

## What Do Banks Actually DO? Teach-In For Occupy Toronto

What do banks actually *DO*? Create credit out of thin air.

Were Canadian banks bailed-out? Absolutely, to the tune of \$200 billion. And they are still protected and subsidized more than any other sector of the economy.

What must be done with these banks? Tax them, control them, and ultimately take them back.

Those are the “take-aways” from a short talk on the banking system that I was honoured to give as part of an Occupy Toronto rally last weekend at the corner of King and Bay in downtown Toronto. Several folks have asked for the written version of my speech, which is posted below. [A video is available here: http://www.youtube.com/watch?v=QoOKY5kH9cc&feature=youtu.be](http://www.youtube.com/watch?v=QoOKY5kH9cc&feature=youtu.be). I free-styled it in places, so there are differences between the written speech and the video (as they say, “check against delivery”!)

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Well, here we are on Bay Street again, amidst all these gleaming towers, and all this luxury, and power, and affluence.

And what an amazing community we have formed here.

On behalf of the CAW and the CCPA, let me begin by thanking all of you for what you are doing. What you are building. The political and moral space you have opened up through the Occupy movement these past few weeks.

There’s no better place than right here to talk about what’s gone so terribly wrong in our society. About the enormous and immoral contrast between what we see here on Bay Street, and what things are like where most Canadians – the 99% of Canadians – live and work. Down on Main Street.

You already know that, that’s why you’re here. All this nonsense I’ve heard in the last two weeks about the Occupiers being naïve and confused, is so wrong. I have a Ph.D. in economics, and I can assure you that the people in this crowd today know more about economics – more about *real* economics – than all the stock brokers in these tall towers put together.

You know about work. About production. About sharing. And about sustaining.

They stand around throwing darts at the dartboard, to pick the next stock they’re going to buy. Proving every day that while government may or may not be able to pick winners, they can’t be any worse at it than the stock market is!

Work. Production. Sharing. Sustaining. That’s the basis of real economics, the real job of improving living standards and protecting the environment.

Not throwing darts. Not rolling dice. Not placing bets.

I often think about what goes on inside these towers. The plush offices, the oak paneling, the fine art on the walls, the private dining areas, the clubs and bars.

Not everyone down here works like that, of course. Most of the real work is done by hard-working office workers, who work hard for not much money.

But the ones who call the shots down here, and call the shots for our whole economy, they do very well. Every now and then I get to step inside one of those towers, in the course of my job. Into one of those investment banks. Those private dining areas. Those boardrooms.

The meals, the furnishings. And of course the compensation. Immoral, offensive compensation. All of it tax-deductible.

Then I compare all that to the generally shoddy state of public institutions and facilities in this city. Like the rec centre in my neighbourhood, out in Parkdale. Or the public schools where my kids go to school. Fine, wonderful schools. But underfunded and dingy, to be sure.

Rob Ford said he went to City Hall to stop the gravy train. When I compare public institutions in this city, to these towers here on Bay Street, I know that Rob Ford missed his target by about 3 blocks. He was 3 blocks too far north.

Want to stop the gravy train, Rob Ford? Come down here to stop the gravy train! A gravy train that's funded with the proceeds of what, ultimately, is just gambling.

Ever since the Occupy movement came to Canada – even before that, actually – there's been an enormous myth propagated that these guys here on Bay Street – the Canadian banks – did nothing wrong.

Our banks are strong and safe, they say. They were prudent. And they weren't bailed out.

They pat us on the head, and they say: "Go to Wall Street to have your little protest. But don't bother protesting here. Because we didn't do anything wrong."

Well that's simply a lie. It's a bald-faced, empirically refutable lie.

In the first place, Canadian banks were bailed out – and in a big way. Check the record:

At the end of 2008, and the beginning of 2009, Finance Minister Jim Flaherty and other federal officials moved heaven and earth to help Canada's banks. Flaherty implemented a new program called the Extraordinary Financing Framework. Or "EFF" for short.

You know, I could think of another meaning for the acronym "EFF." Elitist Friggin' Financiers! That's the real EFF.

It consisted of many different ways to help the banks – these powerful, prudent banks – during their hour of need.

Buying back mortgages in order to inject cash into the banks' coffers. Providing huge loans, at near-zero interest rates, from the Bank of Canada, when commercial lenders wouldn't dare.

Providing other lines of credit, including in U.S. dollars. And backing the whole thing up with very weird forms of collateral – or sometimes with no collateral at all.

For example, the Bank of Canada was willing to accept asset-backed commercial paper, or ABCP, from the banks to back up some of these emergency loans.

Remember the ABCP debacle in Canada? That sophisticated, but highly unstable market totally froze up in Canada, even before the global meltdown.

If you owned ABCP as an individual, you couldn't spend it. It was just paper in your pocket. But the banks held ABCP, and they were able to convert it into cold hard cash, courtesy of the Bank of Canada, when they needed it.

In total, various federal agencies offered the banks up to \$200 billion in cash and short term ultra-low-interest loans, at a point in time when the banks could not attain this financing from normal commercial sources because of the global crisis.

They needed it. They got it. It was a bail-out, pure and simple.

