How The Monetary System Works - And the Fraud of the Canadian Banking System

How The Monetary System Works

This article analysis the intricacies of the present monetary system.

An excellent resource on how to understand the inner workings of the monetary system has been done by Canadian activist and documentary filmmaker Paul Grignon.

Grignon has created a 3 part video series titled: Money as Debt. This article presents the information found here Grignon's series.

Refer to the links above to be redirected to the informative Money as Debt video series found on YouTube.

In part 1 of his series, Grignon provides an excellent account of how money systems in the past have operated, and he cites many examples of how private financiers have taken over and dominated the economy for their selfish interests. These money systems are acknowledged below.

Forms of Monetary Systems

In the past, anything could have been used as money provided that it was portable and exchangeable for objects of real value. In this way, shells, feathers and eventually gold became a form of money used to exchange goods such as food and other resources.

In the 1600s there were goldsmiths who were able to mend the shape of gold into coins whose weight and purity were certified. The goldsmith's skill enabled them to achieve a higher status in the society at the time.

To safeguard their gold, the goldsmiths housed their gold in large vaults, and later rented these vaults to other depositors to safeguard their own gold in exchange for claim checks.

These claim checks were receipts issued by the Goldsmith. The number on the checks represented how much gold an individual could withdraw from the goldsmith's vaults.

Over time, the goldsmiths had learned that their depositors rarely withdrew the gold that they had deposited into the vaults. As a result, goldsmiths began to issue receipts, not only for their personal gold but also for their depositor's gold. As a result, they earned additional interest revenue on their depositor's gold.

In exchange for using their depositor's gold, the goldsmiths offered interest rates to depositors similar to how banks today offer interest rates on our deposits.

Over time, goldsmiths noticed they could become even wealthier if they issued receipts on the gold they did not possess. And in fact, this is what eventually would happen.

This enabled the goldsmith's to amass a great amount of personal wealth, and as a result of this excess wealth, many rumors spread that the goldsmith's wealth had been based entirely on the depositors gold.

This caused depositors to doubt the reliability of the goldsmith's promises to repay their gold and resulted in a ***run on the banks.*** Essentially this happens when depositors lose confidence in the money system and seek to withdraw all of their deposits out of the vault.

And at that time, the depositors had demanded to receive all of their gold from the goldsmiths at once. Since there were more receipts of gold than actual gold in the vaults, many depositors did not receive their gold and became outraged.

Despite this outrage, the excessive creation of gold claim checks was necessary to boost expansion. That is why, instead of outlawing the goldsmiths, the goldsmiths had been authorized to lend the gold under a ***fractional reserve system***.

Under this reserve system, goldsmiths could lend at a fixed ratio of receipts to gold in their vaults. It was at this time that the first initial banking class had been created.

Over the next 200 years, the nature of the banking system morphed from a gold backed currency into a complete ***fiat currency***. Fiat currency is money that is declared legal tender by the government. It is backed by the government's promise to pay.

"Legal tender" means that the courts have the authority to enforce that any transactions be paid in fiat currency.

Thus as is evident, the nature of the manner in which commerce and money is lent and deposited had changed from things such as seashells/ feathers/grains of barley, to gold and silver coins, to gold backed currency, to fiat currency, and finally to the current debt-based currency which is private banking credit.

Present System

To the surprise of many, cash and coins only make up between 1 to 5% of the money in circulation. The rest, over 95% of the money in existence today comes into existence as ***bank credit*** created by private banks.

Bank credit, otherwise known as “Checkbook money,” is a form of money that is created when a borrower pledges an asset as collateral to take out a bank loan. The asset pledged as collateral is usually the object the borrower intends to buy using the loan.

For example, if a borrower intends to buy a car with the loan he has obtained from the bank, then the asset pledged as collateral in the event of a default, is the car itself.

It is important to distinguish the terms of the loan from the banker’s and the borrower’s perspective.

When banks hand out loans to borrowers, they accept a pledge of collateral in the event a borrower defaults on their loan, and in exchange, they offer the principal (loan) to the borrower.

When a borrower takes out a loan, they are making a “promise” to pay the bank the amount of the principal plus interest on the loan.

Some have characterized this system of granting loans as being fraudulent, since the borrower can pledge as collateral an asset he does not yet own (i.e. pledging a car you want to buy with the loan money).

The Banks are also complicit in this fraud by accepting the pledge and offering the borrower a loan.

