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# Money, What it was, and What it has become

by Tarek El Diwany

## Intrinsic Value & Extrinsic Value

- the intrinsic value of an item is that for which it can be exchanged irrespective of legal convention.
- the exchange value of an item is that for which it can be exchanged under legal convention.

## Gold Versus Paper

- gold and silver will always have exchange value, because they have intrinsic value. This is so whichever legal system is in operation.
- paper money has exchange value because the law says so.
- if the legal system was to collapse, paper money would have no value.

## Gold and Silver as Money

- in societies of the past, exchanges were made by free subjective valuation of the intrinsic value of the items being exchanged. A cow for a table.
- money was the item that was most widely bartered for goods and services in a given society.
- throughout history, gold and silver have been the form of money preferred by most societies.

## Which is Better ... Gold or Paper?

The textbooks tell us that a 'good' form of money is:

- Portable
- Durable
- Homogeneous
- Divisible
- Scarce
- Desired by man

## What the Kings did to Money

- debasement is the lowering of the precious metal content of the currency
- debasements were achieved by 'recoinage'
- in England during the 12th Century, one pound of silver was minted into 240 silver pennies
- in England during 1666, one pound of silver was minted into some 700 silver pennies

## Fiat Money

- By means of their debasements, the Kings had created “fiat” money
- fiat money is a token of value ... its intrinsic value is less than its exchange value. Its exchange value is given to it by fiat (i.e. by order) of the King.
- today humanity deals only with fiat money ... no one uses precious metal coins any more

## What the Bankers did to Money

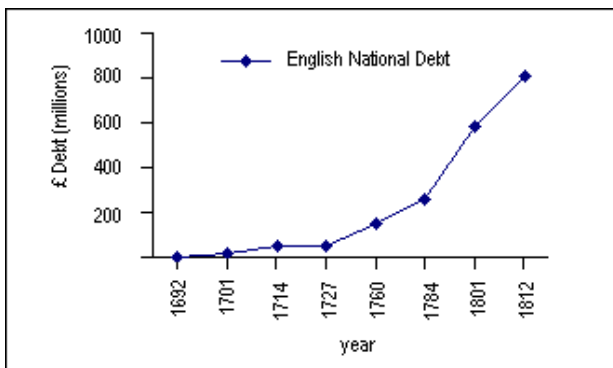
The early English bankers took the idea of token value to its extreme. They produced something of no value (a piece of paper) and gave it the name 'One Pound'. The critical stages in this process were:

- gaining the public's trust
- exchanging paper receipts for gold coins
- promoting bank money over state money
- winning the argument concerning the reserve ratio
- lending receipts, not spending them

## Money and Debt

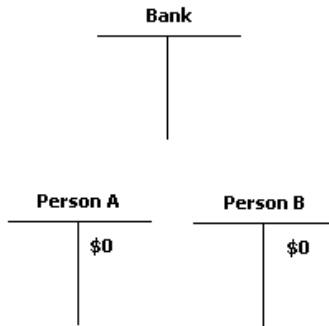
- every unit of bank money is the balance sheet counterpart to a unit of debt
- banks must lend at interest, not on a profit-sharing basis

## England's National Debt



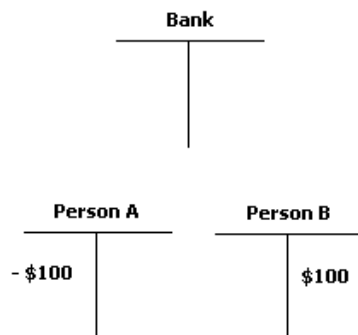
## From Paper Receipts to Checks

Only one bank, two customers

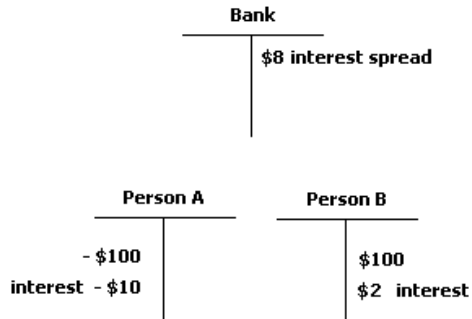


## From Paper Receipts to Checks

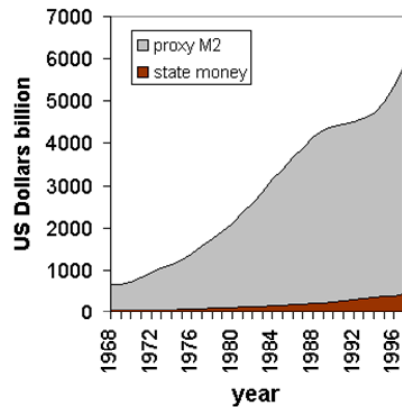
Person A buys a watch for \$100 from Person B



