

The Banking (No 2) Bill which we are currently discussing in the House is very complex and detailed – but, regardless of the detail and complexity, it does nothing to resolve the current banking crisis. It fails to address the actual fault which has led every major banking and currency crisis over the past 200 years including this one. This Bill is quite wrong. It merely, lazily and weakly, papers over the cracks. Like Lilliputians we are trying to tie down Gulliver with ever more strands of rope. It didn't work then. It hasn't worked since 1811. It won't work now. The fault that needs correcting is our current banking system.

In March 1997 I warned in this House that our failure then to address the actual problem would lead to greater hardship. I said then that *"The cycle will continue, but the next time, as before, we will all start deeper in debt and with a burden heavier to carry."* We did not act then in good times. The current crisis is a good reason to act now.

By January last year I could see that the imprudence of bankers had exceeded even my worst fears and I introduced The Safety Deposit Current Account Bill to try to defuse the explosion I could see coming. During the debate in April at the second reading I said that I didn't know under which Act of Parliament the current banking system was established. I understand no Act has been passed by Parliament. The current crisis, like others, emanated from a base of judicial decisions.

Prior to 1811 title to the money in depositors' accounts belonged to the depositor. Lending of depositors' money without their consent

could then have been considered fraudulent. In that year in *Carr v. Carr* [1811], Sir William Grant ruled that since money paid into a bank deposit had been 'paid in generally', and not earmarked in a sealed bag (i.e., as a 'specific deposit') the transaction had become a loan rather than a bailment. Following that, in *Foley vs. Hill* [1848], in the High Court of Chancery, Lord Cottenham stated '*There is a fallacy in likening the dealings of a banker to the case of a deposit to which in legal effect they have no sort of resemblance, money paid into a banker's account becomes immediately a part of his general assets and he is merely a debtor for the amount*'.

These two judicial decisions gave legal status to the banking practice of removing depositors' money from their accounts and lending it to others. Since then, title to depositors' money has transferred from the depositor to the bank at the moment that the deposit is made.

Bankers have always seen it as their job to invest as much of their depositors' money as they prudently can, in order to earn income for themselves whilst, at the same time, maintaining sufficient cash flow to be able to honour depositors' cheques when presented and to meet withdrawals when demanded. If new deposits fail to materialize in sufficient strength or if borrowers fail to repay on time or at all, banks need to be rescued or they will fail. Historically, bank failures then led to a demand for Central banks to act as lenders of last resort in order to save imprudent bankers who get caught short.

These judicial decisions meant that, from then until now, money deposited belonged to the bank and not the depositor thereby

allowing bankers to use customers' deposits as they saw fit, always provided that they could manage cash flow so as to meet depositors' requirements. In good times that enabled them to take greater risks. Then, with the advent of Central Banks as lenders of last resort, the bankers soon learned they could take even greater risks with virtual impunity. When their lending became too aggressive and their reserves and deposit receipts were less than required to meet cash flow, they began to lend to each other. Banks with excess reserves would lend on the overnight market to those with a shortfall. With all of these supposed safety mechanisms to protect them, bankers came to believe they could become even more aggressive in their lending enabling them to make increased profits for themselves. The provision of these safety mechanisms had, in some cases, merely encouraged them to take excessive risks.

Further, these two judicial decisions overlooked or failed to consider the fact that when banks lend depositors' funds, more than one receipt for the same deposit is issued. This was not done intentionally by individual banks or it would immediately have been seen as fraudulent. Rather, it was done by the system as a whole.

Let me explain. Suppose you deposited £100 into your account at, say, Barclays who then gave you a receipt for it. Let us assume that Barclays then lent the £100 to a customer who spent it at a shop and the shopkeeper deposited the cash into his account at Natwest. The same £100 will be received by Natwest as a new deposit and a new receipt will be issued against it. Thus the banking system as a whole will have issued two receipts against the same money and the total of all deposits will increase by £100. You will still have your deposit

in Barclays and the shopkeeper now has his in Natwest. Because the Money Supply is the total of deposits plus money in circulation, the total Money Supply will have increased.

This process will then continue when Natwest loans the shopkeeper's money to someone else who spent it and, as a result, more receipts are issued. This happens every day in retail banking. This is how the U.K. money supply has grown from £31 billion in 1971, when President Nixon closed the gold window, to in excess of £1700 billion today.

Let us consider the implications of those last two figures? They mean that every year since 1971 the banking system has created, on average - for its own use - in excess of £44 billion. That is more per year than the entire money supply which had, until 1971, sustained our economy since recorded history and through two world wars! Is it any wonder that we have suffered such serious inflation over that period? It is clear that the normal, everyday onward lending of depositors funds by retail banks has been the principal producer of inflation.

