‘TURNING THE TANKER’

An ancient Arabic proverb states:

“TRUST IN ALLAH ……….BUT, TIE UP YOUR CAMELS!”

Earlier this year I attended a talk in Lyford Cay, Bahamas. The speaker painted a very clear picture of the economic railway-to-Hell upon which the world seems to be travelling.

Seven serious concerns were identified:

1. To survive, we must master complexity. Few people understand the complexity of the global debt crisis and the rest are avoiding it.
2. We may well have reached the peak of global oil exports and be on the downward slope now.
3. The inevitability of sovereign debt default.
4. The coming failure of citizens to accept austerity measures.
5. The dangers of complacency regarding Europe’s troubles. If you believe the ECB’s policies can buy time, you should ask yourself ‘time for what?’
6. Fresh evidence confirms global water shortages are intensifying, from Texas to Australia, India and the Horn of Africa. An increasing number of rivers run dry before reaching the sea.
7. In the 21st century, profitability has become the most powerful barometer of legitimacy. But, what does profit really have to do with fixing a global drought or curtailing the threat of fast moving viruses across national borders in a matter of hours?

To me, the most telling moment came with questions and answers. Virtually everyone wanted to know how best to maintain their first class seats on the railway to Hell. They just wanted to know how best to tie up their camels.

Not one question was raised about how to ‘turn the tanker’ – to use another analogy. Yet, ‘turn the tanker’ we must or our children and grandchildren will end up in the Hell at the end of the line.

Our economic malaise stems from a crippling burden of debt that has stifled economic activity and from an enormous misallocation of resources.

Both the debt problem and the misallocation of resources are complex problems but there is a common root cause: a fault in the banking system that has not been properly addressed.

Let me explain:

Suppose I open a new bank today and also suppose its 1900 when a gold sovereign was a valid unit of money and let's further suppose that you are my first depositor.

1.) You lodge your gold coin with me for safekeeping.
2.) I issue you with a receipt for one gold coin and
3.) I give you a form upon which I will accept your instructions to pay that gold coin to someone else. (We call that form a cheque today.)

Now you can use your gold coin safely in the marketplace.

Mr. A then comes to see me. He wants to buy Mr. B's car but Mr. A is one gold coin short of the price. Mr. A's credit is good. He is an upstanding individual and I trust him to repay. I lend him the gold coin.

Mr. A then buys Mr. B's car and Mr. B now has the gold coin. Mr. B then becomes my second depositor and lodges his gold coin with me for safekeeping and I give him a receipt and a cheque.

These are perfectly normal everyday banking procedures. Yet, what is my position? I have ONE gold coin BUT I HAVE ISSUED TWO RECEIPTS AGAINST IT.

In any other business that would be considered fraud. If you both came to claim your coins at the same time, one of you would not get a coin.

Ah, the accountant would say, but your bank has collateral - a claim on Mr. A's car. That's true, but whatever the collateral may be, it is not a gold coin. So, the number of gold coins in existence will have been misrepresented. The market will have been led to believe that there is one more coin in existence than there actually is.

In this case, Mr. A has had an accident. The car is a total write-off and the insurance company has failed. Not unlike shares in 1929 and property in the 1980's!

But, as you don't both come at the same time, my bank can then lend it again and again. It will make no difference if the coin is deposited in another bank. The receiving bank will issue a new claim on the same coin and then the entire banking system becomes part of the fraud.

As you can see, for the banking system as a whole, as each new loan is issued and each new claim is created, the gold content or the "exchange value" of each claim already issued by every bank diminishes.

More claims are then required for the same exchanges. In other words – prices go up. It's that simple. That's all there is to understanding inflation. It's not rocket science.

Yet, we were led to believe in economics 101 that when a new loan is issued the money–supply increases and when the loan is repaid, the money-supply decreases. They balance each other out so that there is no increase in the money-supply.

We are taught this is not the cause of inflation. When the money supply does increase, and inflation does occur, we look for some other cause.

