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Head of Secretariat
Financial System Inquiry
The Treasury
Langton Crescent
PARKES ACT 2600

December 5, 2013

Expand Draft Terms Reference to allow:
"Root and branch examination of the financial system"

Dear Madam or Sir

The Draft Terms of Reference for the Financial System Inquiry (FSI) denies achieving the "Government's desire for a 'root and branch' examination of the nation's financial system" as stated in the joint media release[1] of the Prime Minister and Treasurer of November 20th. This also denies protecting Australian citizens and its financial institutions from another global financial crisis that could be much more serious than the one of 2008.

The threat of another crisis motivated the formation on October 2011 in London of the Sustainable Money Working Group (SMWG 2013). We were originally formed as the Green Money Working Group as posted at www.gmwg.org. We changed our name as one of our founding members, the British Chambers of Commerce (BCC), had members who did not support green initiatives. Another larger member of the SMWG is Coops UK, the peak organization of the UK Cooperative movement that represents over 13.5 million[2] citizens. The two objectives of the working group are set out on our new web page at https://sites.google.com/site/smwgorg/.

A responsible government would insist on adopting a terms of reference that inquired into how the objective of the SMWG can be achieved in Australia. That is:

1. Sustain small and intermediate sized businesses (SMEs) by providing alternative sources of liquidity in the event that a financial crisis deters banks from providing finance;
2. Establish a basis to develop a crisis and inflation resisting financial system that can also protect and nurture the environment to sustain humanity on the planet.

The existing type of money and financial institutions in Australia cannot creditably provide the above objectives. Nor can these objectives be property investigated with clause 7 of the draft terms of reference that states: "In reaching its conclusions, the Inquiry will take account of, but not make recommendations on the objectives and procedures of the Reserve Bank in its conduct of monetary policy" (Treasury 2013).

[1] http://jbh.ministers.treasury.gov.au/media-release/023-2013/
[2] http://www.uk.coop/about

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The need for substantive reforms were indicated by the then Governor of the Bank of England in a New York speech on October 25, 2010 when he stated: "Of all the many ways of organising banking, the worst is the one we have today" (King 2010: 18).

The government should invite the former Governor of the Bank of England, Sir Mervyn King to become a member of the "Special External Council comprising five international business people to specifically advise on matters relating to international competitiveness and offshore regulatory frameworks and related issues"[3] In any event the Government should invite Sir Mervyn to explain what he meant by his statement in his 2010 New York speech.

My speculation (Turnbull 2013a) of why "banking, the worst is the one we have today" is because the financial system is:

1. Back-to-front with the private sector creating money to lend to the government instead of the government creating money to lend to the banks. Reversing the current arrangement would avoid the need for any government debt and so taxes to pay interest to government financiers.
2. Upside-down because farmers, producers, traders and investors who create wealth do not create money as they did in Australia in 18th century. Today the banks and the government who consume wealth now create the money.
3. Inside-out because the value of Australian money is not determined by Australians but by foreign central bankers and private sector hedge funds and speculators.

This last point means that the Australian Financial System is not allocating our resources to the requirements of Australians. Nor does its money provide a stable and reliable unit of value for citizens or business to plan ahead. The *Australian Financial Review* provided evidence yesterday. It reported that the Governor of the Reserve Bank of Australia (RBA) stating "A lower level of the exchange rate is likely to be needed" on page 5 and that "Foreign buyers could foil RBA strategy" on page 24. The answer to these problems is for the FSI to investigate the suggestion made on the cover story of *The Economis*t of January 6th 1990 - "Time to tether currencies". A view reinforced subsequently by contagion spreading the 2008 financial crisis and the ongoing problems in the global monetary system.

The Economist (1990: 9) went on say: "Economic historians will look back on the 1980's as the decade in which the experiment with floating currencies failed". *The Economist* (1990: 17-22) summarized arguments for and against floating currencies and the FSI terms of reference should include a review of them. This is also required to meet the second objective of the SMWG referred to above. My article "Can democratic money with environmental values reduce market failures" is a contribution to this issue (Turnbull 2013a).

