A Private Industry or a Public Service - what's the purpose of the Financial System?

A contribution for reflection

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In the beginning
~ before accounting and money

Prehistoric tribal communities attributed roles to their members according to which the tasks and responsibilities were allocated, and the available resources distributed.

It was understood that human beings owed their existence to an all creative world and any transgression within the tribe was also an offence against the world order, thus disturbing the relationship. Often a sacrifice of some kind would be required as a means of restoring the relationship and absolving the offender (and the whole community) of the “debt” incurred.

In later times of great civilisations the ordering of social life was prescribed by the theocratic rulership. Here too remedies were required for offences which might undermine social cohesion as the primary concern was to maintain a stable social order.

Later on

~ from accounting to money

The economic life of early civilisations was guided by the obligations and entitlements of the various social classes.

Early money was essentially a record of the **agreements** between **creditors and debtors**.

Accounting records in cuneiform script have been found in ancient temple sites dating back to the middle of the 4th millennium BC.
The sanctity of the agreements were maintained and enforced under the theocratic rulership of the day.

The divine origin of Money

”I am the sign of Phanes, the Bright One”

The first known inscribed coin was issued by the Temple of Artemis at Ephesus around 600 BC. It is inscribed with the words “I am the sign of Light” or also “I am the tomb of Light”.

The original coin issuing authority belonged to the sacred rites of the temple. Over time this authority was transferred from gods to emperors and kings and finally to reserve bank governors (and their masters).
The word “money” derives from “moneta” a name given to the Roman goddess Juno in whose temple Roman coins were minted.

Money as coin sets up a new possibility as a transferable contract (fungibility) authorised by the issuer. Any person in possession of coins is now in a position to exercise the claim commensurate with the value marked on the coins.

Doing God’s work

“Banks do God’s Work”

Lloyd Blankfein,

former CEO of Goldman Sachs

Financial services intermediating in the real economy

By issuing credit the financial sector facilitates the application of effort and the mobilisation of resources.

Government expenditure is effectively a requisition of goods and services at a market price.

By contrast private sector spending lacking such directive power signals to the productive sector to continue producing.

Financial services intermediating in the “financial economy”

In summary

Serving the economy?

Really?