What we are taught is not accurate. The money-supply does not decrease when a loan is repaid. Only the measurement of the money supply decreases. It decreases because the measurement of the money supply is not complete. The measurement doesn't count all of the money in the system. It doesn't count the 'cash' in bank assets.

We measure the money-supply by the sum of cash-in-circulation plus total deposits. <u>But, cash in the bank is held as an asset – not as a deposit.</u> So, cash in the bank is not part of the measurement.

When a repayment –or any payment - is made to a bank, the payment is credited to the bank's asset account as 'cash'. It will have left the payment-issuer's deposit account. Therefore, total deposits do decrease and the amount of money in existence appears to have decreased.

Yet, the money which is supposed to have mysteriously disappeared can easily be found in the bank's increased assets.

Once a bank uses its 'cash' – to pay a bill, to meet payroll, or to issue a new loan – the money leaves the bank's assets and enters someone's deposit account. It then returns to the measurement of the money-supply and the measurement of the money supply returns to its previous level.

So, borrowing and repaying is not the zero-sum game we are led to believe in economics 101.

Each new loan increases the money-supply and each increase remains. Inflation is the end result.

Bank lending is indeed the single most profligate producer of inflation. The damage it does can be seen throughout history.

In 1904, it took 20 dollars to equal one ounce of gold.

By 1933, it took 35 dollars to equal one ounce of gold.

By 1968, it took 43 dollars to equal one ounce of gold.

The price of gold was determined officially. A series of international conferences each re-assessed and fixed the price of gold. The Bretton Woods Conference in 1944 was the last of these conferences.

None of the conferences addressed the problem of the continued production of new dollars by the banking system. Nor did they accurately measure the relationship between an ounce of gold and all of the claims against it. Instead, the price agreed was a politically acceptable rate of exchange. So, the banking system continued to make new loans and create new dollars and the actual underlying relationship between a dollar and an ounce of gold continued to shrink and remained unmeasured.

In 1971 President Nixon was presented with so many dollars from other governments to exchange for gold at the rate of $35 that there wasn't enough gold to honour them all. He had no choice but cancel convertibility. That was the end of the gold standard. Then the process of revaluation of gold against the dollar began in earnest.

To accurately measure the actual, underlying relationship today, you must divide the amount of gold the U.S. holds by the number of dollars issued.

The U.S.A. is reputed to hold 260 million ounces of gold today and M1 today stands at 2,220 billion dollars. The exact amount of money it would take to exchange each dollar for gold at the same time today is $8461.53.

The damage this debasement does is more than just a loss of value. Money is a unit of measurement. It is the unit of measurement of exchange value. Its continued shrinkage produces the most damaging of consequences.

Measurements taken at different times will not be measured with the same size unit. So, measurements taken at different times cannot be validly compared.

Formulae derived from such comparisons cannot possibly produce the results predicted.

Measurements of exchange value taken at different times may use the same numbers of dollars, but those dollars will each represent a different amount of purchasing power.

The budget we planned will no longer suffice. We have to allocate our smaller than expected resources in some other way. We find ourselves continually short of money and crave more. Soon we can only see the 'short term'. Long term planning is no longer an option.

Our levels of stress increase and we seek someone else to blame. The results are both socially divisive and economically destructive.

Worse, each of our minds holds all manner of distorted data that we use daily to determine the direction in which we each employ our own energy and resources. Is it any wonder that so much misallocation exists?

Why do we continue to allow this destructive mechanism to remain?

As it stands, legally we have no choice.

Back in 1811 a judge in the U.K, Sir William Grant, decided in that the instant you put your money into a bank, title to that money transfers from you to the bank. That made your deposit the bank's money and the bank could then do what it wanted with the money.

You as a depositor became no more than an **<u>unsecured creditor</u>** of the bank.

This decision was challenged in 1848 and Lord Cottenham, the reviewing judge, upheld the decision. It has remained unchallenged since.

Therefore, according to law, the lending of current account depositors' funds is not legally a fraud. BUT THE FRAUDULENT MECHANISM REMAINS and, as we saw earlier, the money-supply continues to increase and the debasement of money continues at an astonishing and increasing rate.

