

The Monopoly of Credit and the Decline of the Middle Class

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ABSTRACT

After a brief introduction in Part I, Part II of this paper examines the decline of the middle class and briefly considers the commonly cited contributing factors. Part III considers the role of central banking in the creation of money and how indebted money plays a pivotal role in the erosion of middle-class wealth. Part IV makes the case that C.H. Douglas's theory of Social Credit offers a solution to the middle-class crisis, by providing a mechanism to create debt-free money, arguing that such change is both possible and necessary.

TABLE OF CONTENTS

I. INTRODUCTION	180
II. THE IMPORTANCE AND DECLINE OF THE MIDDLE-CLASS	182
A. WHY DOES THE MIDDLE-CLASS MATTER?	184
B. WHO ARE THE MIDDLE-CLASS?	185
C. CONTRIBUTING FACTORS	186
D. CREDIT	189
III. CENTRAL BANKING AND THE CREATION OF MONEY	190
A. HISTORY OF MONEY	191
B. THE VALUE OF MONEY	192
C. DEVELOPMENT OF PAPER MONEY	193

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D. BRIEF HISTORY OF BANKS	195
E. CENTRAL BANKS AND THE CREATION OF MONEY	197
F. SUMMARY	199
G. DEBT CREATED MONEY	200
IV. C.H. DOUGLAS AND SOCIAL CREDIT	202
A. A + B THEOREM	204
B. BANKS AND CREDIT	207
C. TECHNOLOGY AND THE UNEARNED INCREMENT	211
D. THE UNEARNED INCREMENT AND THE NATIONAL DIVIDEND	212
V. SOCIAL CREDIT – A SOLUTION FOR THE MIDDLE CLASS	213
A. REDUCING THE INTEREST BURDEN AND NATIONAL DEBT	213
B. ELIMINATES CONFLICTS BETWEEN PRIVATE AND PUBLIC INTERESTS	214
C. MITIGATING THE EFFECTS OF FREE TRADE AND TECHNOLOGICAL ADVANCES	215
VI. CONSTITUTIONALITY OF SOCIAL CREDIT	216
A. OBJECTIONS: FROM THE BANKING SECTOR	217
B. OBJECTIONS: INFLATION	218
VII. CONCLUSION	219

I. INTRODUCTION

In 1919, C.H. Douglas, the founder of the controversial Social Credit movement made the following prediction:

Under the present system of unregulated currency and credit, administered in their own interests by international groups of financiers and superindustrialists, the cost of living measured in terms of intensity of effort will rise, and the standard of life measured in terms of security, leisure, and freedom will fall.¹

Nearly 100 years later, in 2017, world stock markets hit record highs within days of Christine Lagarde (Head of the International Monetary Fund) calling for governments of the world to take “urgent action” in order to solve the

¹ Frances Hutchinson, Mary Mellor & Wendy Olsen, *The Politics of Money: Towards Sustainability and Economic Democracy* (London: Pluto Press, 2002) at 136, citing CH Douglas, “Exchange and Exports” (1919) 18 *The English Review* 368 at 369.

“middle-class crisis.”² It was decades before Douglas’s words would come to fruition. In fact, for the industrialized world, the decade directly following Douglas’s statement was a time of unprecedented economic growth – a time now fondly remembered as the “Roaring Twenties.” Technological advances spurred production and optimism following the turmoil of World War I, both of which fueled the fires of middle-class economic growth. It was a decade hallmarked as one of luxury, filled with flappers, Model Ts, and skyscrapers.³ This apparent utopia crumbled with the collapse of the stock market in 1929. The Great Depression of the decade that followed is remembered for its hardship, as much as the 20s are remembered for their decadence. The Depression finally receded with the outbreak of World War II, as the rusty gears of industrialization were greased by the new demands of war.⁴

Despite the challenges of the time, the Depression era middle-class persisted in the belief that hard work would be rewarded with ever-increasing standards of living.⁵ Middle-class optimism was restored in the post-war decades, as the economies of industrialized nations steadily grew, and promised the following generations that life would be better for their children than it was for them.⁶ By many indicators,⁷ this promise was largely fulfilled until, approximately, the late 1960s.⁸ But at some point, things changed. In 2001,

