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Submission on Christchurch City Council 2020-2021 Annual Plan

By Chris Leitch, Leader; Finance Spokesperson

09.04.2020

I have major concern about the enormous sum of ratepayers' money that is being wasted annually in interest payments on the council's debt.

The plan's financial pages show estimated council debt of $2.2 billion.

They also show estimated interest on council borrowings of $89 million in the coming year, yet the community will have not one additional facility or service improvement to show for that expenditure.

The council's capital works programme is outlined in the plan at $512 million, roughly 17% of which could be paid for out of revenue if the council was not paying interest.

The council, through its membership of the Local Government Funding Agency, and the Local Government Association, should be pushing for much better funding arrangements for capital works.

Instead, for instance, of the Local Government Funding Agency issuing bonds that are bought by the privately owned commercial banks and other investors at between 3% and 4% interest, the Agency should be seeking purchase of those bonds by the Government owned Reserve Bank at zero interest.

After all, the commercial banks create new money with which to purchase those bonds or make loans and the Reserve Bank can do the same. The difference is of course the massive saving in interest charges, and that the profit (if any) of the Reserve Bank would go back to the Government.

For those who will immediately discount this option as nonsense, let me deal with each part of my previous statement separately.

"After all, the commercial banks create new money with which to purchase those bonds or make loans"

Commercial banks are allowed to do something nobody else can do: They can create credit on their books simply with accounting entries.

As the New Zealand Reserve Bank explains:

26 May 2003

Dear Mr Fitchett,

Thank you for your enquiry about the origin of the money in circulation.

Basically, you are quite correct. Since 1990, notes and coins in circulation have ranged between 2 and 3 per cent of M3, averaging approximately 2.3 percent. This proportion varies seasonally; it tends to be considerably higher than average over the Christmas period. As you say, the other 97 per cent of money is credit, created by the banking system.

Yours sincerely

Isabelle Sin
Economic Analyst
Policy Team

Or:

As the Bank of England explains in its Quarterly Review Q1 2014:

"One common misconception is that banks act simply as intermediaries, lending out the deposits that savers place with them."

".....rather than banks lending out deposits that are placed with them, the act of lending creates deposits. ***Commercial banks create money."***

"Of the two types of broad money, bank deposits make up the vast majority - 97% of the amount currently in circulation. ***And in the modern economy, those bank deposits are mostly created by commercial banks themselves.****"*

Or: from

Tragedy and Hope – A History of the World in our Time – Prof. Carroll Quigley.

"Loans were made by creating a deposit for the borrower, who in turn would draw checks upon it rather than withdraw it in money. Such created deposits also were a creation of money out of nothing."

There are numerous books on economics that explain the process in detail.

"the Reserve Bank can do the same"

As the country's central bank (just like the Federal Reserve in America or the Bank of England) it also has the ability to create new money, and has used it in the past.

The book "State Housing in New Zealand" was published by the New Zealand Ministry of Works in 1949.

On page seven it explains how 33,766 houses were built from 1936 using money issued by the Government's Reserve Bank at interest rates of 1% & 1½ %.

"Reserve Bank Credit: To finance its comprehensive proposals, the Government adopted the somewhat unusual course of using Reserve Bank credit, thus recognising that the most important factor in housing costs is the price of money – interest is the heaviest portion in the composition of ordinary rent.

The newly created Department was able therefore, to obtain the use of funds at the lowest possible rate of interest, the rate being 1 per cent for the first £5,000,000 advanced and 1½ percent on further advances. The sums advanced by the Reserve Bank were not subscribed or underwritten by other financial institutions. This action showed the Government's intention to demonstrate that it is possible for the state to use the country's credit in creating new assets for the country."

That is just one of many examples.

"The difference is of course the massive savings in interest charges" – this hardly needs explanation.

"and that the profit of the Reserve Bank would go back to the Government."

The Bank of North Dakota is owned by that state in America. It reports:

"The Bank of North Dakota's revenues have also been a major boost to the state budget. It has contributed over $300 million in revenues over the last decade to state coffers, a substantial sum for a state with a population less than one-tenth the size of Los Angeles County."

If this proposal were to be implemented there would be substantial benefits.

The International Monetary Fund, in a report released in August 2012 titled "The Chicago Plan Revisited" has this to say –

"Allowing the Government to issue money directly at zero interest, rather than borrowing that same money from banks at interest, would lead to a reduction in the interest burden on government finances and to a dramatic reduction of (net) government debt, given that irredeemable government-issued money represents equity in the common wealth rather than debt."

"Another advantage is the ability to drive steady state inflation to zero in an environment where liquidity traps do not exist, and where monetarism becomes feasible and desirable because the government does in fact control broad monetary aggregates."

There would be no need for additional legislation to allow this proposal to proceed.