Our cheque accounts hold our family budgets and our business budgets. It is from these accounts that we pay our bills. Cheque account funds are essential to the survival of our families and our businesses.

Yet, following those legal decisions of 1811 and 1848, cheque account depositors are no more than **<u>unsecured</u>** creditors of the bank. The deposit that you think is yours is not yours. It belongs to the bank.

The bank may owe it to you, but secured creditors – mostly other banks -have first claim on the money you have set aside to pay your bills.

The question of who owns the money in deposit accounts is key to removing the faulty mechanism and solving the debt and the misallocation problem.

As it stands now, all of the money in the country that is not in circulation is in banks. It is theirs to control. Banks only lend. Banks lend to the public sector, to the private sector and to each other. That is their business.

It is this very burden of debt that both underpins your deposits and threatens them.

If a bank goes bust, it will call the loans it has made to other banks, threatening those other banks.

It will also fail to repay banks which have loaned to it - threatening them as well. As it stands now, all banks – American, European and throughout the world - are under these threats. So, too, are your deposits.

These threats are not the only concern. The continued debasement of money finally destroyed the gold standard by 1971. No currency after that was freely exchangeable for gold.

That left banks - and thus depositors - solely dependent on Central Banks as lenders of last resort. By 2007/2008 this moneylending mechanism had also destroyed the Central Banks' ability to act as lenders of last resort. Taxpayers had to be called upon to save the system.

What about deposit guarantees? Ask yourself a simple question: where is the money that is meant to guarantee our current account deposits?

The FDIC certainly doesn't have sufficient money to guarantee all of the deposits it insures. It has enough to cover but a small fraction of the accounts it ensures and is betting on not having to meet a complete bank meltdown. The FDIC could not cover a total bank collapse. There is no insurance company that can.

To answer our earlier question: how safe are your deposits? The answer is as safe as your own guarantee. You are now guaranteeing your own deposits. Frankly, this is a nonsense.

You are the last failsafe. There are no further fail-safes. That is why I am confident that, rather than living through another economic cycle, we are now living through the end game of the paper money system as we know it.

So, what will this end game look like? As we have seen, banks control virtually all of the money in an economy. It is banks which ultimately determine what will and what won't be financed. That gives bankers great power over the direction of investment in the economy.

It also provides banks with an enormity of capital at no cost to invest for their own account.

Bankers will fight tooth and nail to hold onto these positions.

So, I suspect both governments and central banks will continue their programme of printing more and more money - further attempting to save the unsaveable - and money, like the German Mark in 1923, will eventually become valueless.

Banks will again begin to go bust – as Northern Rock and Lehmans did in 2007/2008 – and then the entire house of cards will collapse.

As we speak, the weakness of the U.S. dollar is reflected in its continuing devaluation on exchange markets.

> Since 2009, the U.S. government has spent more than $10 trillion.
>
> To fund its spending in excess of its income, the U.S. Treasury has had to borrow $4 trillion.
>
> To save the American banking system, the Federal Reserve Bank has created nearly $8 trillion.

The rest of the world sees this and begins to worry. What is the world's reaction?

1.) The U.S. dollar has been the preferred reserve currency throughout the world. France, India, the UN, the IMF and others are now calling for a new reserve currency to replace the dollar.
2.) The role of the U.S. dollar as the preferred currency for international trade is also under threat.
    China's trade with Russia, Vietnam and Thailand is now done in Chinese Renminbi or yuan as it is also called.
3.) China is divesting itself of its dollars by investing them and buying assets throughout the world.

<u>We should be very concerned by these changes.</u> Much of the demand that has maintained the strength of the U.S. dollar has been from its position as a reserve currency and its role in international trade. When these two roles are sufficiently reduced, two huge sources of demand will disappear and the value of the dollar will plummet.

<u>The demise of the dollar will have an enormous impact on anyone who earns, saves or invests in U.S. dollars.</u> The price of food, electricity, gas and other essentials will skyrocket.