Fines issued in the US since 2000
Top 10

Bank of America
$82,764,013,078

JPMorgan Chase
$35,819,302,225

Citigroup
$25,454,366,764

Wells Fargo
$21,358,750,745

Deutsche Bank
$18,286,625,302

UBS
$16,792,860,910

Goldman Sachs
$16,365,468,987

Royal Bank of Scotland
$13,473,904,000

BNP Paribas
$12,132,582,950

Credit Suisse
$10,410,557,626

All financial services:
$331,558,339,161

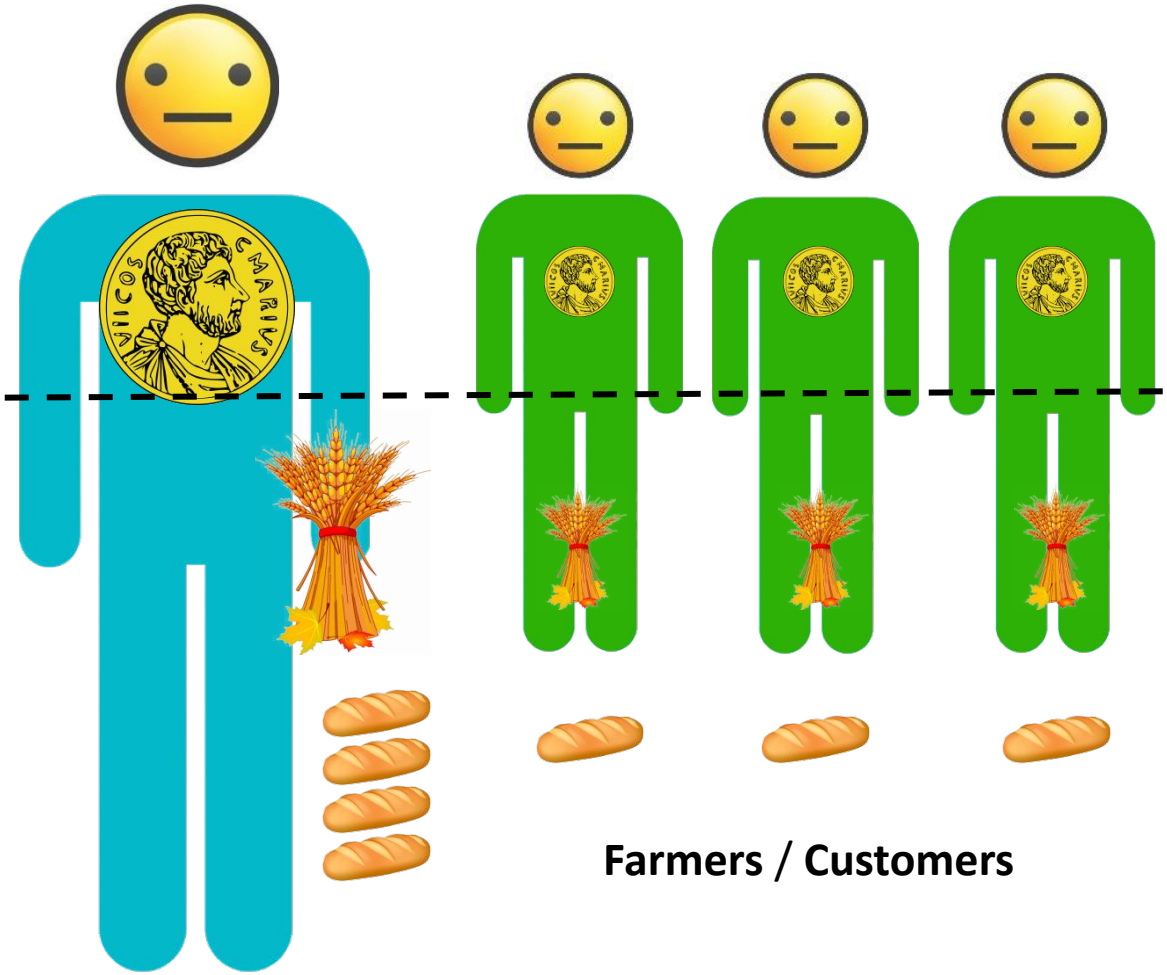
Distinguishing the **Money cycle** from the **Product cycle**

To illustrate the distinction, let's start with a loan from the bank.

1. A deposit (= certificate of claim to a specified amount) is made to a baker, the borrower.
2. The borrower purchases a consignment of wheat from 3 farmers, by transferring three certificates of claim, each being 1/3 of the loan amount.
3. The farmers deliver (as per contract) the wheat to the baker
4. The baker bakes the bread
5. The baker delivers the bread to the farmers. The farmers pay the baker and transfer (back) their 3 certificates of claim.
6. The baker returns the original certificate of claim back to the bank
7. The bread is consumed.

NB. The money is cancelled out on repayment while the bread is consumed.

Money & Product Cycles



Step 1: Bank loan

Step 2: Purchase of wheat

Step 5: Distribution and sale of bread

Step 6: Repayment of bank loan

Step 3: Supply of harvest

Step 4: Bread making

Step 7: Consumption of bread

On debt and forgiveness

It becomes clear when we examine the money cycle, that while goods and services are consumed or completed, money remains constant or even increases when interest is applied.

A consequence of this ever increasing financial pressure is to inflate prices, especially in land, stocks and shares. The expanding debt burden forces us to keep accelerating economic production in a futile effort to catch up and repay our debts.

It Is not for no reason that usury was widely condemned in earlier times. Aristotle deemed it unnatural that money should beget money in a way similar to cattle producing calves.

What's to be done?

Let us remember, that just as money is created "out of thin air" it can, and must, also be removed and destroyed to reverse social indebtedness.