The Public Finance Act (1989) permits the borrowing of funds from the Reserve Bank of NZ on terms favourable to the public interest.

In fact, following the 2008 Wall Street crisis the RBNZ offered the major banks a five billion dollar credit facility to see them through their liquidity crisis. If the Reserve Bank can prop up the overseas owned banks then similar credits can and should be made for local government infrastructure projects.

In the face of the Covid 19 crisis the Reserve Bank has created $60 billion dollars to purchase government and local body bonds back from the banks and other investors that hold them in order to ensure there is enough ‘liquidity’ (read money) in the financial system. The Bank could instead purchase newly issued bonds directly, rather than investors ‘clipping the ticket’ along the way.

Instead of millions of dollars per year being wasted on interest, Christchurch ratepayers would pay the construction cost of projects only, rather construction plus interest, because the cost of interest would be zero. Additionally the risks associated with hedging and derivatives would be removed.

What I am suggesting would be a win-win situation. It’s been done before, right here in our own country. It’s just that we have granted private companies a licence under legislation to create new money (credit) for their own profit, and at our cost, and allowed them to take a strangle hold on the process.

The privately owned overseas banking companies that currently create the new money for councils to borrow, would be less happy of course. But that is not something that the council should be concerned about.

“The NZ banks' combined net profits <u>after tax</u> last year were approximately $6 billion dollars, much of which went out of the country to overseas shareholders. I have no problem with the banks charging commercial rates to commercial entities. However, charging such rates to non-commercial local bodies for essential public works is an anachronism and need not continue.

I realise also that your Council alone would have little success in demanding a reform of this system when policy is made by Government. However, as long as local bodies meekly accept this iniquitous situation, it will persist.

I would like to see the plan contain a commitment from council to work with the Local Government Funding Agency, the Local Government Association, and other local bodies to get the proposal for Reserve Bank funding at very low rates of interest for local body capital works adopted by Government.

Thank you for taking the time to consider my submissions.

Chris Leitch

Please refer to the attached letter to the Prime Minister in regard to funding of the next rates payment and proposed rates increase.

Questions and Answers

Question – You say banks create money when they make loans, but don't they just lend money deposited with them?

Answer – No. The majority of New Zealanders right up to Cabinet level, despite our supposedly better education and lightning speed communications, do not have the foggiest idea of how the rudiments of banking and credit operate, let alone alternatives to it. But our own Reserve Bank spells it out clearly in a letter dated 1 September 1994 "As you noted, banks do create money and credit, adding to the broad measures of the money supply"………."Therefore about 3 percent of M3 (mainly notes and coins) is created by the Reserve Bank, with the remainder being created by commercial banks".

That's about as crystal clear as you can get.

Question – Is this just that old funny money stuff again?

Answer – You tell me which is funnier – The Government printing Government bonds and getting the private banks to buy them using money (credit) created out of thin air, and then paying rental (interest) on those bonds - or the Reserve Bank creating money (credit) for the Government or local bodies to invest in much needed infrastructure without the need to pay interest. Both the bonds and the money are just bits of paper backed by the security of the state or local body.

Question – Wouldn't the money created by the Reserve Bank be inflationary?

Answer – Are you seriously suggesting the money created by the Reserve Bank is more inflationary than money created by privately owned banking companies. The International Monetary Fund reports that inflation would not be an issue.

Question – If what you are suggesting is such a good idea, why hasn't it got more support?

Answer – Read the first part of the answer to question 1, but you might be surprised at just how much support it has. To give you just one example – In America, an organisation called "Sovereignty" is proposing exactly what my submission suggests. It has the support of more than 3400 local governmental bodies from school boards to individual states. Some examples are – State Legislature of Michigan, Illinois State Senate, Iowa State Senate, State Legislature of Missouri, and cities St Louis, Cleveland, Buffalo.

In New Zealand, economic commentators Bernard Hickey, Raf Manji, Bryan Gould (and others) have been recommending this solution, as have economics professors and economic writers. See more here http://tellmemore.org.nz/index.html

Question – But the Reserve Bank can't just issue money willy-nilly surely?

Answer – Absolutely not. Local Body projects would have to be approved by ratepayers as part of council plans through consultation, and projects would have to be prioritised with low interest loans going to the most important first – like water and wastewater, and the environment.

Question – You say this has been done before?

Answer – Yes it has. Few New Zealanders today realise that in 1936 the first Labour Government was able to reduce unemployment by 75% by issuing Reserve Bank credit at 1% and 1.5% to fund state housing. Reserve Bank credit was also used to fund infrastructure projects like road construction and hydro schemes. The Waikato Drainage Board and the Dairy Board were some of the other bodies that had access to Reserve Bank credit.

Question – How about elsewhere in the world?