² Tara Cunningham, “World stocks hit record highs on upbeat data and Trump’s promised tax cuts but Wall Street’s ‘fear gauge’ jumps to two-week high” (16 February 2017), *The Telegraph: Business* (blog), online: <telegraph.co.uk/business/2017/02/16/world-stocks-hit-fresh-record-highs-pound-edges-back-125-optimism/>; Larry Elliot, “Middle-classes in crisis, IMF’s Christine Lagarde tells Davos 2017” (18 January 2017), *The Guardian* (blog), online: <theguardian.com/business/2017/jan/18/middle-classes-imf-christine-lagarde-davos-2017-joe-biden>.

³ Charles Scaliger, “Parallels with the Great Depression” (4 February 2009), *The New American*, 21 at 21, online: <thenewamerican.com/economy/commentary/item/3749-parallels-with-the-great-depression>.

⁴ Peter Ferrara, “The Great Depression Was Ended by the End of World War II, Not the Start of It” (30 November 2013), *Forbes* (blog), online: <forbes.com/sites/peterferrara/2013/11/30/the-great-depression-was-ended-by-the-end-of-world-war-ii-not-the-start-of-it/#3fb1786857d3>.

⁵ Salvatore Babones, “The Death of the Great American Middle Class” (28 February 2012), *Debtwatch* (blog), online: <debtdeflation.com/blogs/2012/02/28/the-death-of-the-great-american-middle-class/#b33>.

⁶ *Ibid.*

⁷ Katie Rose Quandt, “5 Charts That Show How the Middle Class Is Disappearing” (26 January 2015), *Moyers and Company* (blog), online: <web.archive.org/web/20150829040333/billmoyers.com/2015/01/26/middle-class>.

⁸ Babones, *supra* note 5.

author and former professor of the Harvard Business School, David Korten, summed up the current situation of the middle-class with the following statement:

The economy is booming. The stock market is setting new records. The US is again heralded as the world's most competitive economy. We are assured that we are richer than ever before and getting richer by the day.

Yet we are also told there is no longer enough money to provide an adequate education for our children, health care and safety nets for the poor, protection for the environment, parks, a living wage for working people, public funding for the arts and public radio, or adequate pensions for the elderly. According to the official wisdom, even though richer, we can no longer afford what we once took for granted. How is this possible? What's gone wrong?⁹

A century later, these words ring with the echo of Douglas's long-forgotten, and largely ignored, warning.

II. THE IMPORTANCE AND DECLINE OF THE MIDDLE-CLASS

"It's called the American dream because you have to be asleep to believe it."
– George Carlin

The dream of achieving a comfortable middle-class life has lured immigrants to the Americas since the early days of European colonization.¹⁰ This dream was driven by the belief that with enough hard work, the New World offered very attainable possibilities, such as owning a home, maintaining steady work, and providing a quality education for one's children.¹¹ For decades this dream was a reality. Economic growth was driven by a powerful and sustainable force; rising incomes for the middle-class were driven by increased productivity and consumption.¹² This rising tide of income swelled until the 1980s, when wages abruptly plateaued. Consumption, however, did not.¹³ Suddenly, this consumption had to be paid for not by savings and earnings, but

⁹ David Korten, "Money Versus Wealth" (30 June 1997), *Yes! Magazine* (blog), online: <yesmagazine.org/issues/money-print-your-own/money-versus-wealth>.

¹⁰ Torben Huus Larsen, "The American Dream" in Dale Southerton, ed, *Encyclopedia of Consumer Culture* at 40, online: <dx.doi.org/10.4135/9781412994248.n16>.

¹¹ Scott T Fitzgerald & Kevin T Leicht, "Does the American Middle Class Have a Future???" (2014) 55 *Sociological Q* 233 at 233.

