tax lost through avoidance, evasion and failure to collect is of course based on the current regime. To some extent, losses on the old regime would be captured by LVT and wealth taxes in the new. The eventual elimination of unproductive activities such as offshore tax avoidance or pensions tax relief should stimulate productive activity which would improve revenues. The wealth and super tax are set at modest levels and could be set at higher levels. Much of current government spending on welfare, crime or health is about patching up the damage caused by the dysfunctional monetary system. Stopping the damage would reduce much of government as a rescue service.

Taxes to be abolished

Income tax (to be replaced by a high earner super tax and wealth levy)

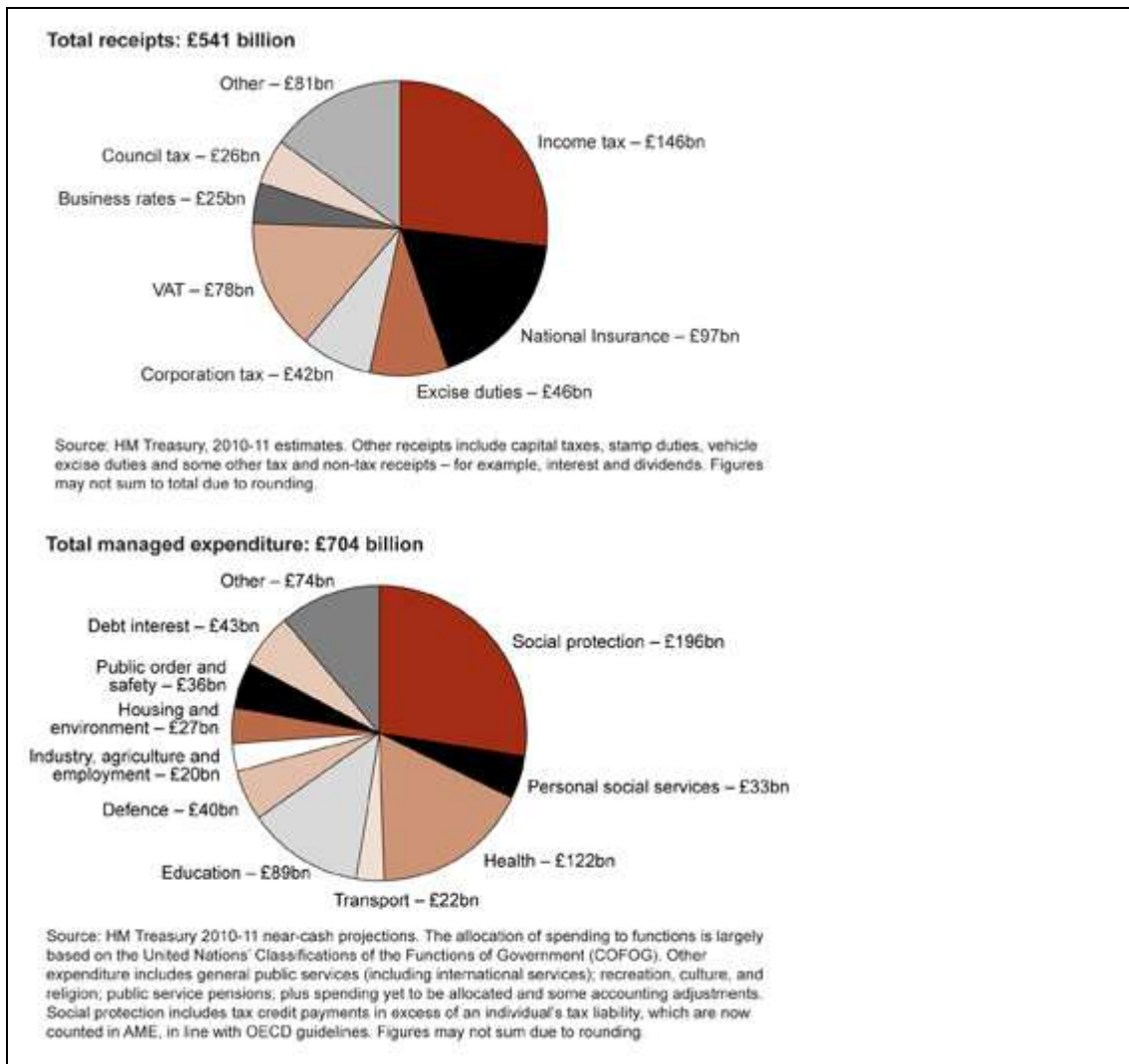
Council tax (to be replaced by the LVT.)

Business rates (to be replaced by the LVT).

VAT (to be replaced by a mix of LVT and green taxes).

Inheritance tax (to be replaced by wealth taxes).

Background: public spending income and expenditure 2010/11



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^{xi} **Capital controls** are measures such as [transaction taxes](#) or caps on volume and other limitations which a country's government can use to regulate the flows into and out of the nation's [capital account](#). They include [exchange controls](#) that prevent or limit the buying and selling of a nation's currency at the market rate, controls on the international sale or purchase of various financial assets, transaction taxes such as the proposed [Tobin tax](#) and sometimes even limits on the amount of money a private citizen is allowed to take out of the country. There have been several shifts of opinion on whether capital controls are beneficial and in what circumstances they should be used.

Foreign exchange controls are various forms of controls imposed by a government on the purchase/sale of foreign [currencies](#) by residents or on the purchase/sale of local currency by nonresidents. Common foreign exchange controls include:

- Banning the use of foreign currency within the country
- Banning locals from possessing foreign currency
- Restricting currency exchange to government-approved exchangers
- Fixed exchange rates
- Restrictions on the amount of currency that may be imported or exported

http://en.wikipedia.org/wiki/Foreign_exchange_controls

http://en.wikipedia.org/wiki/Capital_control

^{xii} <http://www.americanrhetoric.com/speeches/fdrfirstinaugural.html>

^{xiii} <http://www.telegraph.co.uk/finance/comment/kamal-ahmed/8181314/Project-Merlin-is-not-looking-so-magical.html>

'British banking's big idea faces failure before it has been put into practice'.