SENATE COMMITTEE OF INQUIRY INTO BANKING SECTOR POST GFC

SUBMISSION TO THE COMMITTEE FROM K W GRUNDY

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To the Committee.

Points covered in this submission:

1. Stimulating the economy
2. Methods chosen
3. Debt levels
4. An alternate policy

During the Global Financial Crisis (GFC) the Rudd Government, along with most other nations, recognised the need to stimulate the economy. This was a correct decision which delivered a favourable result **in the short term.** Indeed the Treasurer frequently claims the Australian economy is in good shape and he attributes this to his management during the GFC.

The new money injected into the community went mainly to three areas, namely;
$900 was paid to residents who had a taxable income below a prescribed level the previous year.
Most schools were granted funds to build multi-purpose stadiums.
Home insulation above the ceiling was encouraged with subsidies.

2
From where did the stimulus money come?
As with all of the increased money supply over the years, the new money was created by the banking system and added to our overall debt.

This practice of debt funding was adopted throughout the world in a bid to stimulate the economies. It is only now that the cost of that GFC stimulus has returned to haunt us.

The banking system could have been utilised to deliver real benefits without adding to the debt burden.

An alternate policy was available.

As a background to the GFC it is recalled that general reporting from journalists and economists at the time, attributed the cause of the GFC to excessive debt. On that basis, a primary school student would have been able to advise that a cessation of increasing the debt level would be wise. To do otherwise would compare to an addict having one more, even larger dose in an attempt to be rid of the habit.
Showing no form of logic, the financial advisers urged the Government to prescribe the “one more, even larger dose” of debt.

The original Commonwealth Bank was established with the express purpose of serving Australia by providing finance for development of our relatively new nation. King O’Malley, a Member of Parliament at the time deserves much of the credit for establishing the bank and its ground rules to deliver the aims. He understood from his experience in the USA, just how a bank could serve the community rather than be its master.

The key to whether a bank becomes a servant or master depends on whether it creates the new money as a debt or as a credit.

The splitting of the original Commonwealth Bank into an ordinary trading bank and the Reserve Bank (RBA) occurred in 1959 and the latter became our Central Bank.

A former Governor of the RBA, Dr H C Coombs said in an address to the Queensland University in September 1954, that “…any piece of expenditure can be financed from one of four sources (or a combination of sources):

a) new savings
b) accumulated reserves

c) money borrowed, other than a bank
d) money borrowed from a bank

The last source differs from the first three because **when money is lent by a bank it passes into the hands of the person who borrows it without anybody having less. Whenever a bank lends money there is, therefore, an increase in the total amount of money available…"**

Encyclopedia Brittanica Vol 3 page 28 confirms that bank loans do not affect depositor's funds but are new money.

Since the Parliament established and owns the RBA it is right and proper that some direction be given to the bank in formulating a policy which will deliver a stable money system for every person in Australia. A policy which stops inflation and lifts the debt burden would be a first priority.
Findings of the 1937 Royal Commission into Banking on page 530, as quoted by D J Amos (F.C.I.S), confirms the correct relationship between the Parliament and the RBA, which says, "The Federal Parliament is ultimately responsible for monetary policy and the Government of the day is the Executive of Parliament. The Government should give the Bank an assurance that it accepts full responsibility for the proposed policy and is in a position to take, and will take any action necessary to implement it. It is then the duty of the Bank to accept this assurance and to carry out the policy of the Government."

It is appropriate at this juncture to quote more findings from the 1937 Royal Commission into Banking which were summarised in part by the Chairman, Sir Mellis Napier. He said "….that the Commonwealth (read Reserve) Bank can make money available to governments or to others on such terms as it chooses even by way of a loan without interest or even without requiring either interest or repayment of principal…". Quoted from "The Story of the Commonwealth Bank" by D J Amos (F.C.I.S).
4
Considering the general banking remarks from Dr Coombs and the specific findings of the Royal Commission delivered by Sir Mellis Napier, about the RBA, there is an obvious alternate means of stimulating an economy.
The new money required could be introduced as a **credit** which would immediately break the spiral of compounding debt and begin to reverse inflation. Had such a policy been adopted the post-GFC situation which prevails now would have been very different. I wonder whether the Prime Minister at the time, Mr Rudd, was made aware of this alternative. If not, why not?

There are numerous examples in our history where credit finance was used to great benefit. The building of the East-West railway, completed free of debt was one. Recent Governments could have utilised similar credit in the form of relief to flood and cyclone disasters.

Ellen Brown from America is a well regarded writer on economics and financial matters. I will include below, an article she has written about the debt situation confronting the world. It is very interesting to read an American writing with such admiration for the potential of Australia's Reserve Bank to overcome the debt problem. She advocates the US copying our RBA. What a significant vote of thanks for our Central Bank!
Why do we not utilise the RBA for positive results?

