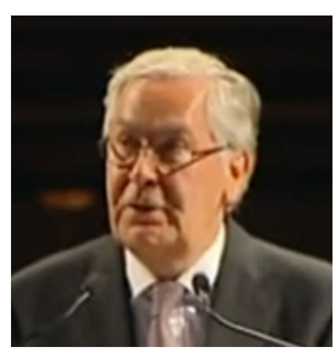
THE PROOF THAT BANKS CREATE MONEY

More than 97% of all the money that exists is created by banks when they make loans. When people first hear this, they often find it hard to believe. But we don't want you to take our word for it, read these quotes to hear what central bankers, finance journalists, and commentators have to say on the subject.

In this video Dirk Bezemer, Associate Professor at the University of Groningen and Michael Kumhof, an IMF Economist explain where money comes from in less than 2 minutes:

When banks extend loans to their customers, **they create money** by crediting their customers' accounts.

Sir Mervyn King, Speech to the South Wales Chamber of Commerce at The Millenium Centre, Cardiff on 23rd October 2012



"The essence of the contemporary monetary system is creation of money, out of nothing, by private banks' often foolish lending."

Martin Wolf, Financial Times, 9th November 2010

The financial crisis of 2007/08 occurred because we failed to constrain the private financial system's creation of private credit and money.

Lord Adair Turner, former chairman of the Finacial Services Authority, Speech to the South African Reserve Bank, 2nd November 2012

Banks do not, as too many textbooks still suggest, take deposits of existing money from savers and lend it out to borrowers: they create credit and money ex nihilo – extending a loan to the borrower and simultaneously crediting the borrower's money account.

Lord Adair Turner, former chairman of the Finacial Services Authority, Speech Credit, Money and Leverage, 12th September 2013

By far the largest role in creating broad money is played by the banking sector… When banks make loans they create additional deposits for those that have borrowed the money.

Bank of England, Interpreting movements in broad money, p.377

Even before the crisis banks enjoyed various kinds of state support, including the effective right to create money.

Independent Commission on Banking Report


ICB Independent Commission on Banking

Interim Report
Consultation on Reform Options

April 2011

So when you take out a loan from the bank, the 'money' is just typed into your account and created effectively out of nothing. Here's further proof from Paul Tucker, Deputy Governor of the Bank of England and Member of the Monetary Policy Committee (the term 'extend credit' is a synonym for 'make loans'):

> Banks extend credit by simply increasing the borrowing customer's current account … That is, banks extend credit [i.e. make loans] by creating money
>
> *Paul Tucker, Deputy Governor for Financial Stability*

> "Banks lend by simultaneously creating a loan asset and a deposit liability on their balance sheet. That is why it is called credit "creation" – credit is created literally out of thin air (or with the stroke of a keyboard)."
>
> *Paul Sheard, Chief Global Economic & Head of Global Economics and Research, Standard and Poors*

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BUT ISN'T THIS JUST THE MONEY MULTIPLIER?

It is important to note that what is being described in these comments is not the money multiplier model of banking so beloved of economics textbooks (which implies the central bank has complete control over the amount of money that banks can create). Empirical research has proved that banks do not need reserves to make loans:

> There is no evidence that either the monetary base or M1 leads the [credit] cycle, although some economists still believe this monetary myth. Both the monetary base and M1 series are generally procyclical and, if anything, the monetary base lags the [credit] cycle slightly.

Nobel prize winners Finn Kydland and Ed Prescott , Federal Reserve bank of Minneapolis (1990)

Under the present system banks do not have to wait for depositors to appear and make funds available before they can on-lend, or intermediate, those funds. Rather, they create their own funds, deposits, in the act of lending. This fact can be verified in the description of the money creation system in many central bank statements, and it is obvious to anybody who has ever lent money and created the resulting book entries.

IMF Working Paper Chicago Plan Revisited, p9

The key function of banks is money creation, not intermediation.

Michael Kumhof, Deputy Division Chief, Modeling Unit, Research Department, International Monetary Fund

The banking system can thus create credit and create spending power – a reality not well captured by many apparently common sense descriptions of the functions which banks perform. Banks it is often said take deposits from savers (for instance households) and lend it to borrowers (for instance businesses) with the quality of this credit allocation process a key driver of allocative efficiency within the economy. But in fact they don't just allocate pre-existing savings, **collectively they create both credit and the deposit money which appears to finance that credit.**

Adair Turner, Chairman of the FSA, Speech: 'Credit Creation and Social Optimality', Sept 2011

MPS TALK ABOUT BANKS CREATING MONEY

Conservative MP Jesse Norman sits on the Treasury Select Committee, a group of MPs that is responsible for scrutinising the Treasury, Bank of England and Financial Services Authority. In 2011 he wrote the following in a paper entitled The Case for Real Capitalism:

> [C]ommercial banks have an even greater power than that: they have the power to create credit—that is, money—by expanding their balance sheets. It is not widely understood how important this power is: of the money presently in circulation in the UK economy today, three per cent takes the form of cash; 97 per cent is in credit and deposits. This financial alchemy is an extraordinary privilege, which we as citizens and taxpayers underwrite.
>
> *Jesse Norman MP, The Case for Real Capitalism*

FROM THE MAINSTREAM PRESS

> Much as they might like to think they are in charge, it isn't really the central bank in a country that creates the money – it is the commercial banks. Every time they expand their lending they increase the supply of money in the economy. And every time they contract lending they reduce it
>
> *Merryn Somerset Webb, editor-in-chief of Money Week, The Financial Times, August 24, 2012*

> It is the normal monetary system, in which the "printing" of money is delegated to commercial banks, that needs defending. This delegates a core public function – the creation of money – to a private and often irresponsible commercial oligopoly…
>
> *Martin Wolf, Financial Times, June 28, 2012*

> It is impossible to justify the conventional view that fiat money should operate almost exclusively via today's system of private borrowing and lending. Why should state-created currency be predominantly employed to back the money created by banks as a byproduct of often irresponsible lending? Why is it good to support the leveraging of private property, but not the supply of public infrastructure? I fail to see any moral force to the idea that fiat money should only promote private, not public, spending.
>
> *Martin Wolf, Financial Times, February 12, 2013*

FROM A MAJOR CITY FIRM

We all know that money makes the world go round. But where does it come from? Before the recent descent into central bank money printing, the answer was that banks created money whenever they made a new loan.

Legal and General Investment Management

FROM THE BANK OF ENGLAND...

“Broadly speaking, at present, the money-creating sector covers UK banks and building societies, whereas the money-holding sector consists of UK households and private companies.”

Bank of England, Proposals to modify the measurement of broad money in the United Kingdom p.402

“In the United Kingdom, money is endogenous—the Bank supplies base money on demand at its prevailing interest rate, and broad money is created by the banking system”

Bank of England, 1994, Q3 Quarterly Bulletin, p.264

“The money-creating sector in the United Kingdom consists of resident banks (including the Bank of England) and building societies”

Bank of England, Proposals to modify the measurement of broad money in the United Kingdom, p.405

“changes in the money stock [i.e. the total amount of money in the economy] primarily reflect developments in bank lending as new deposits are created.”

Bank of England, Interpreting movements in broad money, p.378

“Given the near identity of deposits and bank lending, Money and Credit are often used almost inseparably, even interchangeably…”

Paul Tucker, Deputy Governor for Financial Stability, Bank of Engalnd. Speech: ‘Money and Credit: Banking and the Macroeconomy’

“...the banking sector plays such an important role in the creation of money. Changes in the terms for deposits will affect the demand for money, while changes in the terms for loans will affect the amount of bank lending and hence money supply.”

Bank of England, Interpreting movements in broad money, p.383

"Money-creating organisations issue liabilities that are treated as media of exchange by others. The rest of the economy can be referred to as money holders"

Bank of England, Proposals to modify the measurement of broad money in the United Kingdom, p.402

And if you need further proof, here's a letter written by a correspondent of ours to the Bank of England (see the original here). He asked them:

"When a commercial bank makes a loan to a borrower, does the commercial bank in effect create new money? In other words, when a bank makes a loan to a borrower, is that 'money' just created out of thin air?"

And the Bank of England response was:

"When banks make loans, commercial banks do indeed create much of the money in the economy."

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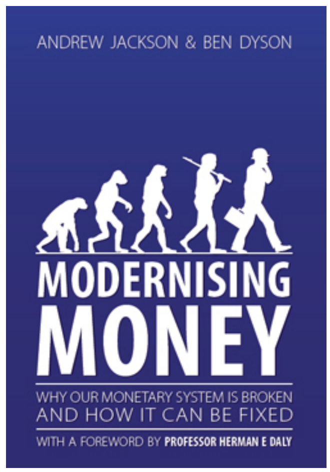

Written by Positive Money's Andrew Jackson & Ben Dyson, *Modernising Money* explains why the monetary system is broken, and how it can be fixed.

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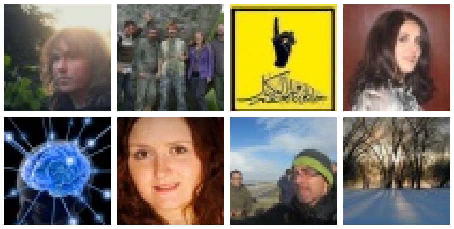

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