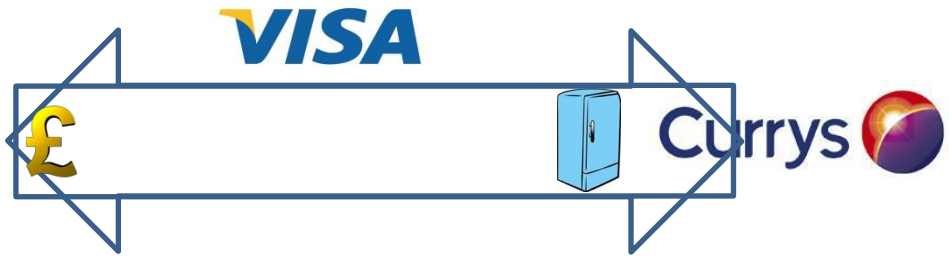
We can consider 3 methods for achieving this:

1. Taxation (by the currency issuer) destroys money and removes purchasing power.
2. Central government spending. The funding of education, social, health and welfare services (along with policing, justice and defence etc.) is akin to "gifting" back into the economy.
3. Debt cancellation or forgiveness in the form of a debt jubilee. This is no outlandish idea and could immediately be applied e.g. to student debt (in the same way that central governments were able to purchase bank debt!).

A tale of two transactions

comparing a *real product* with a *financial product*

1. Buying a freezer



2. Transferring money between banks

1. Buying a freezer (some of the actual and assumed steps)

1. Order for AEG freezer placed online with Currys
2. Online payment made using credit card
3. Order issued to distributer in Germany

(Freezer manufactured and supplied by Electrolux Thailand)

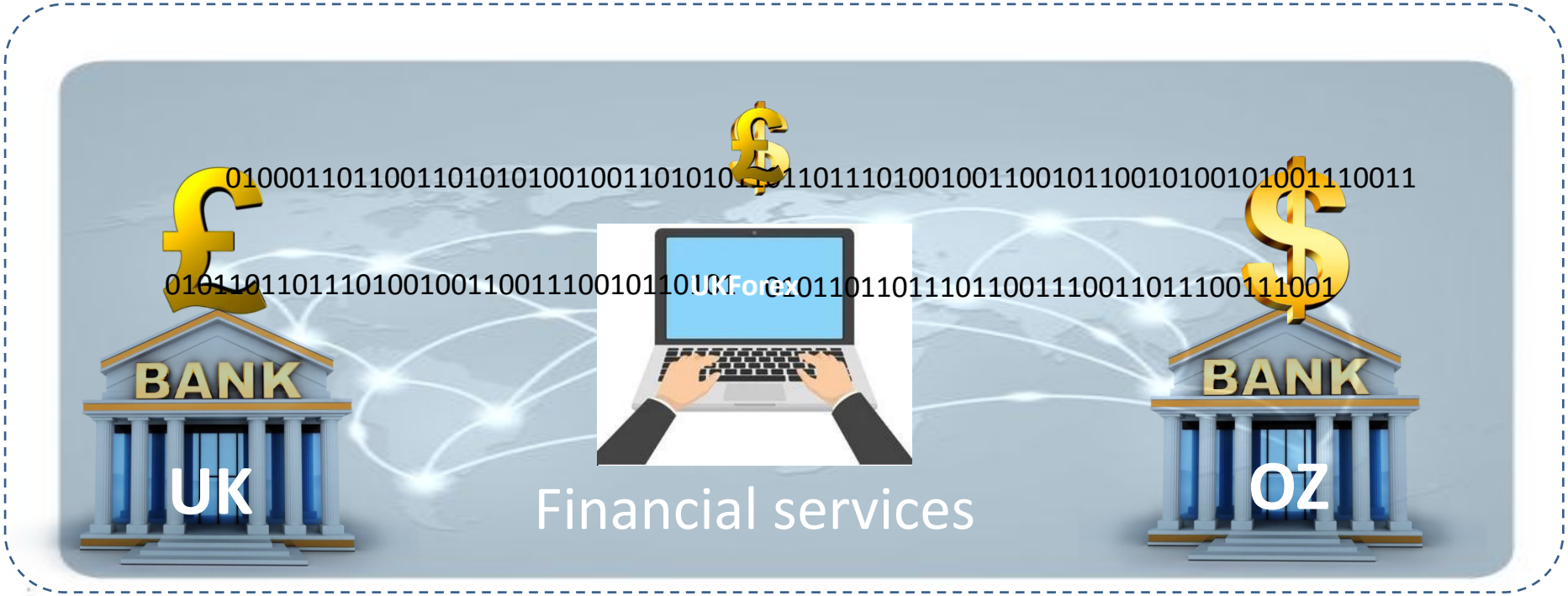
4. Item identified and prepared for shipping
5. Freezer loaded on truck
6. Driven to port
7. Loaded on ship
8. Unloaded in UK
9. Driven to local warehouse
10. Delivery to home address

(After numerous communication regarding delays, the freezer is delivered 6 weeks later)

2. Transferring funds from bank in UK to bank in Australia

1. Set up online account with UKForex
2. Enter transaction details
3. Press Submit (NB: no product has been created or distributed)

   Equipment required: ICT



The two examples cited above illustrate a stark difference between the purchase of a good and a purely financial transfer.

