4TH EDITION

BANKS CREATE MONEY!

THE EVIDENCE

The Encyclopaedia Britannica (14th Edition 1929) in Vol. 3 under " Banking and Credit " states :—

" Banks create credit. It is a mistake to suppose that Bank Credit is created to any important extent by the payment of money into the Banks." (Page 48, " Credit Policy ").

In Volume 15 under " Money " the Encyclopaedia Britannica also states :—

" Banks lend by creating credit ; they create the means of payment out of nothing." (Page 698, " War Finance and Inflation ").

The late Reginald McKenna, Chairman of the Midland Bank Ltd., and an ex-Chancellor of the Exchequer, addressing the shareholders of the Midland Bank Ltd., said :—

On January 29th, 1920—

" When a bank makes a loan to a customer or allows him an overdraft, in the ordinary course the loan will be drawn upon, or the overdraft will be made, by a cheque upon the bank drawn by the customer and paid in to someone's credit at the same or another bank. The drawer of the cheque will not have reduced any deposit already in existence because we are supposing a case in which he has been given a loan or allowed an overdraft. The receiver of the cheque, however, when he pays it into his own account, will be credited with its value and thereby a new deposit will be created."

On January 25th, 1924—

" The amount of money in existence varies only with the action of the banks in increasing or diminishing deposits. . . . Every bank loan and every bank purchase of securities creates a deposit, and every repayment of a bank loan and every bank sale destroys one."

On January 22nd, 1930—

" The Bank of England is the supreme authority in determining the quantity of money available for the use of the public."

" The Economist," of September 4th, 1943, at page 308, under " The Future of Banking," stated :—

" The following table shows the assets and liabilities of the joint stock banks of Great Britain in 1913 and in 1943.

Joint Stock Banks of Great Britain.

Liabilities.

	1913	1943
	£	£
Capital and reserves	99,364,000	176,508,000
Deposits	935,239,000	4,060,125,000
Other Liabilities	88,251,000	163,850,000
Total	1,122,854,000	4,400,483,000

Assets.

	1913	1943
Cash in hand and money at call and short notice	269,919,000	817,430,000
Investments	159,287,000	1,418,538,000
Treasury Deposit Receipts ...	—	905,500,000
Discounts and Advances ...	617,564,000	1,076,533,000
Other Assets	76,084,000	182,482,000
Total	1,122,854,000	4,400,483,000

The most obvious difference between the two years lies in the totals of assets and liabilities. In the thirty years, the balance sheet totals have increased almost exactly fourfold.

The cause of this expansion is, of course, the great creation of credit during the two wars of this generation. . . . When a bank advances £100,000 to the Government against Treasury Deposit Receipt, £100,000 is added to the assets and (when the Government spends the money) to the liability side of the balance sheet without there being any, or at least any commensurate, subtraction from any other items.

The present war is repeating the experience of the last. The exigencies of Government finance are creating the necessity for a large and continuous expansion in the banking system. Every year since 1939, the deposits of the London clearing banks have increased by from 10 to 18 per cent., and 1942, on the average, was about 44 per cent. above 1938.

One thing, however, is clear. The deposits now on the books of the banks have not originated from anything that can properly be called saving. Three-quarters of them have come into existence since 1913, and their origin lies in Government financing. Whatever may have been true in the past, it is almost wholly misleading to-day to regard bank deposits as the fruit of voluntary abstinence on the part of anybody.

The depositor cannot do anything else with his balances but leave them on deposit. They did not originate in any abstinence on his part; they came into existence as bank credit, and can have no other form of existence.

. . . . the joint stock banks are rapidly approaching the position of the Issue Department. On one side of their balance-sheets they are issuers of fiduciary money ; on the other they are holders of public debt."

Mr. R. G. Hawtrey, Assistant Secretary to the Treasury, in a B.B.C. broadcast on March 22nd, 1933, said :—

" Further I agree with him (Douglas) that Banks create money and that trade depression arises from faults in the Banking system in the discharge of that vital function."

" Branch Banking," July, 1938, stated :—

" There are enough substantial quotations in existence to prove to the uninitiated that Banks do create credit without restraint and that they . . . create the means of repayment within themselves."

Writing in the " News Chronicle " on November 10th, 1939, **Mr. Oscar R. Hobson,** the City Editor, stated :—

" What has happened is this. The Government has raised some £50,000,000 from the joint stock banks on Treasury bills . . . and the money so raised has been paid out and now figures as additional purchasing power in the hands of the public, the clearing bank's deposits being up by over £49,000,000.

This, to put it bluntly, is sheer inflation. The £50,000,000 which the Government has borrowed from the banks has come from nowhere. It is as gratuitous an expansion of the total purchasing power in the hands of the public as if £50,000,000 of fresh banknotes had been created and circulated."

" The Times," September 30th, 1942, stated :—

" It is sometimes said that the Government " spend new money into existence," but before it can be spent it has to be created. It is created by the banks by the simple process of taking up Treasury Bills or bonds and crediting the Government account for the corresponding amount.

" When a hard-pressed citizen raises money on credit to pay his taxes, as for any other purpose, new money is brought into existence. The shares or whatever else he pledges as security are not money. The money which they may be said to represent and which he originally paid for them is already in use by the people to whom he paid it. The loan he receives from the bank in exchange creates an additional deposit upon which he is able to draw."

The best official exposition of the manner in which the costless creation of money is carried out is given in the **Report of the Macmillan Committee,** a committee which was appointed by

Parliament under the Chairmanship of the Rt. Hon. H. P. Macmillan, K.C. (later Lord Macmillan) in 1929, to inquire into banking, finance and credit. This Report states on page 34, para. 74 :—

" It is not unnatural to think of the deposits of a bank as being created by the public through the deposit of cash representing either savings or amounts which are not for the time being required to meet expenditure. But the bulk of the deposits arise out of the action of the banks themselves, for by granting loans, allowing money to be drawn on an overdraft or purchasing securities a bank creates a credit in its books, which is the equivalent of a deposit. A simple illustration, in which it will be convenient to assume that all banking is concentrated in one bank, will make this clear. Let us suppose that a customer has paid into the bank £1,000 in cash and that it is judged from experience that only the equivalent of 10 per cent. of the bank deposit need be held actually in cash to meet the demands of customers ; then the £1,000 cash received will obviously support deposits amounting to £10,000. Suppose that the bank then grants a loan of £900 ; it will open a credit of £900 for its customer, and when the customer draws a cheque for £900 upon the credit so opened that cheque will, on our hypothesis, be paid into the account of another of the bank's customers. The bank now holds both the original deposit of £1,000 and the £900 paid in by the second customer. Deposits have thus increased to £1,900 and the bank holds against its liability to pay out this sum (*a*) the original £1,000 of cash deposited and (*b*) the obligation of a customer to repay the loan of £900. The same result follows if the bank, instead of lending £900 to a customer, purchases an investment of that amount. The cheque which it draws upon itself in payment for the investment is paid into the seller's bank account and creates a deposit of that amount in his name. The bank, in this latter case, holds against its total liability for £1,900 (*a*) the original £1,000 of cash and (*b*) the investment which it has purchased. The bank can carry on the process of lending, or purchasing investments, until such time as the credits created, or investments purchased, represent nine times the amount of the original deposit of £1,000 in cash."

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