Ellen Brown's article continues.

Escaping the Sovereign Debt Trap, The Commonwealth Bank of Australia Remarkable Model

Economics / Credit Crisis 2010 Aug 05, 2010 - 06:57 AM

By: Ellen Brown

The current credit crisis is basically a capital crisis: at a time when banks are already short of the capital needed to back their loans, capital requirements are being raised. Nearly a century ago, the Commonwealth Bank of Australia demonstrated that banks do not actually need capital to make loans – so long as their credit is backed by the government. Denison Miller, the Bank's first Governor, was fond of saying that the Bank did not need capital because "it is backed by the entire wealth and credit of the whole of Australia." With nothing but this national credit power, the Commonwealth Bank funded both massive infrastructure projects and the country's participation in World War I.

President John Adams is quoted as saying, "There are two ways to conquer and enslave a nation. One is by the sword. The other is by debt." The major conquests today are on the battlefield of debt, a war that is raging globally. Debt forces individuals into financial slavery to the banks, and it forces governments to relinquish their sovereignty to their creditors, which in the end are also private banks, the originators of all non-cash money today. In Great Britain, where the Bank of England is owned by the government, 97% of the money supply is issued privately by banks as loans. In the U.S., where the central bank is owned by a private consortium of banks, the percentage is even higher. The Federal Reserve issues Federal Reserve Notes (or dollar bills) and lends them to other banks, which then lend them at interest to individuals, businesses, and local and federal governments.

2

That is true today, but in the past there have been successful models in which the government itself issued the national currency, whether as paper notes or as the credit of the nation. A stellar example of this enlightened approach to money and credit was the Commonwealth Bank of Australia, which operated successfully as a government-owned bank for most of the 20th century. Rather than issuing "sovereign debt" – federal bonds indebting the nation to pay at interest in perpetuity – the government through the Commonwealth Bank issued "sovereign credit," the credit of the nation advanced to the government and its constituents.

The Bank's achievements were particularly remarkable considering that for its first eight years, from 1912 to 1920, it did not have the power to issue the national currency, and it operated without startup capital. Sir Denison Miller, Governor of the Bank from its creation in 1912 to 1923, was quoted in the Australian Press on July 7, 1921 as saying, "The whole of the resources of Australia are at the back of this bank, and so strong as this continent is, so strong is the Commonwealth Bank. Whatever the Australian people can intelligently conceive in their minds and will loyally support, that can be done."

This was not just hype. In a 2001 article titled "How Money Is Created in Australia," David Kidd wrote of the Bank's early accomplishments:

"Australia's own government-established Commonwealth Bank achieved some impressive successes while it was 'the peoples' bank', before being crippled by later government decisions and eventually sold. At a time when private banks were demanding 6% interest for loans, the Commonwealth Bank financed Australia's first world war effort from 1914 to 1919 with a loan of $700,000,000 at an interest rate of a fraction of 1%, thus saving Australians some $12 million in bank charges. In 1916 it made funds available in London to purchase 15 cargo steamers to support Australia's growing export trade. Until 1924 the benefits conferred upon the people of Australia by their Bank flowed steadily on. It financed jam and fruit pools to the extent of $3 million, it found $8 million for Australian homes, while to local government bodies, for construction of roads, tramways, harbours, gasworks, electric power plants, etc., it lent

$18.72 million. It paid $6.194 million to the Commonwealth Government between December, 1920 and June, 1923 - the profits of its Note Issue Department - while by 1924 it had made on its other business a profit of $9 million, available for redemption of debt. The bank's independently-minded Governor, Sir Denison Miller, used the bank's

credit power after the First World War to save Australians from the depression conditions being imposed in other countries. . . . By 1931 amalgamations with other banks made the Commonwealth Bank the largest savings institution in Australia, capturing 60% of the nation's savings."

3

Harnessing the Secret Power of Banking for the Public Good

The Commonwealth Bank was able to achieve so much with so little because both its first Governor, Denison Miller, and its first and most ardent proponent, King O'Malley, had been bankers themselves and knew the secret of banking: that banks create the "money" they lend simply by writing accounting entries into the deposit accounts of borrowers.

This banking secret was confirmed by a number of early banking insiders. In a 1998 paper titled "Manufacturing Money," Australian economist Mike Mansfield quoted the Rt. Hon. Reginald McKenna, former Chancellor of the Exchequer, who told shareholders of the Midland Bank on January 25, 1924, "I am afraid the ordinary citizen will not like to be told that the banks can, and do, create and destroy money. The amount of money in existence varies only with the action of the banks in increasing or decreasing deposits and bank purchases. We know how this is effected. Every loan, overdraft or bank purchase creates a deposit, and every repayment of a loan, overdraft or bank sale destroys a deposit."