It was a smart thing to do. The banks have paid the money back, with interest in some cases. (Not much interest, since the interest rates were near zero.)

But that doesn't mean it wasn't a bail out.

So for the banks and their executives to lecture Canadians, and our governments, about the need to be prudent and fiscally responsible and tighten our belts, is the most offensive thing we could possibly hear.

If it weren't for Canadian governments and taxpayers, they would quite possibly be out of business.

We're in this together. Let's start acting that way!

So the banks were bailed out, pure and simple. And moreover, they continue to be coddled and protected and subsidized by the state. Our government is indeed a "nanny state," where high finance is concerned.

They are protected against foreign takeovers.

Tell me, if we can protect our banks against foreign takeovers, why can't we protect our land, and our resources, and our factories, and our jobs against foreign takeovers? Why is it protectionist to protect people, but not protectionist to protect banks?

They are protected against crises of confidence by an extensive public deposit guarantee system, and a public mortgage insurance program that eliminates most of the risk of their lending.

And they receive enormous subsidies delivered through Canada's distorted tax system.

Here's just one example. Capital gains taxation. If you make money by buying and selling an asset, your speculative profit is called a "capital gain."

In Canada, you only have to declare *half* your capital gains income on your tax return. It's called "partial inclusion."

If you flip hamburgers in a hot, greasy fast food restaurant all day, you have to declare every penny of your hard-earned income on your tax return.

But if you flip stocks and bonds all day in one of these towers, you only declare half.

That's immoral. It's inefficient: because it encourages gambling over real production. But most of all it's offensive, when these subsidized fat-cats lecture the rest of us about tightening our belts.

Same goes for across-the-board corporate tax cuts. The federal CIT rate has been cut almost in half since 2000, from 29% to 15%. Tell me, have any of you had your tax rates cut in half since 2000? I didn't think so.

But these banks have.

Those cumulative tax cuts (along with provincial rate cuts) have saved the financial sector over \$10 billion per year. Just the new tax cuts that the Harper government implemented since 2006 alone (cutting the federal rate from 21% to 15%), put another \$3 billion per year into the pockets of the banks.

Tell me, looking around Canada today, and all the problems we face. Is further enhancing the after-tax profits of the financial industry, really the top priority? Really the most important thing for Canada to spend \$3 billion on per year?

Of course not. But in our society, it's not priority that determines where money is spent. It's power.

So banks are protected and subsidized, and bailed out when needed. But what do banks actually *do*, in return for all that money?

What is their actual economic function?

Let's cut through the mystification of high finance, and ask that simple question: What do banks *do*? What do bankers actually *produce*?

The practical answer, in concrete terms, is simple: nothing. They produce nothing.

In that, the banks are different from the real economy, where hard-working people like you and I produce actual, concrete goods and services that are useful.

Banks, and the financial sector more generally, don't produce goods and services that are useful in their own right. They produce paper. And then they buy and sell paper, for a profit.

Here's a little economic lesson. You can't live off paper. You need food, clothing, and shelter to survive – not paper. And since we are human beings, not animals, we need more: we need education, and culture, and recreation, and entertainment, and security, and meaning. Those are the fundamentals of economic life. Not paper.

What is paper actually good for? You can wallpaper your house with it. You can line your birdcage with it. In a pinch, you can wipe your butt with it.

But other than that, paper is just paper. It is not concretely useful in its own right.

How do banks create that paper? Let me put it bluntly again: They create it out of thin air.

It is not an economic exaggeration to state that the private banking system has the power to create money out of thin air.

Not cash. Not currency. Only the government can produce that.

But most money in our economy – over 95% of money in our economy – is not currency. Most money consists of entries in electronic accounts. Savings accounts. Chequing accounts. Lines of credit. Credit card balances. Investment accounts.

In that electronic system, new money is created, not by printing currency, but through creating credit. Every time a bank issues someone a new loan, they are creating new money.

It's like a big magic machine, creating money out of thin air. And it's called the private credit system.

One of my favourite economists, John Kenneth Galbraith, put it this way: “The process by which private banks create money is so simple that the mind is repelled.”

How do they do it? They start out with some capital. Let's say a billion dollars. Then they lend it out. Then they lend it out again. And again. And again and again, 10 or 20 or 50 times over.

Each new loan, is new money. The economy needs that money, let's be clear. Without new money, we wouldn't be able to pay for the stuff we make. So we'd stop making it, and we'd be in a depression.

So the creation of new money (or credit) is as essential function for the whole economy. It's like a utility. But we've outsourced that crucial task to private banks. We've given them a legal license to print money – and the freedom and power to do it on their own terms.

Their goal is not providing the economy with a sensible, sustainable supply of the credit we need. Their goal is using their unique power to create money out of thin air, to maximize the profits of the banks, and the wealth of the shareholders.

How does this system work, creating money out of thin air? It only works if:

Number 1: Not everyone comes to the bank to withdraw all this imaginary money, in the form of real cash, at the same time. And if...

Number 2: The banks keep lending to each other, which is essential to make sure each one has the cash it needs for withdrawals.