¹² Rex Nutting, "Middle class is drowning in debt, hobbling the economy" (27 June 2014), *MarketWatch* (blog), online: <marketwatch.com/story/middle-class-is-drowning-in-debt-hobbling-the-economy-2014-06-27>.

¹³ *Ibid.*

by debt.¹⁴ Easy credit allowed this precarious situation to continue for another 30 odd years until the credit bubble burst in 2007.¹⁵ When falling housing prices led banks to close the credit spigot, the middle-class of the entire industrialized world were forced to reduce spending.

According to a report from UK thinktank, the Institute for Fiscal Studies – home ownership levels have plummeted since the 2007 recession, and reliance on state benefits has increased.¹⁶ This means that Britain’s “middle-class” of today is beginning to strongly resemble the “poor” households of the past.¹⁷ In Canada, median after-tax family income has increased on average by less than half a percentage point per year, over the last 30 years, and the typical 35-year old Canadian today is able to save less than half of what his parents did at that age.¹⁸

Yet somehow this financial plague has left some not just unscathed, but further ahead.¹⁹ As an example, consider that in 2013 the United States reached its highest point of cumulative wealth ever, and that with an average of \$348,000 for every adult, the country still only ranked fourth in the world in terms of actual wealth per person.²⁰ However, this mathematical average was a far cry from the average American income, which was a mere \$31,688.²¹ Additionally, the US Census showed that while the middle 60% of the American population earned only 53.2% of the national income in 1968, this share steadily decreased to 45.8% in 2013.²² For comparison’s sake, consider that although Mexico’s lack of a strong middle-class is often cited as a concern, in Mexico, the middle 60% actually took home 46.6% of the national income,

¹⁴ Silvia Federici, “From Commoning to Debt: Financialization, Microcredit and the Changing Architecture of Capital Accumulation” (2014) 113:2 *South Atlantic Q* 231 at 234.

¹⁵ Nutting, *supra* note 12.

¹⁶ Chris Belfield et al, “Living standards, poverty and inequality in the UK: 2016” (2016), Institute for Fiscal Studies Report at para 17, online: <ifs.org.uk/publications/8371>.

¹⁷ Larry Elliot, “Middle-income families in UK resemble the poor of years past, says IFS” (19 July 2016), *The Guardian* (blog), online: <theguardian.com/business/2016/jul/19/middle-income-families-poverty-ifs-report>.

¹⁸ Ralph Goodale, “Canada’s Middle Class Shouldn’t Celebrate” (30 April 2014), *Huff Post Politics: Canada* (blog), online: <huffingtonpost.ca/ralph-goodale/canada-middle-class_b_5235420.html>.

¹⁹ Richard V Burkhauser, Jeff Larrimore & Kosali I Simon, “A ‘Second Opinion’ on the Economic Health of the American Middle Class” (2012) 65:1 *National Tax J* 7 at 8, online: <ntanet.org/NTJ/65/1/ntj-v65n01p7-32-second-opinion-economic-health.pdf?v=%CE%B1>.

²⁰ Quandt, *supra* note 7.

²¹ *Ibid.*

²² *Ibid.*

suggesting that, relatively speaking, Mexico's middle-class is actually slightly better off than the American middle-class, by this measure.²³

A. WHY DOES THE MIDDLE-CLASS MATTER?

Economic historians point out that a large middle-class is central to successful economic development.²⁴ As evidence, historians generally note that the middle-classes were a driving force of economic development in Western Europe, and specifically cite England's great middle-class as a reason for England being the first to industrialize.²⁵ Conversely, cross-country studies indicate that high rates of income inequality correlate with poor economic growth.²⁶ Beyond representing and contributing to the economic and social well-being of a nation, American economist William Easterly, writing for the World Bank, illustrates that the ramifications of a constricted middle-class even extend to the physical; ultimately, affecting health, life expectancy, and even infant mortality.²⁷

Despite the importance of maintaining a thriving middle-class, research indicates that income inequality is increasing, and thus, that the middle-class is disappearing. The 2008 Organization for Economic Cooperation and Development's ("OECD") report - entitled "Growing Unequal," showed that the gap between rich and poor was growing in most OECD countries.²⁸ By 2011, this inequality was cited almost universally as a concern of policy makers and the general public.²⁹ Interestingly, this increasing polarization of wages occurs in nearly all OECD countries, even including traditionally egalitarian countries, such as Germany, Denmark, and Sweden.³⁰ The report also stated that the economic crisis of 2007-2008 had precipitated a need to deal with policy issues related to inequality, as the impact has increased social tensions

²³ Babones, *supra* note 5.

