It's hell when money goes to money heaven

Neil Dawe, Special to Oceanside Star
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The bursting of the U.S. housing bubble has sent shock waves that continue to reverberate around the world. The ensuing liquidity crisis and financial meltdown has spread to stock markets around the world, with the Toronto Stock Exchange shedding 30% of its value in the past six weeks.

People are rightly worried about their retirement income, their personal financial security and the sustainability of our economic system.

The U.S. federal government has committed $1 trillion of taxpayer's money to bail out major U.S. banks and insurance companies, a financial transfusion that equals one-third of the annual U.S. budget.

As one analyst put it: "On a macro-level, what is going on is a massive deleveraging. Deleveraging (or reducing the amount of debt a company or individual holds) is by its very nature deflationary. Money goes to money heaven when it happens. The Fed is trying to offset this by pumping as much liquidity into the system it can."

What does all this mean and, more importantly, how has it all happened? We won't get the real answers from our political leaders. In order to understand the current situation, we have to understand the basics of how money is created, a sad and nearly unbelievable story.

There's no need to go into the history of how money creation came about, interesting though it may be. All you have to understand is that today, money is simply created through debt.

When you go to the bank and take out a loan, the bank does not loan you the money from its deposits as is commonly believed. With government approval, it creates the money out of thin air and credits your account. And you spend the money into circulation. When you pay off your loan the money is removed from circulation and goes to "money heaven."

Now imagine that not only you but individuals, companies and local, provincial, and federal governments around the world all take out loans, which accounts for all the money that is in circulation today. Mortgages, personal loans, credit cards, government bonds are all forms of loans that create the money that's circulating through the economy.

Since all money is created through debt, every dollar that exists must be paid back. Interestingly, when you as an individual pay off your loan you consider yourself better off, because you now have more money to spend on other things. But what would happen if every person and company paid off all their loans? Simply put, there would be no money in circulation! No money at all!

This is known in financial circles as the deleveraging paradox: a few individuals or companies can reduce their borrowed capital but the whole system cannot as it leads to a destructive liquidation trap with falling asset prices causing financial distress requiring further asset sales and further price declines.

But in this tale of folly we haven't yet discussed the interest owed on the loans. Where does the money to cover the interest come from? It has to come from the money that is already in circulation. But remember, all the money that's in circulation has to be paid back since it was created through debt.

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So we can now see three important characteristics of our current monetary system. First, more and more money has to be created (loaned) and placed in circulation simply to make it available to cover the interest owed on the monies already borrowed. This means that national debts are perpetually increasing, never to be paid off.

Second, along with more and more money comes inflation because the more money that is dumped into circulation the less value the existing money has. This is why a "basket of goods" that cost CD$100 in 1950 would cost CD$924.80 today for the same basket of goods.

Third, corrections such as bubble bursts, bankruptcies, and loan defaults are built into the system; otherwise the entire system would collapse. Some system!

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As if that isn't crazy enough, think about this. Assume you're having financial troubles and can't make your mortgage payment, which causes the bank to foreclose on your home. This would mean the bank would wind up holding a real, tangible asset by simply creating money from thin air, money it never had in the first place.

It doesn't sound as though both parties have put up a legitimate form of property or "consideration" which is normally required by a legal contract. It also explains why the big banks get richer over time and the people, such as you and I, get poorer.

Our monetary system by its nature is inherently unstable. Because it is based on the concept of exponential growth it demands an increasing supply of people and the goods and services they consume to help pay the interest on the debt.

This, in turn requires increasing use of natural resources from a limited supply. Obviously it can't continue until all the natural resources are gone because a good portion of those resources are important for ecosystem functioning and the provision of the life-support services of the planet. It's one thing to have an economic collapse but entirely another to have ecosystems collapse.

We need a new monetary system that is not interest-based, one that cares about people, rather than profits. That's the only true path to sharing the potential abundance of our planet and achieving economic and social sustainability.

In the meantime, we have emergency plans in place for natural disasters such as earthquakes and floods. If we are wise, we'll start pushing local governments to have an economic emergency plan.

A number of Local Exchange Trading Systems (LETS) are in place around the world. Such a plan could be quickly activated in times of severe financial crisis, and allow people to access the local goods and services they need for survival. Perhaps it's time we established one here.

In the meantime, you can start educating yourself by viewing these free Internet videos at http://www.informationclearinghouse.info/article18205.htm and http://video.google.com/videoplay?docid=7065205277695921912 -- it's one of the best investments you can make.

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