

# The story of Macavity and the credit crunch

## how to counterfeit money

ONCE UPON A TIME Mr Macavity, a respected citizen, had a heavily locked vault but nothing else of any value. People put gold into his vault for safekeeping. This is a mythical story but you might notice parallels with modern banks.

Over time Macavity realised that many of those making deposits seldom withdrew their gold, so he started lending it to others and charging interest on the loans. But these borrowers found that gold fell through holes in their pockets so they were happy to receive chits instead that said “I promise to give the bearer on demand X” – a certain amount of gold.

With the added interest Macavity now had a regular income. Instead of asking people to pay him for storing their gold, he paid them a small percentage of its value. This encouraged others to take gold from under their mattresses and put it in his vault.

Getting bolder he lent more and signed promissory chits for many times the value of gold in his vault, hoping that people would not all want to take out gold at the same time. He grew fat from the interest on these loans.

People, seeing Macavity’s girth expand, realised what was happening and demanded that he should be restrained. But by this time trade in the kingdom depended on the chits that were circulating, so the King, who was preoccupied

with fighting his neighbours, took the easy option and legalised Macavity’s practices. What’s more, the King said that anyone could swap Macavity’s chits for the national currency, the ‘pounds’ that the King himself issued. Macavity was amazed but delighted at this turn of events because it meant that when he issued chits he was, in effect, creating the country’s currency. People now felt happy to place any chits they had saved into Macavity’s vault alongside the original gold.

The King had to tax his citizens in order to build the schools and hospitals they needed, and he had to pay the builders upfront before the next year’s revenue came in. He could have issued more of his pounds but instead he acted very strangely. He borrowed the money from Macavity and paid him interest. Muttering in the marketplace was overheard: “Has the King lost his marbles?!”

However, in order to provide some restraint, the King said that Macavity must not lend more than ten times the value of the reserves in his vault.

Now things really started to get out of hand. Macavity was able to lend and charge interest on ten times the value of gold and chits in his vault. As more interest came in he could lend and charge interest on ten times this additional money as well. He took every opportunity to lend to anyone who came along. His chits

multiplied until they far exceeded – by 30 times – the number of the King’s pounds; yet the citizens were allowed to swap any amount of Macavity’s promissory notes for the King’s limited supply of real pounds.

The citizens started to get suspicious: “Hey,” they asked, “is what you’re storing for us gold, the King’s pounds or just those bits of paper you printed?” Macavity didn’t answer.

Macavity realised that he was taking a huge risk by issuing so many chits without having the gold or pounds to back them up, so he bundled up some of the deposited chits with other assets and sold the bundles to financial dealers who did the same and sold bigger bundles to yet other dealers. It all became so complicated that no one knew which bundles had worthless bits of paper or who would have to pay if more than

just a few people demanded real money at any one time.

Then trade slowed down. Instead of borrowing, people started withdrawing their saving. But they wanted gold or the King’s pounds, not Macavity’s bits of paper. As the pounds ran out people came hammering on Macavity’s door.

The King was caught in a trap because he himself had been responsible for allowing this fat cat of dubious virtue to exploit his citizens. But instead of putting Macavity in prison, the King promised him a handsome pension and said that he, the King himself, would manage the business for a time and honour Macavity’s debts even though this would mean more taxes on his citizens. The guarantee meant that Macavity’s business now had an advantage over its rivals.

This story is, of course, about commercial banks, private institutions that have been given the incredible privilege of being allowed to create the country’s money and charge interest on it for their own benefit. This mixing of real and virtual money is why the country’s, and indeed the world’s, economy is prone to sudden collapse.

Who makes the money we use? The mint, you might have said. Wrong. Absolutely wrong! Only 3% is created by the mint as notes and coins, the rest, 97%, is created by commercial banks, and this percentage is rising as electronic cards take over from cash.

Government coins and notes are real and don’t attract interest. But the money created by banks (computer entries are the equivalent of Macavity’s promissory chits) can exist one moment and cease to exist the next, it is virtual money, there is nothing real about it.



“The modern banking system manufactures money out of nothing,” said Lord Josiah Smith, former Director of the Bank of England. “The process is perhaps the most astounding piece of sleight of hand that was ever invented.”

To understand this virtual money, walk into a bank or building society and ask for a loan. You will get an IOU for the money if you give your house as security. Then, if before leaving you say sorry, you don't want the loan after all, the manager will tap into his computer, and the money, to the value of the loan that had existed – was ‘in circulation’ – for a few minutes, now no longer exists.

Most of the country's money is unreal. It is debt. Your debt. Your house on the line. The word mortgage means, literally, a death-pledge.

In the real world everything decays. Your clothes rot. Your house needs maintenance. But debt doesn't conform to the laws of nature. Debt doesn't decay. Your investments may crash but your debt will always increase. Bankers love debt because it grows and they are owed more money each year. And you, not they, have pledged it. This orgy of unreal money, created as debt, now sloshes around the world among the wealthy to the tune of \$2 trillion a day. It is several times the value of goods and services available for exchange. It is a virtual commodity in a fantasy world.

You may have noticed that the bank only creates the original value of a loan. Where does money to pay interest come from?

New loans create new money and there is a time lag before this money is paid back. In the meantime it pays the interest on previous loans.

Without this money interest could not be paid, banks would not be willing to lend, there would be no money and the economy would crash. So a stable economy, one without growth, is not possible with the money system we use. Unfortunately, we live on a planet with finite resources. Resources are depleting and our frenetic activity is harming the sky, oceans and land. A growth economy is only sustainable in the fantastical minds of economists, not in the real world. When the economy slows because resources, like oil or food, are running out politicians and economists get alarmed, they lower interest rates and encourage people to consume what is left at an even faster rate in order to maintain growth.

Commercial banks should be forbidden from creating money, just as you and I would go to jail if we were to counterfeit bank notes.



We would, of course, pay banks a fee for handling money, just as we pay other professionals. All the money needed for exchange should be issued free of interest by a central authority that is independent of government, in the way that notes and coins are issued. This would be the first step towards a sane and stable money system.

You can guess who rubbishes the simple logic of that proposal.