The Terms of Reference should explicitly demand answers to two questions that officials have not dared to ask because economic experts around the world have largely neglected their consideration. They are:

1. Is modern money fit for purpose?
2. Is the financial system fit for purpose and if so is it cost effective?

Because leading economists have failed to inquire into these questions the FSI reporting date by November 1, 2014 may need to be extended. But the government should request from the FSI as a matter of urgency how to establish "financial lifeboats" (Turnbull 2011a) to protect Australian citizens and businesses from another global financial crisis.

[3] Media Release of Australian Treasurer and Prime Minister of November 20th 2013 posted at: http://jbh.ministers.treasury.gov.au/media-release/023-2013/

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It is an issue of highest urgency because the Secretary General of the Basle Committee on banking supervision stated "it will be impossible to avoid a repeat of the failures that caused a near collapse of the financial system in 2008" (Drummond 2011).

Another failure could be much greater because of the "Doom loop" described by the Executive Director – Financial Stability of the Bank of England (Haldane 2011). Substantial increases in banks lending to each other have created the Doom Loop. It means that if one bank fails many connected banks could also fail.

Australian Banks are dependent upon foreign banks to a dangerous degree. The Australian Prudential Regulatory Authority (APRA) did not even report this danger and perhaps did not even see it before the *Australian Financial Review* published in April 2008 my Opinion article that was headed: "The blind leading the blind" (Turnbull 2008)[4]. Just six months later the Prime Minister announced on October 13, 2008 that the government would provide its guarantee to secure the dangerously excessive foreign borrowing of Australian Banks.

The foreign borrowings of Australian Banks remain excessively dangerous. The FSI terms of reference should seek an explanation of this danger, how it arose and what can be done to remove the danger. The current draft terms of reference represent a cover up of past regulatory neglect and a cover up of how the Australian Financial System is exposed to ever growing dangers.

Technology has introduced the prospect of profound changes in the nature of money and the financial system. This issue and its extent are very much underplayed in Section 3.1 of the draft terms of reference. The FSI is to advise on "the role and impact of new technologies, market innovations and changing consumer preferences and demography". Whereas the Bank of England research staff investigated a much more fundamental concern if money would exist in the future? Capie, Tsmocos & Wood, (2003) investigated if the technology of modern global communications would allow E-barter to replace fiat money? They concluded: "that the information-economising properties that allowed money to develop will also allow it to survive, despite actual and hypothesised technical progress which reduces the cost of electronic barter."

The researchers also entertained the possibility that central bank money would be replaced by electronic money issued by many organisations. This was consistent with the view of the then governor the Bank of England who stated: "Will future historians look back on central banks as a phenomenon largely of the twentieth century?" (King 1999: 47). King (1999: 48) also stated: "There is no reason, in principle, why final settlements could not be carried out by the private sector without the need for clearing through the central bank". Cell phones and the many private currencies like Bitcoin have now achieved this. These transformational changes have likewise been understated in the terms of reference.

Children are now becoming familiar with many types of virtual currencies like Bitcoin that do not pay interest. To avoid the need for costly programs of improving financial literacy the FSI should present its arguments in a way a 12 year old can understand. Daddy or Mummy should not need to explain why official money should earn interest when it is created out of nothing and why the financial system is back-to-front, upside-down and inside out.

Many private e-currencies are virtual just like the money created by the fiat of governments. A virtual currency is one whose value cannot be specified by reference to any specific goods or services. Government money now has many competitors. Choice in currency as promoted

[4] Illustrated with a picture of pilots in an aircraft with their windscreen iced over.

by Hayek (1976) is now a global reality. There is a need for the FSI to consider what privately issued currencies might be used, favoured or forbidden? (Turnbull 2013b). This is why Clause 7 of the FSI should be omitted to allow consideration of these questions.