²⁴ William Easterly, "The Middle Class Consensus and Economic Development" (2001) 6:4 *Western J Economic Growth* 317 at 318.

²⁵ *Ibid.*

²⁶ *Ibid.*

²⁷ Peggy Hollinger, "A Hollowing Middle Class", *OECD Observer* (blog), online: <oecdobserver.org/news/fullstory.php/aid/3660/A_hollowing_middle_class.html#sthash.Z0LDiwT0.dpufOn>.

²⁸ See generally OECD, *Divided We Stand: Why Inequality Keeps Rising*, 2011 OECD Report, online: <read.oecd-ilibrary.org/social-issues-migration-health/the-causes-of-growing-inequalities-in-oecd-countries_9789264119536-en#page1> [2011 OECD Report].

²⁹ *Ibid.*

³⁰ *Ibid.*

in many countries.³¹ Discontent is rapidly spreading, as economic conditions lead young people to feel increasingly hopeless about their future and many of the middle and lower-income earners believe that they have disproportionately suffered from the effects of an economic crisis for which they were not responsible. Meanwhile, higher income individuals were spared from many of the consequences.³²

The middle-class has increasingly become the focus of politicians and a driving force behind various initiatives, such as former US President Obama's *White House Task Force on Middle-Class Working Families*. This was also a hotly pursued campaign issue for both Canadian Prime Minister Justin Trudeau³³ and American President Donald Trump.³⁴ Despite faring the 2007 financial crisis comparatively well,³⁵ in 2014, the Canadian press reported that a leaked internal document of the Conservative government, prepared by *Employment and Social Development Canada*, expressly stated that, given market conditions and stagnating wages, for the middle-class, living the Canadian dream was increasingly becoming "myth more than a reality."³⁶ A 2014 poll also indicated that Canadians are feeling the pinch, as a decreasing number consider themselves to be of the middle-class – now only 47%, which is down from a previous high of 67%.³⁷

B. WHO IS MIDDLE-CLASS?

Addressing the causes, or possible solutions, to the decline of the middle-class is complicated by the fact that this group is notoriously difficult to define.

³¹ *Ibid.*

³² *Ibid.*

³³ Justin Trudeau, "Justin Trudeau on Fairness for the Middle Class", *Liberal Party of Canada* (blog), online: <liberal.ca/realchange/justin-trudeau-on-fairness-for-the-middle-class/>.

³⁴ Donald Trump, "Donald J Trump Delivers Groundbreaking Contract For The American Voter In Gettysburg" (22 October 2016), *Donald J Trump* (blog), online: <donaldjtrump.com/press-releases/donald-j.-trump-delivers-groundbreaking-contract-for-the-american-vote1>.

³⁵ Canada, International Affairs, Trade and Finance Division, *The global financial crisis and its impact on Canada* (December 2008), by Philippe Bergevin, online: <lop.parl.gc.ca/content/lop/researchpublications/prb0834_05-e.htm>.

³⁶ Dean Beeby, "Middle-class dreams a 'myth' in troubled economy: internal government report" (23 February 2014), *The Globe and Mail* (blog), online: <theglobeandmail.com/news/politics/middle-class-dreams-a-myth-in-troubled-economy-internal-government-report/article17056573/>.

³⁷ Erin Anderssen, "The Middle Class: Just Who Are They Anyway?" (18 September 2015), *The Globe and Mail* (blog), online: <theglobeandmail.com/news/politics/who-are-the-middle-class-anyway-how-politicians-risk-missing-the-mark/article26431270/>.