## From Paper Receipts to Check

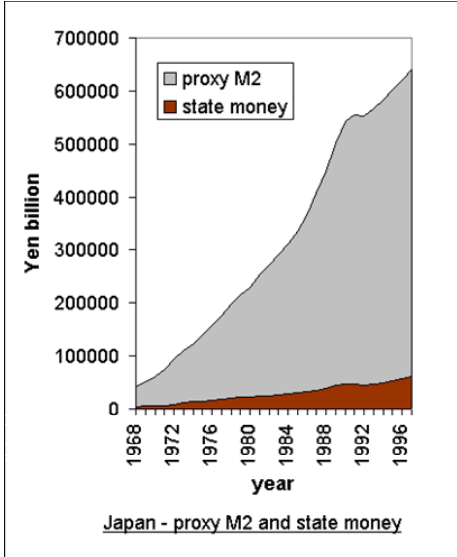


## The Scale of Money Creation

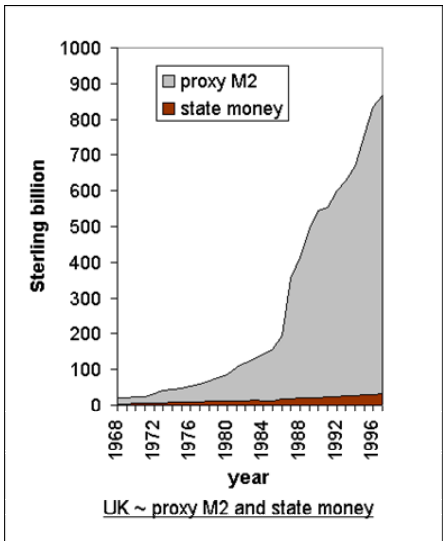


USA ~ proxy M2 and state money

### The Scale of Money Creation

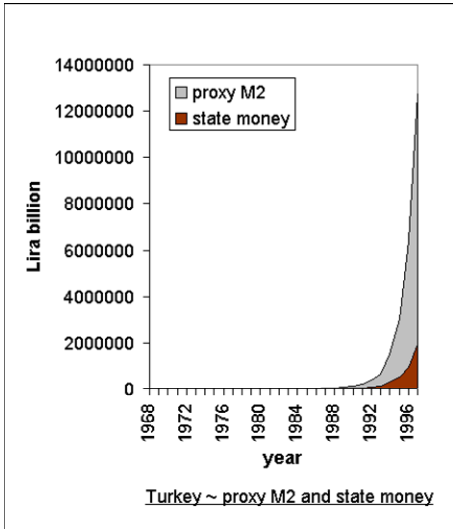


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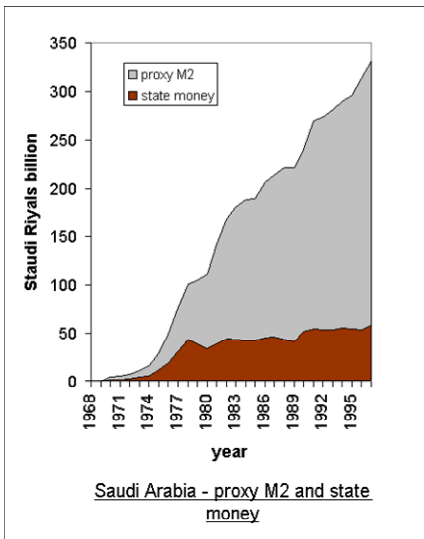




