The Origins of Modern Banking

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"I believe that banking institutions are more dangerous to our liberties than standing armies. Already they have raised up a money aristocracy that has set the government at defiance. The issuing power should be taken from banks, and restored to the people." Thomas Jefferson

Money was originally invented as a convenient alternative to barter, an alternative without which a highly developed civilisation like ours could not exist.

Imagine trying to pay the taxi driver with a bag of coal or the grocery bill with a box of spanners and a set of golf clubs. Imagine trying to carry all that around with you when you go shopping. As societies grew more complex and social roles became more specialised, the idea of money was conceived as a better and more flexible way to exchange, and thereby distribute among men, goods and services.

Money is quite simply an idea agreed upon among people that some system of tokens or symbols: discs of metal (coins) paper with symbols on it (notes) and so on, will be used by them to represent or stand proxy for goods and services and that those tokens can be exchanged for goods and services. One can then exchange the tokens rather than bags of coal, boxes of spanners or what-have-you and the tokens are easy to carry around. Its workability depends upon the participants' confidence that those tokens are and will continue to be exchangeable for a certain amount of goods or services.

That's all money is. It is no more complicated than that, although men may try to make it seem complex and hard to understand. The truth however, as truths tend to be, is simple; it is alterations of the truth - lies -that are complicated.

Many societies have used gold and silver coins as their tokens, then later pieces of paper to represent gold and silver coins, and later cheques and ledger entries to represent notes and coins and in modern times electronic money, the shifting and balancing of numbers in computer memories, alongside or in place of coins, notes and cheques. Thus when we receive a computer print-out of our bank statement saying we have £500 in our current account we usually visualise a stack of £l0 notes sitting in a vault somewhere, or perhaps a bag of gold coins, although in reality there is no pile of notes or bag of coins, merely the ledger-entry in an electronic memory Saying we have £500. Should we then write a cheque in order to spend £50 of it, the numbers in our ledger change to £450 and the payee's account increases by £50, although no notes, gold or anything else move from one account to another.

Yet it works because we have confidence in it and trust it and we know we can change that £500 for real notes, real coins or real goods or services whenever we want to.

This evolution in the system of tokens we use to represent real goods and services comes about through a succession of bright ideas in the direction of making distribution and exchange more convenient, the movement of wealth between people smoother and faster. However, anything can be used for money, provided people agree to use it and have confidence in it. For instance dried yak dung was once used in Tibet, notched pieces of wood in Medieval England, leather discs in Medieval Europe and even cigarettes and tins of coffee in post-war Germany. The money in use in a country is called currency, from the word current, meaning prevalent, in circulation or in use.

Governments firm up that agreement and confidence by enshrining a particular system of tokens in law and demanding those tokens in payment of taxes. A particular system of creating, denominating, issuing and circulating money - currency - where backed by law and deemed by law the only recognised system, and which cannot be legally refused as payment of a debt, is called legal tender. Where barter is no longer practised, one has to possess those tokens in order to acquire goods and services from others. It is the medium of exchange.

Tokens, be they yak dung, metal discs or numbers with the '£' symbol in front of them, are exchanged back and forth between people instead of goods and exchange does now usually occur without the use of tokens or the promise of tokens on the future.

The way one acquires tokens is by producing something and then selling it to someone who has expressed his want for it by offering us some of his tokens. We do the deal and receive the tokens he has offered. Now we can go and exchange those tokens for other products that we desire, which we do not produce ourselves. Thus money enables goods and services to be exchanged among people and distribution of those goods and services to occur naturally, and according to the needs and wants of the participants.

The more of those tokens one possesses or is able to acquire through one's production, the more one can if one wishes acquire goods and services from others. One can also store money in a safe or bank account without having to build a couple of warehouses in which to store container-loads of spare goods. Money therefore confers exchange power or spending power on he who possesses it in direct ratio to the amount of it he is able to offer up for exchange.

GOLDSMITHS

In the old days gold was minted into coins and those coins, along with silver coins, formed the nation's currency. Goldsmiths had strongboxes and vaults in which to securely store the precious metal with which they worked. It was natural enough then that other people took to asking the goldsmith to store their gold and gold coins in his vault and to pay the goldsmith for the service. A merchant (for example) would entrust to the goldsmith £20 worth of his own gold for safekeeping. When he handed over his gold, the goldsmith would provide him with a receipt or note promising to hand back the gold (pay the bearer on demand) whenever the depositor returned and presented the note. The receipt held by the depositor was in fact as good as gold because he could exchange it for his £20 worth of gold any time he chose. But the note was easier to carry around than heavy and bulky amounts of gold and easier to conceal, so the depositor was often content to leave his gold in the goldsmith's safekeeping for long periods. In fact when the time came to pay for some commodity with his £20 of gold, instead of returning to the goldsmith, exchanging the receipt for the gold and then using the gold to pay for his purchase, it was more convenient for him simply to hand over his receipt to the seller. The seller was happy to accept the receipt in lieu of actual gold because it was more convenient to carry around and he knew that should he present it to the goldsmith, £20 of gold would be handed over to him.