Keep in mind that the money loaned by banks is usually not in the form of real money but rather a **“promise to pay”** to the borrower. This is not evident initially because the bank credit that is deposited into the borrower’s account shows an increase in the amount of the loan.
In reality, banks do not offer the borrower anything except a **“promise to pay”** just as the borrower has **“promised to pay”** the loan. This represents an exchange of promises; no real cash transfers hands.
Through this monetary system, it is possible for the borrower to buy a real good such as car without a single dollar being put up by the banks.
This then leads one to seek out the manner in which private banks create money.

Money Creation

If a borrower can buy a real good such as a car with virtual bank credit, than why don’t the banks simply buy everything and loan it out to borrowers at an interest?
Contrary to what many people believe, banks cannot create bank credit without deposits. The bank creates credit on the pledge of the borrower. If there are no borrowers, and no incoming deposits into the bank, then the bank cannot issue more money or bank credit.
The implications of this are many. With the way the private banking system operates, in periods of slow economic “growth”, banks are incentivized to favour immigration as a means of expanding their operations since immigrants deposit their money at the banks.
This helps continue the chain of the system to keep on shifting.
The excess bank credit that is created then complicates matters further.

Effects of Bank Credit

Initially, bank credit spent into existence can increase the money supply, stimulating new production by temporarily enlarging the economy.
Bank credit spent in the form of home mortgages often stimulates the residential construction industry and creates jobs for those in the real estate sector.
After this temporary stimulus however, the bank credit becomes a liability since it dilutes the money supply and devalues the purchasing power of everyone in the economy.
In that sense, bank credit is no different than counterfeiting which dilutes the real money supply with fake money if left undiscovered.

Bank credit is only extinguished when the borrower repays the bank the amount of the principal + interest. As seen below, there is a basic accounting flaw in the monetary system used by the banks.

Accounting Flaw

Banks are able to lend by creating credit from the borrower's pledge to pay which is backed by nothing.
This pledge to pay is listed as an asset on the bank's ***ledgers*** (a document of all the banks accounts) and is the principal of the loan + the interest.
The loan or the promise to pay the borrower is listed as a liability on the banks ledger, and represents the principal of the loan.
Already, one can see the accounting flaw on the banks ledger sheets – that the banks liabilities do not equal their assets.

Bank Ledger

Assets (Principal + Interest) =/= Liabilities (Principal).

This system is bankrupt by design as the total debts owed by the borrower (P+I) are greater than the total assets (P).
Another interesting thing to consider is that while banks create the amount of the principal in the form of bank credit, they do not create the interest.
So where does this interest come from?

Interest

In a <u>stable monetary system</u>, the interest needed to pay the loan should come from the banks.
Any interest revenue banks receive from the borrowers through interest payments should be redistributed in the form of;

1. Dividends to shareholders
2. Interest Payments on Deposits
3. Bank Operating Expenses (Paying Bank Staff)

Since the interest is **not** created by the banks (yet the loan is), the interest revenue gained must in its entirety, be <u>completely recycled</u> through one (or more) of the above forms in order to allow people to earn it and pay the interest on their loans.

For all borrowers to be able to make their payments of principal + interest two things must be true

1. The dollar, created as the principal of the loan, must be available to be earned by the borrower in order to make the principal payment to extinguish that dollar
2. Every dollar the borrower pays to the bank as interest must also be available to be earned by the borrower

In Canada, as in most other countries, the two conditions are not met. The current banking system in Canada does not force banks to redistribute their interest revenue back to the people, nor does it stop banks from re-loaning or hoarding the interest revenue for its own benefit.

In order to be able to pay this interest off, the interest revenue must be <u>spent</u>.

If the interest revenue is re-loaned at interest or hoarded then there is an inherent shortage of money to pay off the aggregate debt. A shortage of the money necessary to pay the principal + interest results in defaults as some borrowers will not have enough money to pay the interest.

Defenders of the current monetary system argue that if all interest charges can be earned, then all loans can be repaid. If the Canadian government actually enforced that all interest revenue must be redistributed by the banks, then the above argument would hold true, but sadly it does not.

The argument is also false when one realizes that banks are not the only ones that offer loans, ***secondary lenders*** also offer loans and they can charge interest as well.

If a secondary lender manages to get a hold of money issued by the bank, then they can relend it at interest. The end result is that the same money is earning two types of interest.

So even if banks redistribute their interest revenue in a way where people could earn it, there is no guarantee that secondary lenders would not redistribute it as well.

In the event that a secondary lender hoards the money that has been first created by the banks, then the interest to pay that money will never be earned by the people, and the difference must constantly be borrowed forever resulting in a perpetual cycle of debt.