### The Scale of Money Creation



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## Un-repayable Debt

Whole economy time 0	
gold 100	
TOTAL 100	

## Un-repayable Debt

Whole economy time 0	
gold 100	
paper 400	debt 400 @ 30%
TOTAL 500	

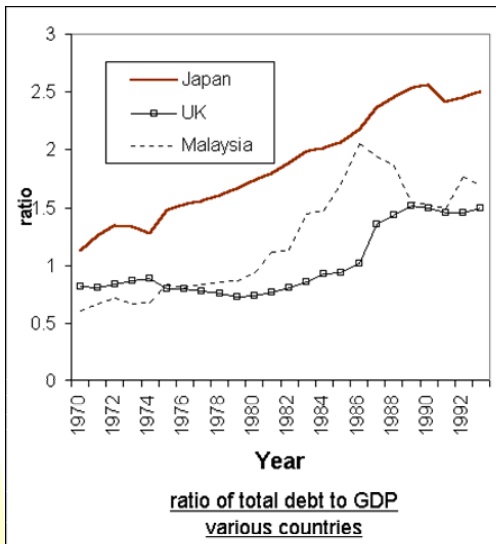
## Un-repayable Debt

Whole economy time 0		
gold	100	
paper	400	debt 400 @ 30%
TOTAL	500	

Whole economy time 1	
	debt 520 due now

## Debt as a % of GDP



## Leverage

- the rationale of modern business is to borrow at 10% and invest at 15% return on assets. This yields the businessman with a 5% profit on the money he borrows
- in order to maximise profits, the businessman must maximise borrowing
- big borrowing means big projects
- the small businessman disappears, variety is lost, society suffers from huge anonymous projects

## Collateral and Wealth Inequality

- banks lend money to people who can provide collateral
- the wealthy have more collateral than the poor...
- so the poor don't get much financing ...
- ... so the wealthy do most of the business ...
- and become still wealthier than the poor ...

## Boom and Bust

- money creation leads to inflation if productivity does not also rise
- leverage provides a motor for speculation, with increasing asset prices acting as collateral
- when money creation is insufficient to repay old debts, a recession can begin
- the government tries to prevent recession by borrowing into existence the money that the private sector refuses to borrow

## Forced Economic Growth

- because there is insufficient money to repay the debts of society, society is forced to compete ... the alternative is that yours will be the business that cannot repay its debt
- competition means the ever increasing search for economies of scale, for cheaper production methods, lower quality goods which can be sold cheaper to beat the competition
- ... which can lead to resource depletion and pollution

## Death in the Third World

“Relieved of their annual debt repayments, the severely indebted countries could use the funds for investments that in Africa alone would save the lives of about 21 million children by 2000 and provide 90 million girls and women with access to basic education”

*UNDP Human Development Report 1997, page 93*

## Paterson ...

“The Bank hath benefit of interest on all moneys which it creates out of nothing”

*William Paterson, first Director of the Bank of England, upon receiving the Charter of the Bank in 1694: quoted in Tragedy and Hope, Carroll Quigley, MacMillan New York (1966)*

## Jefferson ...

“And I sincerely believe with you, that banking establishments are more dangerous than standing armies; and that the principle of spending money to be paid by posterity, under the name of funding, is but swindling futurity on a large scale”

*Thomas Jefferson in a letter to John Taylor 28 May 1816, Writings (1984) New York: Literary Classics of the United States*

## Lincoln ...

“The government should create, issue and circulate all the currency and credit needed to satisfy the spending power of the government and the buying power of the consumers. The privilege of creating and issuing money is not only the supreme prerogative of government, but it is the government's greatest creative opportunity. By the adoption of these principles, the long-felt want for a uniform medium will be satisfied. The taxpayers will be saved immense sums of interest, discounts and exchanges ... money will cease to be the master and become the servant of humanity. Democracy will rise superior to the money power”

*President Abraham Lincoln, Senate Document 23 1865*

## McKenna ...

"I am afraid that the ordinary citizen would not like to be told that the banks, or the Bank of England, can create and destroy money. The amount of money in existence varies only with the action of the banks in increasing and decreasing deposits and bank purchases. Every loan, overdraft or bank purchase creates a deposit and every repayment of a loan, overdraft or bank sale destroys a deposit"

*Postwar Banking Policy (1928) Heineman, by Reginald McKenna, Chancellor of the Exchequer of Great Britain, later Chairman of Midland Bank*

## Knight

"In the abstract it is absurd and monstrous for society to pay the commercial banking system interest for multiplying severalfold the quantity of the medium of exchange when a) a public agency could do it all at negligible cost, b) there is no sense in having it done at all, since the effect is merely to raise the price level, and c) important evils result, notably the frightful instability of the whole economic system"

*Saturday Review of Literature, p. 732 (1927), Frank Knight*



## Summary

- commercial banks create money out of nothing
- the banks lend the money that they have created, and that has cost nothing to produce, at interest.
- the people and the nations work to repay the debt
- but the debt is un-repayable because the banks do not create enough money to repay principal AND interest
- to repay yesterday's borrowing, society must borrow still more today ...
- ... and live in the dust of riba

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