

1<sup>st</sup> March 2016

To whom it may concern,

**Re: Parliament Issue 169 - Umbætur á fyrirkomulagi peningamyndunar  
Support for Parliamentary resolution on reforming the mechanism of money creation.**

I am writing on behalf of Positive Money in support of the parliamentary resolution on reforming the mechanism of money creation. The resolution proposes the establishment of a committee to review the current mechanisms of money creation and make recommendations for improvements.

**About Positive Money**

Positive Money is a UK-based not-for-profit research group focused on reform of the monetary system. We have made detailed proposals for a separation of the money creating and lending functions of banks, as well as proposals for more effective use of the central bank's capacity to create money. We have discussed such reforms with the Bank of England, the regulators and a wide range of economists, finance professionals and economic journalists.

**Growing support for a similar committee in the UK**

There is growing support for the need for a similar committee to investigate the nature of the UK's monetary system. In November 2014, the UK parliament held its first debate on money creation since 1844, and a number of MPs expressed the need to re-consider the mechanisms of money creation. For example, Zac Goldsmith MP (now the Conservative candidate for Mayor of London) said: "I want to put on the record my support for the establishment of a meaningful monetary commission".

In a 2014 report, London-based think tank the Institute for Public Policy Research (IPPR) called for the establishment of a commission, saying:

"The UK has not effectively examined how its money and credit system operates since the Macmillan commission in the 1930s. Yet in that time the nature of money and the scale of credit has changed significantly. Moreover, how credit is created, circulated and accumulated has vital consequences for the UK's economic and social wellbeing, something increasingly recognised in mainstream debate. We therefore need a much better understanding of the nature and role of money and credit if we are to shape the monetary system to best support economic and social wellbeing. **We therefore recommend that an in-depth parliamentary commission should be established to investigate the role of money and credit within the economy.**"

**The Committee is Necessary**

A committee to review the mechanism of money creation is very necessary, because the fundamental problems at the heart of the financial system have not been solved. This is because global efforts to fix the banking system have ignored the role of money creation by commercial banks. Lord Adair Turner, former chairman of the UK's Financial Services Authority, has highlighted the issues in the current monetary system, stating that "*The financial crisis of 2007-08 occurred*

*because we failed to constrain the private financial system's creation of private credit and money."* In his foreword to Frosti Sigurjónsson's report "Monetary Reform", Lord Turner writes that the efforts made by financial regulators and governments since the crisis:

"...have still failed to address the fundamental issue – the ability of banks to create credit, money and purchasing power, and the instability which inevitably follows. As a result, the reforms agreed to date still leave the world dangerously vulnerable to future financial and economic instability."<sup>1</sup>

### **Growing Support for the Need for New Mechanisms of Money Creation**

Historically there has been little understanding of the way that money is created in the modern economy, with most people assuming that only the government's central bank had the authority to create money. But in most countries today around 95-98% of the money supply is actually created by private sector banks, in the form of the deposits (electronic numbers representing accounting entries) in people's bank accounts. The Bank of England confirmed this in their 2014 paper:

"[T]he majority of money in the modern economy is created by commercial banks making loans."<sup>2</sup>

This arrangement, whereby most of a nation's money is created by banks, has been heavily criticized by notable commentators, including Martin Wolf, who is the chief economics commentator of the Financial Times and was chosen to be one of the five Commissioners on the UK government's Independent Commission on Banking. Wolf has said that proposals to separate the creation of money from the business of banking:

"...would bring huge advantages. It would be possible to increase the money supply without encouraging people to borrow to the hilt. It would end "too big to fail" in banking. It would also transfer seigniorage – the benefits from creating money – to the public."<sup>3</sup>

Mervyn King, the former Governor of the Bank of England, in his newly released book states that:

"During the twentieth century, governments allowed the creation from money to become the by-product of the process of credit creation. Most money today is created by private sector institutions - banks. This is the most serious fault line in the management of money in our societies today."<sup>4</sup>

In 2012 the IMF Working Paper "The Chicago Plan Revisited" endorsed the approach of removing the ability of private banks to create money, and through the use of economic modeling has found that this would have significant beneficial impacts on public debt, private debt, and economic growth.<sup>5</sup>

---

<sup>1</sup> <https://www.forsaetisraduneyti.is/media/Skyrslur/monetary-reform.pdf>

<sup>2</sup> <https://positivemoney.org/how-money-works/proof-that-banks-create-money/>

<sup>3</sup> <http://www.ft.com/cms/s/0/7f000b18-ca44-11e3-bb92-00144feabdc0.html#axzz41I38kc8H>

<sup>4</sup> Mervyn King: *The End of Alchemy* (March 2016)

<sup>5</sup> <http://www.imf.org/external/pubs/ft/wp/2012/wp12202.pdf>

Further research and debate is needed on the feasibility of proposals to separate money creation from the business of banking, especially given the heightened risk of financial crisis in 2016, and by establishing the committee, Iceland could be a leader in that process.

### **The Need for New Monetary Policy Tools to Tackle the Next Financial Crisis**

In the last two years, a significant debate has emerged amongst economists about new monetary policy tools. Since ultra-low interest rates and Quantitative Easing have failed to sufficiently stimulate the global economy, a number of economists are now debating the use of negative interest rates. However, there is a growing consensus that this policy is simply 'more of the same' and that new tools may be needed, such as 'helicopter money' in which the central bank finances direct transfers to citizens or government spending. So far over 100 economists and financial sector professionals have expressed support for such alternative policies<sup>6</sup>.

There is also a growing concern that the world may be approaching another global downturn. This means that it is important to question the current monetary policy arrangements, and now is the right time to establish a committee to consider these issues in Iceland. We believe it is better for Iceland to be proactive in considering these issues than to wait to see what other central banks and governments do in the face of the next global recession or financial crisis.

### **We offer our assistance**

Positive Money has been undertaking research into the structure and nature of the monetary and banking system for the last six years. We would be happy to speak to any established Committee and offer research assistance or guidance.

### **CONTACT**

Ben Dyson, Head of Research Positive Money

+44 207 253 3235 / [ben.dyson@positivemoney.org](mailto:ben.dyson@positivemoney.org)

---

<sup>6</sup> A list of such economists and finance professionals can be at [www.positivemoney.org](http://www.positivemoney.org): [here](#), [here](#), [here](#) and [here](#).