Answer – Here are just a few examples:-

The Bank of Canada issued over half of Canada's credit during 1935-1945 and up to 30% until the mid 1970s.

The Commonwealth Bank (when it was the central bank of Australia) funded numerous Australian government projects in the 1930's and 40's.

Guernsey Island saved itself from destitution in 1820 by issuing its own currency, which is still used, independently of British Sterling.

Abraham Lincoln's administration issued 'Greenbacks' during the Civil War, bypassing the debt finance system, as did the Confederacy, issuing Graybacks as non-interest bearing money. President John F Kennedy did something similar with the issue of US Notes.

Question – If it worked so well why aren't we still doing it?

Answer – Because over time the so called economic experts have convinced us that being in debt is somehow the way to go. Great men like Henry Ford, Thomas Jefferson, and Thomas Edison new better. Edison, who held over 1,000 US patents for his inventions, elegantly explained the difference in a few paragraphs that are more succinct and important than a library of economic books:

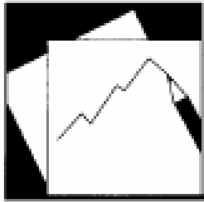
"If our nation can issue a dollar bond, it can issue a dollar bill. The element that makes the bond good, makes the bill good also…

Both are promises to pay, but one fattens the usurers and the other helps the people. If the currency issued by the Government was no good, then the bonds would be no good either. It is a terrible situation when the Government, to increase the national wealth, must go into debt and submit to ruinous interest charges…"

I submit that (with apologies to Thomas Edison)

It is a terrible situation when Councils, to increase the national wealth by building infrastructure projects, must go into debt and submit to ruinous interest charges.

WP/12/202



IMF Working Paper

The Chicago Plan Revisited

Jaromir Benes and Michael Kumhof

INTERNATIONAL MONETARY FUND

Conclusions – Extracts

This paper revisits the Chicago Plan, a proposal for fundamental monetary reform that was put forward by many leading U.S. economists at the height of the Great Depression.

Fisher (1936), in his brilliant summary of the Chicago Plan, claimed that it had four major advantages, ranging from greater macroeconomic stability to much lower debt levels throughout the economy.

(1) Much better control of a major source of business cycle fluctuations, sudden increases and contractions of bank credit and of the supply of bank-created money.

(2) Complete elimination of bank runs.

(3) Dramatic reduction of the (net) public debt.

(4) Dramatic reduction of private debt, as money creation no longer requires simultaneous debt creation.

We find support for all four of Fisher's claims. Furthermore, output gains approach 10 percent, and steady state inflation can drop to zero without posing problems for the conduct of monetary policy.

In this paper we are able to rigorously evaluate his claims, by applying the recommendations of the Chicago Plan to a state-of-the-art monetary DSGE model that contains a fully microfounded and carefully calibrated model of the current U.S. financial system.

The critical feature of this model is that currently the economy's money supply is created by banks, through debt, rather than being created debt-free by the government.

Our analytical and simulation results fully validate Fisher's (1936) claims. The Chicago Plan could significantly reduce business cycle volatility caused by rapid changes in banks' attitudes towards credit risk, it would eliminate bank runs, and it would lead to an instantaneous and large reduction in the levels of both government and private debt.

It would accomplish the latter by making government-issued money, which represents equity in the commonwealth rather than debt, the central liquid asset of the economy, while banks concentrate on their strength, the extension of credit to investment projects that require monitoring and risk management expertise.

We find that the advantages of Chicago Plan go even beyond those claimed by Fisher.

One additional advantage is large steady state output gains due to the removal or reduction of multiple distortions, including interest rate risk spreads, distortionary taxes, and costly monitoring of macro-economically unnecessary credit risks.

Another advantage is the ability to drive steady state inflation to zero in an environment where liquidity traps do not exist, and where monetarism becomes feasible and desirable because the government does in fact control broad monetary aggregates.

This ability to generate and live with zero steady state inflation is an important result, because it answers the some what confused claim of opponents of an exclusive government monopoly on money issuance, namely that such a monetary system would be highly inflationary. There is nothing in our theoretical framework to support this claim.

Further Reading:-

http://tellmemore.org.nz/index.html

Funny Money – A commonsense alternative to mainline economics

Paul Hellyer – Former Canadian Deputy Prime Minister

Triumph of the Bankers : Money and Banking in the Eighteenth and Nineteenth Centuries
William F Hixon

The Lost Science of Money

Stephen Zarlenga – Director, American Monetary Institute

We Hold These Truths: The Hope of Monetary Reform

Richard C. Cook – former U.S. Treasury Department analyst

Money as Debt (Video DVD or Youtube)

Paul Grignon – Canadian film maker

The Money Masters: How Banks Create 90% of the World's Money

(Video DVD or Youtube)