Thus those gold receipts began to circulate and became the first paper money. People were happy to exchange them back and forth rather than the cumbersome gold they represented. The receipts had value because people were confident that in the goldsmith's vault lay the gold, which they could redeem at any time.

Eventually the goldsmiths noticed that the gold left by depositors remained in their vaults for longer and longer periods. People turned up wishing to exchange their receipts for gold less and less often, and that the receipts they had issued to depositors circulated in its stead. It seemed a shame to have that gold just sitting there doing nothing. Why not lend some of it out for a while? If it just sat there for year after year the owner, the holder of the receipt, was not going to miss it if it were loaned to someone else for a period.

As long as there was enough gold in the vaults to satisfy anyone who did turn up with a receipt, then no-one would be any the wiser. So depositor Joe would leave £20 of gold with the goldsmith for safekeeping and depart with his receipt which he would then use as money in lieu of the gold and it would circulate. It might be years before anyone turned up with that £20 note asking for £20 of gold. Meanwhile Tom would turn up at the goldsmith's asking to borrow £20 of gold and the goldsmith would lend it to him, demanding that it be paid back after a certain period at a certain amount of interest. But instead of lending Tom actual gold, the goldsmith would draw up a £20 receipt, just like the one depositor Joe had been given. Tom was happy to take the receipt in lieu of the gold because it was more convenient to carry around and people were happy to accept such receipts in payment for things.

So Tom went off with his £20 note, content that through it he was now in temporary possession of £20 of gold. But unbeknownst to Tom, Joe also has a receipt representing that gold. In other words there are now two notes in circulation representing the same £20 of gold! Clearly the goldsmith's issuance of two receipts for the same amount of gold is fraudulent - particularly when Tom repays the gold he believes he has borrowed in real gold. As each receipt promises to hand over the same £20 of gold on demand, the goldsmith is making a promise he knows he cannot keep.

Several things are clear at the moment the second receipt was issued and entered circulation: new money has been created out of thin air; that new money has been loaned into existence; as the loan has interest charged upon it, then a debt has been created out of nothing that is greater than the amount of new money created.

And another thing: Tom will eventually return to the goldsmith and repay his £20 loan, say at 10% interest. He will therefore hand the goldsmith, £22 in real gold. In other words, the goldsmith, in creating that bogus receipt and lending it to Tom, is creating for himself, albeit after a delay, real debt-free gold worth more than the new money he loaned into existence! It gets worse.

After a while the goldsmith, seeing that his fraud is working pretty well, thinks that if he can issue two £20 receipts against the same £20 of gold, then why not two, three or even four?

So Joe deposits £20 of gold and the goldsmith gives him his receipt. In time four other people turn up at his shop wanting to borrow that £20 of gold. The goldsmith obligingly lends it to each of them at interest, giving each a receipt purporting to represent that £20 of gold. There are now five receipts in circulation representing the same deposit of gold, one for the original depositor and one for each of the four borrowers. For that deposit of £20, £80 (4x £20) of new money is created merely by writing on a fancy piece of paper.

If(say) £2 of interest (10%) is charged on each loan, at the same time that £80 of new money is created out of thin air, a debt of £88 is also created out of thin air.

Property is held as security against these loans so if the borrower fails to repay with real gold the fraudulent piece of paper he borrowed, the goldsmith takes his property.

Each time the goldsmith lends £20 of bogus gold he charges 10% interest on the loan. By lending out £20 four times over and charging £2 interest on each loan, the goldsmith makes a whopping 40% (four times £2) in interest on the £20 "reserves" that were not even his to begin with! The goldsmith cannot lose and soon begins to amass a fortune from his fraud. It is the greatest get-rich-quick scheme ever invented. And it is, in essence, the basis of the modern banking system.

The goldsmiths of yesteryear became the bankers of today and although paper money and latterly electronic money took over from gold, essentially the same fraud is being run.

BANKERS

The business of lending pieces of paper pretending to be gold made the goldsmiths very wealthy and very influential men. Their easy wealth enabled them to move to upmarket premises. They became pillars of the community and some even became international financiers, lending money to kings and governments.

In the seventeenth century conflict between the bankers of the day and the Stuarts led the bankers to act in concert with bankers in Europe. They joined forces with those in the Netherlands to finance the invasion of England by William of Orange. William overthrew the Stuart Kings in 1688 and became King William III.

By the end of the 1600s England was in financial ruin, gold and silver supplies were running low and a costly civil war followed by costly wars with France and Holland, all in a fifty year period, had left her heavily in debt.

