ANALYST-2010

“Money is neither my god nor my devil. It is a form of energy that tends to make us more of who we already are, whether it's greedy or loving.” ~Dan Millman. The world moves around money and the money moves around the world due to Debt. The Debt Engine is a phrase to describe unrelenting, forever increasing private and government debt. The need to stay ahead of escalating debt fuels practically everything we do; it forces us out of bed in the morning to go to jobs that most of us despise. Corporations make all their decisions around first how to service their snowballing debt, and secondly around profit. Governments spend all their time worrying about how to meet their social agendas while at the same time service the increasing debt load of deficit spending.

Un-repayable Debt is different than the everyday debt of normal life. Un-repayable Debt is an actual built in flaw of our present monetary system: The Fractional Reserve System. It benefits no-one except those intimately connected with the banking industry and in spite of its devastating repercussions, it is a flaw that can be fixed.

Money is neither created nor destroyed, it just flows:

Everyone has some ideas about money, who controls it, where it comes from and how it operates. Some say the government prints it; others say hard work makes money, while others would guess that it's something to do with gold. They might also picture it as a vast pile with everyone competing for as much as they can get. Bankers sometimes inflame our passions by claiming that the government has grabbed all the money and there is none left for private industry.

Our money supply isn't created by the government; a brilliant idea doesn't make money and neither does hard work. Our money is a national accounting system of who owes what to whom, and it is a system that is owned and operated by the private banking industry. There is no such thing as a static heap of money created by hard work and business cunning. Money flicks in and out of existence as credit and debit balances; the money supply swells and contracts continuously as loans are created and then destroyed. Money is simply a bookkeeping system; a man created device.

The Fractional Reserve System:

The man who invented the monetary system which we use today was a Scotsman, John Law, who lived during the 18th. century. He invented a new type of money to replace the old one of specie (the use of coins). In doing so he created the mechanism to finance the industrial revolution, and ultimately our modern technological world.

Much has been made of the astounding inventions of that era but what is often forgotten is that most of them would have never have seen the light of day without John Law and his invention: the Fractional Reserve Money System. Without it, there would have been no development in any field. There would have been no space shuttle, no Love Canal, no drift net fishing, no heart transplants and no Cruise missiles. What John Law did with his invention of a new money system was enable the Industrial Revolution, with all of its good and bad aspects, to take place. Without him, the Revolution would have fizzled and died. And with it, our technological world would have died too.

Here was the problem which John Law solved. In the early 1700's the newly industrializing nations of the world were in a perpetual state of economic crisis because their coinage system of money could not keep up with demand. Governments tried everything to increase the money supply. One trick was to make new coins much smaller than the old thereby getting more per ounce, but it was a stop gap measure at best. To grasp the magnitude of the problem, try to imagine building just one modern skyscraper using only gold coins as finance. The industrialists of the Industrial Revolution were faced with a similar problem; how to build their factories, mills and railroads using only scarce gold coins.

John Law's solution was to create a national paper money supply; banknotes that would be officially recognized as "real money". The advantages were obvious. Paper money could be expanded indefinitely and was much cheaper than specie to make. To get and keep initial public confidence, Law suggested a fraction of gold be always kept on hand for the few people who wanted to redeem their notes.

Through a process of trial and error it was found that specie could support about ten times its value in paper money. That is, a bank which held $10 in gold could safely print and loan out about $100 in paper money. The gold held in reserve was obviously a mere fraction of the banknotes which it supported and so the system became known as the Fractional Reserve System. Cheques or credit cards have largely replaced paper money but the principle remains the same; the banking industry creates the money which government and society then borrows.

John Law's method of money creation is still the dynamo that powers our present world. By replacing specie with a simple national accounting system of credit and debit, he made money infinitely more flexible, able to be contracted or expanded to meet any situation. However, using the Fractional Reserve System has not been a universally happy experience. It has a built in mechanical flaw that always keeps total national and private debt ahead of the money available to repay it. In fact the more a nation expands, the more it automatically goes into debt to the system over and above the money that it borrows.

To explain, imagine the first bank which prints and lends out $100. For its efforts it asks for the borrower to return $110 in one year; that is it asks for 10% interest. Unwittingly, or maybe wittingly, the bank has created a mathematically impossible situation. The only way in which the borrower can return 110 of the bank's notes is if the bank prints, and lends, $10 more...at 10% interest.

When presented with this scenario, there is often a tendency to think :"Ah, but the borrower can always make the extra $10 somewhere else, through hard work or a deal overseas." However, although we frequently inter change the two sayings, earning money is not the same as making it. Earnings are simply a transfer of money from on ownership to another and not increase or decrease the total money in existence. Making money actually does increase the nation's money supply but no-one can do that but the banking industry itself as laid down in its charter from the federal government.

The result of creating 100 and demanding 110 in return, is that the collective borrowers of a nation are forever chasing a phantom which can never be caught; the mythical $10 that were never created. The debt in fact is un-repayable. Each time $100 is created for the nation, the nation's overall indebtedness to the system is increased by $110.

Many economists are not unmindful of the problem but pass it off as irrelevant. They say that if the marketplace economy keeps expanding, thereby fuelling an increase in the total money supply, there is no problem with meeting interest payments on an increasing debt load. But under such circumstances, economic expansion is not a luxury but an imperative to stay ahead.

In John Law's day, the need to continuously expand to meet growing debt repayments was seen as a minor problem of no consequence. Today however we all know the planet cannot sustain unlimited growth. Even so, we are stuck with a monetary system that demands continuous expansion or face the chaos of total economic collapse.

The consequences of the Debt Engine are everywhere. Political and business leaders are sacrificing the planet to stay ahead of bankruptcy. Technology is not being used to create a sane and sustainable lifestyle for us all but is being channeled into the narrowest band of activity: the market place activity of "making" money. Just as governments are forced into ignoring vital social and environmental questions in their efforts to balance the books, so many corporations are putting to one side such things as resource depletion and the destruction of the ecosystem in their frantic efforts to remain economically alive.

The Fractional Monetary System proposed by John Law has slowly showed up its true form. During the Industrial revolution, everyone was contented because of the growth. But, gradually it came into notice that the un-repayable debt phenomenon is bringing a huge gap between the rich and the poor. The saying, “Rich gets richer and the poorer gets poorer” is the correct way to describe the exact scenario.

Source: Based on an Article by Roger Langrick

QUESTIONS

1. John Law suggested a system that was well suited to his time.But this system has flaws leading to an unbalanced flow of money. Can you think of ways to reform the fractional reserve system to fix the flaws it bears till this day? Suggest changes in the fractional reserve system that could adapt it to the present economic scenario. Support your answer with Facts, Graphs, Illustrations, etc..
2. “Rich gets richer and the Poor gets poorer”. Searching for a solution to this, suggest an alternative monetary system to the one proposed by John Law which can result into a sustainable global economy.
3. Can you think of a world without money? Clearly identify the short comings and advantages of re-developing a world without money.

Note:
1. All references to Data, Information and Statistics used in your solutions should be properly appended with their source.
2. Your answers should not completely rely on your thought process but should be supported by facts, figures and illustrations.
3. Huge amount of reference links and material are provided on Google Groups.