Those who are on fixed incomes will have to choose between buying medicine, paying rent or buying food. These problems will also be faced in any country whose currency is tied to the dollar.

Isn't it time we properly addressed the issue? Isn't it time to concentrate our energies on 'turning the tanker'?

We can and must change the system. It is possible to stop the collapse before it destroys lives and tears communities apart.

So, what can we do to resolve this damaging process?

May I suggest a solution! One which will avoid these damaging processes and provide a permanent fix.

The first step I suggest is to enact legislation which returns title of deposits to depositors. That's where it properly belongs. Then banks will no longer be able to lend depositors' funds.

That legislation must also ensure that each bank contains the precise amount of cash that has been deposited with it – 100% reserves in other words.

That enactment will stop the debasement immediately. Money can then begin to find its real exchange value – making it once again an accurate measurement of exchange value and a proper store of value.

In England, legislation to begin this process has already been drafted. Lord Caithness introduced such legislation in the House of Lords in January of 2008.

The legislation didn't reach the third reading before the end of Parliament. It died a natural death.

Then the banking system itself was not as suspect. Now, many – including Members of the House of Lords – are becoming more aware. Lord Caithness intends to re-introduce his Bill this autumn when the Banking Bill arrives in the House of Lords.

Similar legislation could be enacted here in Canada or the U.S.A. or anywhere else, for that matter. Our British Bill could serve as a useful template for anyone who wishes to advance the idea.

Following the enactment of such legislation, banks will have the fiduciary responsibility to each depositor which they should always have had.

Banks will be held responsible for the safe storage of the exact amount of each depositor's cash.

In restructuring banks to this end, we must remember that there are two types of deposits at banks: savings account deposits and current account deposits.

Savings account deposits are funds given to the bank to invest on behalf of depositors. For these deposits, the relationship between the investor and the bank should be that of an investor and any other fund manager.

Funds should be held on behalf of the client by the investment manager in a client account until invested.

Once invested, title to the money should be transferred to the investment vehicle and title to the investment should be transferred to the depositor.

The cash will then enter the current account of the investment vehicle.

Current account deposits are funds entrusted to banks to store and distribute for depositors. Title to these funds should not be and should never have been transferred to the bank. Title to these funds rightly belongs to the depositor.

Government auditors must be required to audit both the central bank's and each commercial banks' current accounts and the 'cash' held by each. This will ensure that all of the money on deposit in current accounts is either held in each bank as 'cash' or has been lodged by it with the Central bank as 'cash' for safe keeping. Audits must be sufficiently regular to ensure no leakage.

At the moment of change, no bank will have sufficient cash on hand to cover all current account deposits. Over 90% of their cash is currently invested. Banks will have to liquidate some of these investments.

To help in this process, government can repurchase bonds, treasuries and other government issued instruments held by each bank in exchange for new cash minted by the government. (No increase in the money supply or inflation will occur due to this 'printing' of new money because one form of 'money' is simply being exchanged for another.)

If the sum of these government purchases and the cash held by the central bank is not sufficient to put 'cash' behind every current account deposit, governments can then purchase from the bank sufficient of its other good, income producing assets in exchange for further newly minted 'cash'.

Following these adjustments, banks and the central bank should, between them, hold the exact amount as 'cash' that is held in the banking system as current account deposits. Then all current account deposits will be 100% safe. That alone should remove the element of fear from current market conditions.

The remaining 'investment assets' of each bank will belong to savings account depositors. These investments can be transferred to investment holding companies or funds whose shareholders or unit holders are savings account depositors.

For instance, the mortgages owned by the bank might be put into the XYZ Bank Mortgage Company and the savings account depositors will each own their proportion of the shares of the company.

The company will be managed by the bank but the profits will accrue to the shareholders. That company will then issue any new mortgages when existing ones are repaid or when it raises sufficient new capital.

Banks will no longer write-off investment losses from their own profit and loss statement when investments go wrong.

