Frank Greenall: Making a mint out of interest

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Recently, rugby star Sonny Bill Williams' anti-BNZ logo gesture has invited a closer look at the role of banks and usury in contemporary society.

NZ Herald contributor Bryan Gould was one to take an interest.

Now Gould's no economic slouch -- a Kiwi by birth, he ended up in Britain as Labour's shadow chief secretary to the Treasury in the 1990s.

In his comment last week, he referenced deregulated banks' ability to create money for loans and mortgages "out of thin air", allowing banks to increasingly clip the interest ticket, and helping fuel such dynamics as housing booms.

Former New Zealand Reserve Bank governor Don Brash then leapt into the fray to pronounce that Gould's "thin air" claim was nonsense, and that all banks positively bristled with fiduciary integrity.

Brash did concede that banks do, indeed, create money, but through the "multiplier effect", whereby banks only have to hold a certain fraction of depositors' funds in reserve.

The remainder may be loaned out which, in turn, ripples through other banks who progressively expand the original amount via the same process.

We've all seen Don's ability to walk a plank, and his case here is similarly wobbly.

If this isn't creating money out of thin air, I don't know what is - although that's not to say these loans are not without fiduciary obligations on both parties. Unfortunately for the borrower, though, the loan may not be repaid in the same currency - namely, thin air - in which it was created.

But former governor Brash's view on money creation is contrary to, for example, that of a recent governor of the Bank of England, Sir Mervyn King.

Sir Mervyn ruffled establishment feathers in the City by publicly conceding what many other contemporary economists similarly assert -- that banks create money the instant they action a loan.

The loan is entered as an asset in the bank's ledger, while the same amount is simultaneously entered as a deposit (in the same customer's name) in the ledger's liabilities. In other words, banks have no need to wait for customer deposits to roll in before lending out - deposits themselves are created by nifty double-entry book-keeping every time a loan is made.

Although certain legal constraints may apply, this is all mainly done with electronic entries in the bank computer.

When - and if - the debt is finally discharged, the "money" disappears as though it never existed, and, in the meantime, the bank has handsomely clipped the ticket with unremitting interest charges.

As long as confidence holds, it's a legalised Ponzi scheme.

Economies fail to take account of all this "thin air" money, and this is why some contend the true inflation rate in recent times is more in the order of 10+ per cent, rather than the purported 1 or 2 per cent. And why many prices - including house prices - are what they are.

Speaking of reserve banks, *Chronicle* correspondent Heather Marion Smith made an excellent point a few weeks back regarding money creation. For government spending at least, our sovereign NZ Reserve Bank has exactly the same ability to create credit, but without the debt-creating burden of interest charges.

It has already been done. Sovereign public money was issued by the first Labour Government to build social housing at cost price, and similarly used for stabilising the banking system in the 2007-09 crisis.

The question, though, as Heather rightly asks, is why does government continue to access funds through privately-owned banks at a debt-servicing cost of about $16 million per day when it is perfectly capable of simply creating those funds cost-free itself?

James Rickards, a respected American economist, was one of few to predict the last global financial meltdown. In an interview with RNZ's Kim Hill, he maintained a repeat was imminent because bank excesses were continuing as before.

Why had things not changed? Because banks own governments, was his answer.

Scarily, perhaps they do.