Dr. Coombs, former Governor of the Reserve Bank of Australia, said in an address at Queensland University on September 15, 1954, "[W]hen money is lent by a bank it passes into the hands of the person who borrows it without anybody having less. Whenever a bank lends money there is therefore, an increase in the total amount of money available."

Ralph Hawtrey, Assistant Under Secretary to the British Treasury in the 1930s, wrote in Trade Depression and the Way Out, "When a bank lends, it creates money out of nothing." In his book The Art of Central Banking, Hawtrey clarified this, writing, "When a bank lends, it creates credit. Against the advance which it enters amongst its assets, there is a deposit entered in its liabilities. But other lenders have not the mystical power of creating the means of payment out of nothing. What they lend must be money that they have acquired through their economic activities."

Banks can do what no one else can: "create the means of payment out of nothing." The Commonwealth Bank's far-sighted founders roped this guarded banking secret into the public service.

4

The Bank Collapse of 1893 Spawns a New Public Banking Model

The Commonwealth Bank was founded under conditions like those prevailing today: the country had just suffered a massive banking collapse. In the 1890s, however, there was no FDIC insurance, no social security, no unemployment insurance to soften the blow. People who thought they were well off suddenly found they had nothing. They could not withdraw their funds, write checks on their accounts, or sell their products or their homes, since there was no money with which to buy them. Desperate people were leaping from bridges or throwing themselves in front of trains. Something had to be done.

The response of the Labor government was to pass a bill in 1911 which included a provision for a publicly-owned bank that would be backed by the assets of the government. In a rare move for the time, the bank was to have both savings and general bank business. It was also the first bank in Australia to receive a federal government guarantee.

Jack Lang was Australia's Treasurer in the Labor government of 1920-21 and Premier of New South Wales during the Great Depression. A controversial figure, he was relieved of his duties after he repudiated loans owed to the London bankers. In The Great Bust: The Depression of the Thirties (McNamara's Books, Katoomba, 1962), Lang described the Commonwealth Bank's triumphs and tribulations in revealing detail. He wrote:

"The Labor Party decided that a National Bank, backed with the assets of the Government, would not fail in times of financial stress. It also realised that such a bank would be a guarantee that money would be found for home building and other needs. After the collapse of the building societies, there was a great scarcity of money for such purposes.

". . . Chief advocate of the cause of a Commonwealth Bank was King O'Malley, a colorful Canadian-American . . . Before coming to Australia, he had worked in a small New York bank, owned by an uncle. . . . He had been much impressed by the way that his uncle had created credit. A bank could create the credit, and at the same time manufacture the debit to balance it. That was the big discovery of O'Malley's banking career. A born showman, he itched to try it out on a grand scale. He started his political career in South Australia by advocating a State Commercial Bank. In 1901 he went into the first Federal Parliament as a one-man pressure group to establish a Commonwealth Bank, and joined the Labor Party for that purpose.”

5

King O’Malley insisted that the Commonwealth Bank had to control the issue of its own notes, but he lost on that point – until 1920, when the Bank did take over the issuance of the national currency, just as the U.S. Federal Reserve was authorized to do in 1913. That was the beginning of the Commonwealth Bank’s central bank powers. But even before it had that power, the Bank was able to fund infrastructure and defense on a massive scale, and it did this without startup capital. These achievements were chiefly due to the insights and boldness of the Bank’s first Governor, Denison Miller.

The other bankers, fearing competition, had thought that by getting one of their own men in as the bank’s governor, they could keep it in line. But they had not reckoned on their independent appointee, who saw the opportunity posed by a government-backed bank and set out to make it the finest institution the country had ever known. As Lang tells the story:

“The first test came when a decision was required regarding the amount of capital needed to start a bank of that kind. Under the Act, the Commonwealth had the right to sell and issue debentures totalling £1 million. Some even thought that amount of capital would be insufficient, having in mind what had happened in 1893. . . .

“When Denison Miller heard of it, his reply was that no capital was needed.”

Miller was wary of going to the politicians for money. He could get by without capital. Like King O’Malley, he knew how banking worked. (This, of course, was before the modern-day capital requirements imposed from abroad by the central banker’s bank, the Bank for International Settlements.) Lang went on:

“Miller was the only employee. He found a small office . . . and asked the Treasury for an advance of £10,000. That was probably the first and last time that the Commonwealth lent the Bank any money. From then on, it was all in the reverse direction.