Bad debts – or any other losses for that matter - will be borne by the shareholders of the particular investment vehicle that holds the investments which fail – not by the banks' shareholders.

Other bank assets, such as land, buildings, furnishings, fixtures, and equipment will belong to the shareholders of the bank.

Depositors who wish to remove excess money from their current accounts and invest it as savings, can go to their bank's investment management department or any other fund manager for advice. Bank investment managers will have to compete for depositors' savings on an equal playing field with every other fund manager.

After these changes, banks will no longer own or control 90% of the money supply. Individual depositors and savers will. Each depositor will now make his or her own decisions and they will not be restricted to investing via debt. Many might wish to re-examine the opportunity offered through equity investments.

For instance, investors might re-examine the advantages of preference shares for defensive investment and for generating income.

- Preference shares have first claim on all or some of the assets of the company.
- Preference share dividends must be paid fully before ordinary shareholders can access any funds from the company.

This gives an investor virtually the same protection as debt investment.

Businesses will discover that, by issuing preference shares, they can fund their needs with permanent capital – without burdening themselves with debt. Unlike loans, preference shares need not be repaid.

The investor who wishes his money back will simply sell his preference shares. The preference shareholder will then have his investment back. The money raised by the business will remain in the business and the company will remain more fully funded.

A fully funded company will be better able to keep employees on during any downturn and, thus, can be better prepared for any upturn. It will also be better able to hire and train new employees for expansion.

In the absence of bank guaranteed savings deposits, new demand will be created for sound income producing preference shares. Existing demand for money for business creation and expansion will continue.

The combination of these two will drive the creation of new markets to buy and sell preference shares. These new markets will provide liquidity for good preference shares and as more and more investors choose to invest in preference shares, today's continuing and growing burden of debt will begin to shrink. A collection of assets for the benefit of future generations will then begin to grow.

The next problem we need to resolve is public sector debt and public deficit spending.

1.0 Governments cannot issue preference shares but they can print sufficient new money to repay all of the domestic holders of their debt. Then domestic holders of government debt will have cash to spend or invest, creating new economic activity.

2.) Governments which cannot otherwise buy-back their foreign debt will have to print sufficient new money to buy back the foreign debt for cash.

This newly created currency can then be held as reserves by the receiving country, used for foreign exchanges or used for expenditure in the country of issue. When it eventually returns to its country of issue it, too, will create new economic activity.

4.) Many governments have borrowed from their central banks. There is <u>no</u> reason why those debts cannot be cancelled.
Central banks will have created the money loaned to the government out of thin air. It can be returned to thin air. No loss will occur to anyone.

By these three measures above, governments can rid themselves of debt. They will no longer have to pay interest on debt.

Their costs will be substantially reduced. Plus, they will have a new income stream from the 'other investments' they purchased from banks. They will be better placed to balance their budgets.

As the new money created flows into the marketplace, it will find its new level of exchange value and then remain relatively stable. In this process both wages and prices will seek their new and realistic levels.

As a result, there needn't be the harsh austerity measures now demanded. There is no need to promote civil unrest.

As you can see above, once the new legislation has been passed, it is not difficult to reorganize the financial system so that every current account deposit is fully covered by cash.

It will be up to bank managers to ensure that they live up to their fiduciary responsibility to you. They will be responsible to you – not you to them!

Your current account deposits can then be 100% safe and your banks will be able to weather any storm.

It is the money-lending mechanism of the banking system that has brought us to this end game. It is destroying capitalism. This destruction can be stopped in one move: **RETURN TITLE OF YOUR DEPOSITS TO YOU.**

That is how we can begin to turn the tanker! It is possible. We must remove the burden of debt that both stifles current economic activity and threatens future generations.

With these changes in the banking and monetary system, the value of money will become stable. Only then can we begin to correct the distorted data in each of our minds.

Only then will it be possible to make accurate and lasting corrections to the misallocation of resources that has been occurring for far too long indeed.

I hope you can now see that there is a positive way out of the current economic malaise. The tanker can be turned - and reset on a proper course: building assets for future generations.

John Tomlinson

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