In the latter case ownership of a financial asset (certificate of claim) is transferred and the result recorded in another currency.

Money can only purchase commodities (goods or services), and money itself cannot be a legitimate commodity as it has none of the attributes of a commodity (it is not produced, cannot be consumed and does not wear out).

Treating money as a commodity leads not just to misunderstanding the financial system (deeming it to be an "industry") but also the inevitable abuses that we currently experience.

Financial products
do they really exist?

Product: *a thing that is grown, produced or created, usually for sale* - Oxford English Dictionary

What are classed as financial products?

These are basically **contracts** with financial institutions that help you to save, invest, get insurance or borrow money.

These basic contracts have been vastly expanded to include a bewildering array of **Financial Derivatives,** whose value derives (in principle) from the values of underlying assets. There may however be any number of intermediary links to any **real** asset.

There is virtually nothing that we cannot insure or hedge against.

Rethinking money as a **Social Contract**

The process by which money is created is so simple that the mind is repelled - John Kenneth Galbraith

Once we recognise that **Financial Products** are actually **Financial Contracts**, the mind need no longer be repelled. Just replace "money" with "social contract" and "created" with "agreed".

Contracts acquire their "substance" or efficacy solely by virtue of legislation, regulations and agreements.

As contracts they clearly do not meet a commonplace definition of a *product*. The economist Karl Polanyi recognised this and called them "fictitious commodities" (along with labour and land).

Transparency

To achieve transparency means exposing otherwise concealed or obscured facts.

Transparency alone is however not of itself adequate to the task of remedying the malpractices currently taking place. In addition we must properly interpret the facts to ensure a correct diagnosis which can inform appropriate legislative and regulatory remedies.

As a first step we can begin with correctly labelling the practices of the financial system and finance sector. The use of vague and misleading terms stands in the way of a clear vision for action.

Let us begin by replacing the term “financial product” with financial service the result of which is either **advice** or a **contract** (not a product).

In conclusion

Let us talk about *banking services* not *banking industry*.

Then we can discuss what is genuinely a *service* as opposed to a speculative gamble designed to benefit the financial institution.

When the interests of society as a whole define the purpose of the finance system, then its scope will be properly limited to that end.

Notes

A few examples of mislabelling which results in misthinking

- **Money can "work" for you** (people and machines work, money is a certificate/contract)
- **Money = wealth** (wealth comprises real resources or capacities)
- **Finance Industry** (nothing tangible is being manufactured)
- **Insurance products** (contracts are not products)
- **Wealth management** (money is not wealth)
- **Financial markets** (money is not a commodity)

The purpose of the financial system is to facilitate the production, distribution and consumption of goods and services.

Money can achieve this when it serves as:

1. A payment system
2. An investment instrument (allocation of resources)
3. A means for allocating entitlement (social equity)

In this way it can serve the needs of society.

The current process whereby it engages in facilitating its own “production” without direct reference to the real economy is both unnatural and contrary to social purpose.
Such activities are actually parasitic and should be deemed illegitimate.

From the book **Wealth: A Christian View** prepared by the Wealth Committee of the Congregational Union of Scotland, 1962.

1. We believe that the existing system of debt-finance, whereby practically all money comes into circulation as interest-bearing debt, is prejudicial to human well-being, a drag on the development and distribution of wealth, finds no justification in the nature of things, and perpetuates a wrong conception of the function of money in human society.
2. We believe that the virtual monopoly of credit enjoyed by the banking system is contrary to reason and justice. When a bank makes a loan, it monetizes the credit of a credit-worthy customer, admittedly a necessary service. But when it has done this, it hands him back his monetized credit as a debt to the bank plus 6, 8 or 9%. There seems to be an anomaly here, masked by use and wont, that calls for examination. The true basis of credit is found in the assets of the nation—men, labour, skills, natural resources and the enormous power for production now in human hands. The creation or function of money ought to bear a strict relation to those physical facts, and to nothing else.