The roles of money are typically described to be a unit of value, medium of exchange and store of value. What texts book commonly neglect to explain is that for "the invisible hand" described by Adam Smith to efficiently allocate resources is dependent upon there being a creditable basis for defining economic values. But when the value of money is not tethered, anchored or defined by any one or more goods and services the question arise how can monetary values become a reliable, predictable, efficient and effective invisible hand? By its nature virtual money is not connected to reality. So why should we believe that an electronically created social construct that we use to define economic values as a sound basis for allocating real resources? Visitors from another planet would think that either we are mad or it's a religion. Indeed, for many, a belief in market forces is like a religion.

One source of market failure is the fact that all official modern money has become virtual. Sir Nicholas Stern in his report to the UK government noted that Climate Change was the result of "The biggest market failure the World has ever seen" (Stern 2006). The need for taxing or trading carbon could be reduced or eliminated (Turnbull 2010b) if money was no longer a store of value but incurred a usage cost as supported by Fisher (1933), Keynes (1936), and Buiter (2009).

The value of national currencies and so relative prices of goods and services around the world have all become interdependent and subject to manipulation by monetary policies of other nations. "Monetary policy works by changing relative prices" (Meltzer 1999). However, nations can longer control the value of their currencies and so the *relative* prices and costs of goods and services. The result can be major misallocation of resources (Turnbull 2010b). There is no way for the services of nature to provide feedback values to the economy to indicate which resources for sustaining humanity on the planet are renewable or not.

For money to be fit for purpose to allocate real resources on a sustainable basis we need a financial system anchored in renewable services of nature. How this might achieved is described in my other writings (Turnbull 2010a,b, 2011b, 2012, 2013a,b,c,d). This submission is focused on need for the FSI to consider how the nature of money and the financial system needs to be fit for purpose.

Beside the need to tether economic values, prices and costs to sustainable services of nature there are compelling arguments to change the nature of money in other ways. The reasons arise from asking the question: why should money earn interest when it is created out of nothing? Interest is supposed to be an award for not consuming what money can buy. But virtual currencies that can be produced out of nothing do not require anyone to *forgo* consumption or investment. Virtual currencies allow the reverse to happen by providing the means for paying for *more* consumption and investment.

Fisher (1933), Keynes (1936) and Buiter (2009) supported the idea of reversing the ability of money to earn interest. This meant that money would possess a usage fee, a carrying cost or demurrage charge. This type of money was widely introduced privately in Europe and the US during the Great Depression. It was called "Stamp Scrip" because the money lost all its value unless a stamp was purchased from the issuer and affixed to paper scrip on a periodic basis. Cell phones now make negative interest rate currencies practical again (Turnbull 2010a). Phones allow the issuer to automatically collect usage fees without the inconvenience of selling stamps to be affixed to currency notes.

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There are compelling reasons for supporting the re-introduction of cost carrying money, at least as a supplementary currency to official money. A pressing practical reason advocated by Buiter (2009) is that it provides a way to stimulate an economy without resorting to potentially inflationary credit creation now practiced by central bankers of the larger global economies (Turnbull 2009).

Beside the religious reason of avoiding interest, there are compelling social reasons for using cost carrying money. Money with a carrying cost has existed since it was invented thousands of years ago. Money was typically a commodity that could deteriorate over time and/or be subject to storage costs. The idea of attaching a usage cost to circulating money was invented by Gesell (1916). His objective was to remove the ability of money owners acquiring additional wealth through interest payments whether or not they or their money were adding value to society. In this way money having a usage cost reduces inequality from unearned income. Keynes referred to Gesell as "unduly neglected prophet". In Chapter 23 part VI of his "General Theory", Keynes (1936) states that Gesell had described: "the establishment of an anti-Marxian socialism" based on "an unfettering of competition instead of its abolition"

Demurrage money removes the role of money being a store of value. It creates a more level investment playing field to encourage resources to be allocated to increase production and prosperity. Interest earning money creates a disincentive for increasing prosperity. Privately issued cost carrying money is currently circulating again in Germany (Gelleri 2009).