This difficulty is perhaps just as much a matter of perception as it is one of statistics.³⁸ For example, geography is a complicating factor because wages and the costs of living vary considerably by region. For example, those earning up to \$100,000 US are easily considered middle-class in North America,³⁹ while those earning the equivalent of \$800 US per year are considered middle-class in certain regions of Asia.⁴⁰ Even within the borders of a single county, these factors play a significant role, as what constitutes a mid-range income in Calgary would constitute a top 10% income in Leamington, Ontario.⁴¹

For the purposes of this paper, it is not necessary to establish a precise definition of the middle-class. This paper is concerned with addressing general concerns and it is sufficient for the term “middle-class” to mean, roughly, those whose income or net wealth falls approximately within the middle 60% of national averages. However the middle class is defined, it is increasingly apparent that the middle-classes of industrialized nations are struggling.⁴²

C. CONTRIBUTING FACTORS

As inflation outpaces income growth, many middle-class households are increasingly forced to rely on consumer credit such as credit cards, to make ends meet.⁴³ However, this debt often carries high interest rates and fees. Ultimately, the high cost of maintaining consumer debt reduces household spending, and lowers the standard of living for middle-class families.⁴⁴ In short, the middle-class is being squeezed by both, falling incomes, and rising interest payments.⁴⁵ A review of debt accumulation reveals that if consumer debt interest payments are subtracted from incomes, it is estimated that an additional 4 million Americans fell below poverty thresholds in 2007.⁴⁶

³⁸ See Joshua Keating, “Who is Middle Class?” (12 June 2014), *Slate: Science* (blog), online: <slate.com/articles/health_and_science/science/2014/06/definition_of_middle_class_economists_developing_counties_and_agencies_disagree.html>.

³⁹ Sudeep Reddy, “How Do You Define Middle Class? People Who Make What I Do” (13 September 2013), *Wall Street Journal* (blog), online: <blogs.wsj.com/economics/2013/09/13/how-do-you-define-middle-class-people-who-make-what-i-do/>.

⁴⁰ See Keating, *supra* note 38.

⁴¹ See Anderssen, *supra* note 37.

⁴² See generally 2011 OECD Report, *supra* note 28.

⁴³ Robert H Scott, III & Steven Pressman, “A Double Squeeze on the Middle Class” (2011) 45:2 *J Economic Issues* 333 at 333-335.

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*

⁴⁶ *Ibid.*

Accounting for consumer debt interest payments is especially important, as these people have not generally been considered “poor” by traditional measurements. However, when interest payments are accounted for, it is clear that these people may be properly categorized as “poor.”⁴⁷

Advancing technology is also commonly cited as a contributing factor to the increasing disparity between top and bottom wage-earners. Advancing technology impacts both the quantity and quality of available middle-class jobs in, at least, two ways; first, technological advances have created automated processes that manufacture products more efficiently, and ultimately less expensively, than human labour. This means that machines are replacing large portions of the human workforce.⁴⁸ This will likely only increase with further technological advances as automation becomes more efficient.⁴⁹

Second, even when technology does not directly replace human labour, research has indicated that technology disproportionately aids higher skilled workers, such as lawyers, accountants, and economists.⁵⁰ At the same time, new technology disadvantages lower-skilled workers, such as bank clerks or public sector workers, either by directly replacing them, or reducing the number of workers required to accomplish the same work.⁵¹ Economists suggest that this phenomenon occurs because new technology decreases the cost of communication and access to knowledge.⁵² Decreases in the cost of communication can lead teams to rely more on problem solvers, and thus upper managers can solve more problems.⁵³ Over time this decreases the level of knowledge required to perform production work, rendering these positions less valuable to a company, thus lowering wages.⁵⁴ Technological improvements in communication also allow top level managers to efficiently apply their knowledge to solve an increasing number of problems. As a result, top managers become more valuable and are compensated accordingly with higher

⁴⁷ *Ibid.*

⁴⁸ Noah Smith, “Guess What’s destroying the Middle Class?” (25 March 2015), *Bloomberg* (blog), online: <bloomberg.com/view/articles/2015-03-25/what-s-destroying-middle-class-wages-china>.