Government officials met with the financiers to negotiate the loans they needed. King William was £20 million in debt and he could not pay his army. Apparently it did not occur to William or anyone that if William needed to pay his army or get the economy going, all he had to do was have the government print its own money and use that to pay the troops -something that Abraham Lincoln would do successfully during the American Civil war nearly two hundred years later!

King William's "friends", the bankers, were willing to loan him the money he needed but the price they wanted for their "help" was high. They wanted a government-sanctioned but privately owned central bank that could; through fractional reserve lending, create money out of nothing and loan it to the government.

They got their way. In 1694 the world's first privately owned central bank was created. It was to be called the Bank of England. The Bank's charter included the following immortal words: "The bank hath benefit on the interest on all monies which it creates out of nothing."

Instead of exercising its right to create money and spend it into the economy, the government had the bank create it, then lend it to the government so that the government could spend it into the economy, then pay the loans back later at interest. That completely unnecessary complication was to have devastating consequences for the futures of the English people.

As well as delivering extraordinary power over the nation into the hands of a privately owned business corporation, it began the National Debt, a debt that would go on increasing remorselessly over the ensuing years until it had reached around £380 billion in 1996, costs us around £30 billion a year in interest payments and is still climbing.

By the end of the 17th century, the goldsmiths' scam had become respectable banking. The role of the banks in issuing money through lending to individuals and businesses had already become widely accepted. Thus there came to be established two routes by which money was borrowed into the economy: private and commercial borrowing on the one hand and government borrowing on the other. That combined debt in the present day has now soared to well over one trillion pounds.

In 1704, just ten years after the creation of the Bank of England, the banks' promissory notes, on the recommendation of the bankers and financiers who advised the government, were declared legal tender.

Although the new central bank was an entirely privately owned corporation, the name chosen for it led generations of Englishmen to believe that it was part of their government, when it most certainly was not. Like any other privately owned corporation the new central bank sold shares to create its initial capital. Its investors - whose identities were never disclosed - were supposed to put up a total of £1 ¼ million in gold coin to purchase their shares. Only three quarters of a million was ever received.

Nevertheless, despite that minor technicality, the bank was chartered in 1694 and began the business of lending out several times the money it supposedly had in its reserves.

In exchange for this unique and immensely profitable privilege, the bank would very kindly lend the English, and later British, government as much money as it wanted, at interest, provided the debt was secured by direct taxation of the people.

THE MODERN INCARNATION OF FRAUD

What happens when you or I, or for that matter the government, borrow money from the bank? Prepare yourself for a surprise.

Let's say we want to borrow a £100,000 mortgage on a house. The bank or building society does what the goldsmith did and creates £100,000 out of thin air. Instead of handing us a paper certificate, it simply credits our bank account with the £100,000 and registers that £100,000 as a debt, with (say) a further £100,000 interest over 25 years. The money is simply penned into our account without any account anywhere being debited the loaned money. New money is therefore created. Alongside it a debt (in this case £100,000 plus the roughly £100,000 of interest) is created. When we repay the debt, the interest is accounted as income for the bank. The £100,000 we originally borrowed is withdrawn from circulation and is accounted as collateral for further lending, loaned back into circulation when someone else borrows.

Our house is held as security so if we fail to keep up our repayments, the creditor takes possession of it. The repayments themselves can vary through no fault of our own, according to interest rates set by the banking industry.

After 25 years of blood sweat and tears we finally pay back the last installment of the £200,000 capital-plus-interest we owed and the house in finally ours. It is not ours until that point.

The lender, who loaned us money which did not exist until the moment he created it out of nothing, winds up with £100,000 of interest on the loan: that is real, spendable income that comes courtesy of our real work and real wealth creation. The numbers have been simplified to highlight the nature of the fraud and in practise the process is hidden under a great deal of complexity but this in essence is the process of money creation.

Each time the banks create money they create a debt that is greater than the spending power they create. One can see too that each time they are creating a debt for the borrower, they are ultimately creating debt free money for themselves.

Before the goldsmiths' scam began, the money in circulation was hard currency - usually gold or silver minted into coins which then circulated as the tokens used to represent goods and services. That minting and circulation of coinage was usually administered by the government or king.

However as soon as the goldsmiths' certificates became used in lieu of gold, paper money had made an appearance. As soon as the goldsmiths began issuing paper notes for gold they did not actually have, the goldsmiths were themselves creating new money and lending it into circulation.

One can see that this establishes debt as the basis of our currency. Where once, long ago, the British pound represented something -so much gold or silver - it now represents so much debt, which is not only nothing it is less than nothing.

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“Whoever controls the volume of money in any country is absolute master of all industry and commerce. And when we realize that the entire system is very easily controlled, one way or another, by a few very powerful men at the top, you will not have to be told how periods of inflation and depression originate.”

U.S. President James Garfield. A few weeks after making this statement, he was assassinated on July 12, 1818.

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