When paper money was backed by gold, this same production of new receipts by the banking system increased the number of claims for the gold held in reserve without in any way increasing the amount of gold available to meet them. Therefore, the amount of gold available for each receipt became smaller and the value of paper money decreased. The normal, everyday banking practice of onward lending of depositors' funds led to such a continued increase

in the number of claims for the gold available that it caused a series of revaluations of paper money with respect to the amount of gold each could claim. The rates of increase varied from country to country, creating complexity in foreign exchange markets and leading to a series of international agreements to try to determine the correct relationship between various national currencies and gold. The last of these was the Bretton Woods agreement in 1944. It was breached in 1971 when the huge increase in the number of dollars created since 1944 forced President Nixon to close the gold window in 1971.

This same banking mechanism, which destroyed the gold standard, is now destroying the Central banking system. Central banks can no longer cope. The Treasury and the taxpayers have now to try to pick up the pieces. In fact, the failures are so serious and banks have been so imprudent that they are now unwilling to lend to each other and governments have now even been asked to help to kick start inter-bank lending. The world now looks at the imperilled state of the Western Monetary System with shock and there is so little faith in paper money that cries are heard for a new Bretton Woods.

All of this has occurred because of the failure of governments, economists, the press and the public at large to recognize the faults in the banking system that were given legitimacy by those early judicial decisions.

Even today the Government is striving to save this discredited system with still more legislation that attempts to control the degree to

which this fraudulent but legal mechanism can continue to operate. Why are we trying to save a system that, since 1811, has overcome every attempt to harness it?

We do it to protect depositors' funds and for our own convenience. We have all become accustomed to 'going to the bank' (in whatever form) when we need money. We have become accustomed to using our current accounts to manage our personal budgets. Many are tied into the system through having our incomes paid directly into our accounts and using direct debits to pay for our regular expenditures. It is very convenient and we wish to continue to have these facilities available to us. But, our overall approach is wrong. We should not be trying to perpetuate a system that issues more than one receipt for the same deposit. We should not be trying to perpetuate a system that debases the currency and produces inflation. We should not be trying to perpetuate a system that is flawed and dishonest.

When I introduced the Safety Deposit Current Account Bill a year ago it was an attempt to try to begin the job of defusing the time-bomb within the banking system which I believed was about to explode. Instead, I was accused of trying to place a bomb in the system. Lord Davis called the Bill 'explosive'. Lord Razzall said its effects would be 'volcanic'. Well, now we can all see the truth of the matter. The bomb was already in place and has exploded! The volcano has erupted! I urge the Government not to re-ignite it. Let's fix the banking system instead of throwing more money and more regulations at it.

What we all need is a system that will continue to provide us with the convenient facilities we wish and which will provide us with the means for continued and sustainable investment - a system which will provide us with the means for responsible investment rather than the so called 'boom and bust' scenarios and their serious social and economic consequences.

So, how do we best achieve that? I suggest that the Government now consider in detail a system to correct the fault by creating accounts which do not transfer title to depositors' money from depositors to the banks. Banks must not be allowed to continue to lend depositors' money without the consent of the depositor. This will immediately stop the issuance of two receipts against the same money. Depositors would have to pay for the storage and distribution of their money in current accounts and banks would have to compete and earn their income through storage and distribution charges.

For those who wish to earn an income with their money and who wish banks to invest their savings for them, savings accounts are available. The cost of storage and distribution will drive funds from current accounts to savings, and will ensure a steady flow of funds for investment. Some of that will go into savings accounts at banks and banks will lend it to borrowers. Therefore, the same duplication of receipts will also occur but will be much easier to control. If savings were directed into bank managed/supervised open-ended investment companies or unit trusts, then savers would exchange

their money for an asset, i.e., shares or units but they will not receive deposit receipts for their money. If the investment company or unit trust wishes to lend it to a borrower, and the borrower spends it and the recipient deposits it into his bank account, that deposit will then be a genuine new deposit.

With these two actions we can completely remove the duplication of receipts from the banking system and stabilize the money-supply. Banks will no longer be able to lend depositors' funds. Depositors' funds will then be safe. There will be no further need for lenders of last resort. Taxpayers will no longer be required to bail out future bank failures and inflation will be halted in its tracks.

Can it happen? Yes. Will it happen? That depends on us at this very minute and on the government's response. Will the Government grasp the nettle and cease throwing taxpayers' money at a faulty system and stop trying to control the uncontrollable? There can be no better time than now.