“. . . By January, 1913 [Miller] had completed arrangements to open a bank in each State of the Commonwealth, and also an agency in London. . . . [O]n January 20th, 1913 he made a speech declaring the new Commonwealth Bank open for business. He said:

“‘This bank is being started without capital, as none is required at the present time, but it is backed by the entire wealth and credit of the whole of Australia.’

6

“In those few simple words was the charter of the Bank, and the creed of Denison Miller, which he never tired of reciting. He promised to provide facilities to expand the natural resources of the country, and it would at all times be a people's bank. ‘There is little

doubt that in time it will be classed as one of the great banks of the world,’ he added prophetically.

“. . . Slowly it began to dawn on the private banks that they may have harbored a viper. They had been so intent on the risks of having to contend with bank socialisation that they didn’t realise they had much more to fear from competition by an orthodox banker, with the resources of the country behind him.

“. . . One of the first demonstrations of his vigor came when the Melbourne Board of Works went on the market for money to redeem old loans, and also to raise new money. Up to that time, apart from Treasury Bills and advances by their own Savings Banks, Governments had depended on overseas loans from London. . . . In addition to stiff underwriting charges, they found that the best they could expect would be £1 million at 4 per cent., at 97 1/2 net.

“They then decided to approach Denison Miller, who had promised to provide special terms for such bodies. He immediately offered to lend them £3 millions at 95 on which the interest rate would be 4 per cent. They immediately clinched the deal. Asked where his very juvenile bank had raised all that money, Miller replied, ‘On the credit of the nation. It is unlimited.’”

Another major test came in 1914 with the First World War:

“The first reaction was the risk that people might start rushing to the banks to withdraw their money. The banks realised that they were still vulnerable if that happened. They were still afraid of another Black Friday.

“There was a hurried meeting of the principal bankers. Some reported that there were signs that a run was already starting. Denison Miller then said that the Commonwealth Bank on behalf of the Commonwealth would support any bank in difficulties. . . . That was the end of the panic. But it put Miller on the box seat. Now, for the first time, the Commonwealth Bank was taking the lead. It was giving, not taking, orders. . . .

“Denison Miller . . . was virtually in control of the financing of the war. The Government didn’t know how it was going to be achieved. Miller did.”

And so this interesting story continues. Miller died in 1923, and in 1924 the bankers got back in control, throttling the activities of the Commonwealth Bank and preventing it from saving Australians from the ravages of the 1930s Depression. In 1931, the bank board came into conflict with the Labor government of James Scullin.

7

The Bank’s chairman refused to expand credit in response to the Great Depression unless the government cut pensions, which Scullin refused to do. Conflict surrounding this issue led to the fall of the government, and to demands from Labor for reform of the bank and more direct government control over monetary policy.

The Commonwealth Bank received almost all of the powers of a central bank in emergency legislation passed during World War II, and at the end of the war it used this power to begin a dramatic expansion of the economy. In just five years, it opened hundreds of branches throughout Australia. In 1958 and 1959, the government split the bank, giving the central bank function to the Reserve Bank of Australia, with the Commonwealth Banking Corporation retaining its commercial banking functions. Both banks, however, remained publicly-owned.

Eventually, the Commonwealth Bank had branches in every town and suburb; and in the bush, it had an agency in every post office or country store. As the largest bank in the country, it set the rates and set policy, which the others had to follow for fear of losing customers. The Commonwealth Bank was widely perceived to be an insurance policy against abuse by private banks, serving to ensure that everyone had access to equitable banking. It functioned as a wholly owned state bank until the 1990s, when it was privatized. Its focus then changed to maximization of profits, with steady and massive branch and agency closures, staff layoffs, and reduced access to Automated Teller Machines and to cash from supermarket checkouts. It has now become just another part of the banking cartel, but proponents say it was once the lifeblood of the country.

Today there is renewed interest in reviving a publicly-owned bank in Australia on the Commonwealth Bank model. The United States and other countries would do well to consider this option too.

Special thanks to Peter Myers for reproducing major portions of Jack Lang's book in his weekly newsletter.

Ellen Brown developed her research skills as an attorney practicing civil litigation in Los Angeles. In Web of Debt, her latest book, she turns those skills to an analysis of the Federal Reserve and "the money trust." She shows how this private cartel has usurped the power to create money from the people themselves, and how we the people can get it back. Her earlier books focused on the pharmaceutical cartel that gets its power from "the money trust." Her eleven books include Forbidden Medicine, Nature's Pharmacy (co-authored with Dr. Lynne Walker), and The Key to Ultimate Health (co-authored with Dr. Richard Hansen). Her websites are www.webofdebt.com and www.ellenbrown.com.

Ellen Brown is a frequent contributor to Global Research.