Perpetual Debt

This perpetual cycle of debt that is created has been a recurring problem that has plagued human civilization for centuries. In Ancient Rome, moneylenders had charged interest on the gold coins they had lent out. With gold being a scarce commodity, the act of charging interest in a fixed money supply system led to enormous complications for the Romans. The act of charging interest on gold, quickly privatized the supply of gold into the hands of the moneylenders themselves.

The lack of gold placed an enormous strain on the government of Rome and eventually led to its demise.

Today, one can still see the effects of the convoluted monetary system in Canada. Banks have exerted an unprecedented amount of influence over the global economy through the practice of tightening and loosening the money supply through loan requirements.

By tightening the flow of bank credit the banks can significantly reduce the money supply causing a deflationary spiral.

Alternatively, banks can also offer massive amounts of loans to individuals at very low interest rates to spur the economy into a booming inflationary period.

In fact, the private banks operating in Canada have been adopting this practice today.

To illustrate the effects of the monetary system on inflation and deflation, we present the scenarios of deflation and inflation below;

Deflation and the Monetary System

When individuals and businesses confidence in the economy is shaken, this leads to deflationary pressures in the economy and the money supply becomes restricted since people do not want to take out loans or incur any risks.
With no incoming loans, the money supply becomes even tighter as banks cannot create additional bank credit since no deposits are coming in.
With no money, consumers are not buying and businesses have no choice but to reduce the price of goods to boost sales. The end result is that businesses are often left with excess inventory that no one wants to buy.
In such an economy, one alternative to address this, is increased government spending (stimulus).
Governments can either create the money they spend (debt-free) as Canada has done prior to 1974 with its Bank of Canada, or they can choose to borrow money from the private banks at compound interest.
Unfortunately, since 1974, Canada has opted to borrow from private banks and the result of this decision continues to affect Canadians to this day as the net debt is over $1.1 trillion.
As another strategy, the government may also implement tax cuts to spur consumers into buying more goods and services.

Inflation and the Monetary System

When businesses and consumers have a strong confidence in the economy, this creates inflationary pressures since when businesses are seeking to expand, there is a race for loans as other businesses also seek to expand in order to keep up with competitors.

With so many loans being created, the money supply over-inflates, and the purchasing power of the public is significantly reduced.

In addition, by offering loans to people with questionable backgrounds, the bank exposes itself to the risk of defaults by the borrower.

Borrower's that cannot afford to pay back loans must pay the bank with their collateral. If many defaults occur at once such as in the mortgage market, the price of the collateral (house) can drop significantly thus forcing heavy losses and even bankruptcy.

Banking Benefits

The moneylenders of ancient Rome enjoyed the private accumulation of gold through the use of interest charges, but what do their modern counterparts receive?

One of the most obvious benefits received to the private banks, is the interest revenue obtained from interest payments on consumer loans and mortgages. The banks can use this profit to speculate on the open market and engage in risky speculative bets in the unregulated derivatives market.

Banks can also use their excess credit to acquire large portfolios of corporate and government bonds, which allows them to heavily influence decisions that pertain to industry and government.

Perhaps the most lucrative benefit for banks is their ability to acquire real world assets such as homes and cars in the event the borrower defaults, all without ever having to spend any real money.

Even in the worst case scenario, banks can always rely on the government to provide bailouts financed through increasing tax payer debt which would affect their children's outcomes as well.

Conclusion

Throughout history, the monetary system has evolved into the current system we have today. The system manifests itself through the lucrative benefits given to the bankers as well as the perpetuating debt placed onto the Canadian public.

It is clear that the monetary system is prone to failure as the assets (principal) do not equal the liabilities (principal + loan).

In a system where interest revenue is not re-spent into the economy, borrowers must fight amongst themselves in a money supply of which 95% is interest bearing bank credit.

The monetary system also takes away more and more government revenue to pay the interest on the net debt.

This forces the government to enact difficult decisions including austerity cuts as mentioned in Part 1 of the series.

Many individuals have criticized and attacked the monetary system and the system has just recently come under fire by a 12 year old girl named Victoria Grant.

In the following video, Grant presented a speech explaining how the private banking system has worked with the government to extract the financial wealth of the Canadian people.

In her speech, Grant discussed the Bank of Canada's historical role, and how the Canadian government neglected their right to borrow interest-free

money from their central bank as was authorized in the Bank of Canada Act.
Victoria Grant explanation https://www.youtube.com/watch?v=xB3wKqqVrhY