However, the German demurrage currency uses the Euro to define its value. This makes it a virtual currency like all other government currencies and many other privately issued currencies operating around the world (CCRC 2013).

In 1933 a Bill was introduced into the US Congress for the government to issue one trillion dollars of stamp script to be distributed to each State in proportion to the population with half of it being given away to welfare recipients and half to build infrastructure projects. In this way cost-carrying money can stimulate the economy on a self-financing basis that does not require taxpayers money, the government to go into debt or the need for any debt ceilings (Turnbull 2009). Draft legislation is provided in the Appendix of Fisher (1933).

Given this situation, it should become a matter of urgency for the FSI to consider the use of a demurrage supplementary currency for underwriting the viability of the Australian economy in an economic downturn and especially in times of a financial crisis.

Alternatively, the government should accept private issues of supplementary currencies as proposed by the Sustainable Money Working Group (SMWG 2013) to provide "financial lifeboats" (Turnbull 2011a).

If there is another crisis, as expected by many commentators around the World, how might voters treat a government who did not build financial lifeboats for its citizens after they had obtained a written warning as presented in this submission? My unheeded warning in April 2008 was only six month ahead of the crisis.

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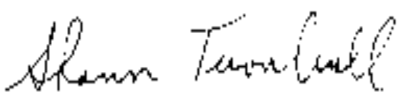
Yours faithfully



Shann Turnbull PhD

APPENDIX

The Treasury Draft Terms of Reference for Financial System Inquiry - Online Forum

http://consult.treasury.gov.au/fsi/

Posted comment number 2 by Dr Shann Turnbull at 4:58 pm, November 21, 2013

Co-founding member of Sustainable Money Working Group (UK)

It is not clear from the draft terms of reference posted at http://consult.treasury.gov.au/fsi/ that the Governments stated interest in a "Root and branch examination" of the financial system is going to be undertaken. Both the draft terms of reference and the four points raised in the joint media release by the Prime Minister and Treasurer at http://jbh.ministers.treasury.gov.au/media-release/023-2013/ seem to imply an inquiry into the existing system rather than considering any fundamental reforms?

The Governor of the Bank of England raised the need for fundamental "root and branch" reform when he stated: "Of all the many ways of organising banking, the worst is the one we have today" (refer to page 18 at http://www.bankofengland.co.uk/publications/speeches/2010/speech455.pdf).

Why the inquiry should consider fundamental changes in the financial system are indicated by the view that the system has become back to front, inside out and upside down. This view has been little noticed by academics and practitioners. Details are set out in my article: "Can democratic money with environmental values reduce market failures" (Link available from http://www.longfinance.net/component/content/article.html?id=828).

The draft terms of reference does not appear to provide a mandate to inquire if Australia is using the most appropriate type of money, if money is being created in the most appropriate way, by the most appropriate institutions and distributed in the most appropriate and efficacious manner.

Indeed, this line of inquiry is partially prohibited by clause 7 of the draft terms of reference that denies making "recommendations on the objectives and procedures of the Reserve Bank in its conduct of monetary policy."

Clause 7 needs to be omitted and a new clause 2 added along the lines suggested below:
———————————————————————

The inquiry will consider if the structure of money and the financial system is fit for purpose by considering:
1. Modern money has become a virtual social construct whose value is not tethered to any specific goods or services to provide a reference unit of value for the efficient, reliable and sustainable working of a market economy;
2. The value of Australian money has become indeterminate, unpredictable and uncontrollable by being subject to international transactions influenced by speculators, hedge funds and manipulations by alien central banks determining money creation, interest rates and exchange rates;
3. Numerous privately created virtual currencies are now competing with official money around the world with the capability of by-passing the banking system;
4. Cell phones are being used to by-pass the banking system.
5. Cell phones make feasible the re-introduction of negative interest rate money.
6. Internet technology makes choice in currencies practical anywhere in the world.
7. How can the rapid increase in cost of the financial system as a percentage of the GDP be justified when evidence exists that the system is not self-regulating, capable of being reliably regulated or fit for purpose?