We can immediately see that this system is inherently fragile. Banks create new loans many times larger than their capital, profiting off the interest they earn. But the money was created out of thin air. It's not actually there, if people want it at the same time, and if the banks won't help each other out.

So Canada's banks are fragile, too. True, our banks only lent their capital out 20 times over, not 50 times like the Europeans did. That's because Canadian regulations capped the leverage at 20. But they've still got 20 times more loans out there, than they actually have money in the bank.

Confidence is essential to the stability of the whole system. But confidence is intangible and impossible to predict. If confidence went south, Canadian banks would collapse as surely as Lehman Brothers or Dexia did.

Now, what do the banks do with all that money they created out of thin air? They lend it out. Some of it flows into the real economy, to pay for homes and cars and capital equipment. But not enough goes there. That's why our real economy is stuck. That's why there are 2 million Canadians unemployed, official and unofficial.

What about the money that *doesn't* flow into the real economy? Unfortunately, the banks use enormous amounts of it to place bets, enormous bets, buying and selling the paper assets that are created and traded in these towers. It's gambling, not production. It's legalized, subsidized gambling, all protected by the state.

The interaction of the private credit system, together with the speculative motive, that creates such turmoil and destruction, with each successive financial bubble. Without massive injections of new credit, the asset bubble could never expand so far – whether it's sub-prime derivatives, dot-com stocks, or rare earth futures.

If speculators had to spend their own money on these asset bubbles, the prices could never rise to such precarious and destructive levels.

Now, there are *two key problems* with the operation of this private credit system, and its interaction with speculation, that we must understand in order to fight for change.

*First*, the flow of credit – created out of thin air by these banks – is like a roller-coaster, all depending on the mood swings of the bankers.

When their greed overwhelms their fear, they will lend to anyone with a pulse. But when their fear overwhelms their greed, and they want to hoard every penny possible against the feared run on the bank, they pull back loans even from their most reliable customers.

This roller-coaster, called the “bankers’ cycle,” is an inherent and destabilizing feature of the private credit system. And since the whole economy depends on the flow of new money, the flow of new credit, we are forced to follow the same roller-coaster.

The *second* problem is that there's nothing underpinning the paper valuations of financial assets, when they've been pumped up by the combination of speculation and irresponsible credit creation.

Then, when speculators' moods switch polarities, the whole thing comes crashing down. Quoting Galbraith again, “A popped balloon never deflates in an orderly manner.”

And then we *all* pay the price for a crisis we didn't cause. And we all suffer the hangover from a party we weren't invited to.

This cycle of paper expansion and contraction, euphoria and panic, is hard-wired into the DNA of the deregulated private financial system. The cycle has happened before. And it will happen again. The current crisis was no unfortunate accident, no “perfect storm.” This crisis is simply par for the course, for a system that values speculation over production – and that gives the private credit system free reign to throw gasoline on the fire, through unlimited, unregulated credit creation.

It will happen again and again, until we change the rules of this pointless, destructive game.

So what do we do?

First, *tax them*. That’s the idea behind the Robin Hood Tax, that we are fighting for today. Make them pay a little bit, with every pointless, unproductive transaction, to help clean up the mess they left behind.

A transactions tax alone won’t solve the problem. It won’t stop the process. But at least it will support the public services that we need, all the more so in the wake of each financial meltdown.

Same goes for corporate tax cuts. Let’s reverse them. Put the federal rate back to 18% for the financial sector alone, and we’d raise \$1.5 billion per year for essential public services.

Taxing the banks is important. But taxing the banks is not enough.

So, second, we must *control them*. Put in place rules that require them to use this immense power, the power to create money out of thin air, to use it sensibly and productively. Prohibit the gambling. Make sure loans are aimed at sustainable, productive purposes.

The new measures being promoted internationally by Mark Carney are a step in the right direction. But a tiny, tiny baby step. We need more powerful restrictions.

And friends, even controlling the banks is not enough.

What we ultimately have to do is *take them back*. There’s nothing magical about creating credit out of thin air. There’s no special technology or knowledge needed. Just the legal power.

We can create credit out of thin air, just as well as any private bank can. Ultimately, we need a public, democratic, accountable banking system. One that serves the Canadian economy, not the wealth of those who own banks.

If we can create money out of thin air to buy and sell sub-prime mortgage bonds, then by god we can create money out of thin air to pay for affordable housing that could end homelessness.

If we can create money out of thin air to buy short options on Greek sovereign debt, then we can create money out of thin air to invest in a green energy system to stop global climate change.

If we can create money out of thin air to speculate on international currencies, we can create money out of thin air to buy needed medicines to prevent hundreds of millions of needless deaths from disease in the Third World.

There's no magic to it. These ideas are prudent and rational and economically sound. Because like we said at the beginning, it is work and production and sharing and sustaining that supports our real economy. Not gambling with paper.

These towers look powerful. But ultimately they are built on paper.

We've got the real power, with our ability to work and produce and share and sustain. We've got the power to build something new. We've got the power to replace these towers with a system that works.

And that's exactly what we've started to do with this movement. Thank you for what you are doing! And let's get on with the job!

*JS/kvcope343*