⁴⁹ *Ibid.*

⁵⁰ Hollinger, *supra* note 27.

⁵¹ *Ibid.*

⁵² See generally Luis Garicano & Esteban Rossi-Hansberg, “Organization and Inequality in a Knowledge Economy” (2006) 121:4 QJ Economics 1383.

⁵³ *Ibid* at 1385.

⁵⁴ *Ibid.*

wages.⁵⁵ In short, advanced technological change results in increased wage inequality within a given corporate structure, and the economy as a whole.⁵⁶

Of course, technological advancement is not the sole cause of underemployment. Free trade agreements force companies operating under vastly different economic regulations and conditions to compete, which results in underemployment for countries that legislate higher wages. And yet, in a world officially dominated by a global free trade agenda, some argue that there is surprisingly little free trade – but a great deal of debt.⁵⁷ Research indicates rising import volumes generally correlate with reduced wages and higher unemployment within a given labour market.⁵⁸ In total, import competition is estimated to be responsible for at least one-quarter of the aggregate decline in US manufacturing employment.⁵⁹

In response to increasing losses of manual or lower-skilled labour jobs and competition from foreign exporters as a result of free trade agreements, politicians often point to education as the solution.⁶⁰ These politicians suggest that increasing education will reduce rising income inequality in the industrialized world and that through education, the middle-class will thrive and enjoy increased standards of living.⁶¹ However, research indicates that there is a growing perception that even a high quality education no longer ensures a well-paying job or membership in the middle-class.⁶² While some workers do respond positively to foreign competition by acquiring new or advanced marketable skills and thereby successfully obtain better-paying jobs, others fail to take such proactive measures and ultimately move downward into lower-skill occupations.⁶³ This suggests that, in the end, reliance on increased education may exacerbate, rather than relieve the problem of income inequality.⁶⁴

⁵⁵ *Ibid.*

⁵⁶ *Ibid.*

⁵⁷ Gavin Fridell, “Debt Politics and the Free Trade ‘Package’: the case of the Caribbean” (2013) 34:4 *Third World Q* 613 at 614.

⁵⁸ See generally David H Autor, David Dorn & Gordon H Hanson, “The China Syndrome: Local Labor Market Effects of Import Competition in the United States” (2013) 103:6 *American Economic Rev* 2121.

⁵⁹ *Ibid.*

⁶⁰ Emily Blanchard & Gerald Willmann, “Trade, education, and the shrinking middle-class” (2016) 99 *J Intl Economics* 263 at 263.

⁶¹ *Ibid.*

⁶² *Ibid.*

⁶³ *Ibid.*

⁶⁴ *Ibid.*

D. CREDIT

The 1980s marked a significant turning point in creating an increasingly debt-based economy.⁶⁵ In the United States, up until this time, the *Banking Acts* of 1933 and 1935 prohibited the payment of interest on demand deposits and authorized the Federal Reserve to set interest rate ceilings on time and savings deposits paid by commercial banks.⁶⁶ Congress passed this legislation in part because they sought to encourage country banks to lend more to individuals and businesses within their local communities who would use the credit productively, rather than invest balances with larger banks in financial centers for speculative purposes.⁶⁷ Given that interest rate caps would subsequently lower banks' interest profits, another objective of this legislation was to limit banks' competition for deposits in the hopes that banks would then resist the temptation to acquire risky assets to raise profits.⁶⁸ However, in 1980, in response to pressure from both banks and other lending institutions, the American Congress adopted the *Depository Institutions Deregulatory and Monetary Control Act*, which eliminated interest-rate caps and made sub-prime lending feasible.⁶⁹ Credit became more accessible than ever with the advent of credit cards and removal of state anti-usuary laws, while decreased wages, unstable employment conditions, and increasing costs of education and health care added fuel to the credit fire, and the middle-class was increasingly forced to rely on credit to finance necessities.⁷⁰ This is particularly dangerous as it carries the consequence of creating a liability that requires future payment with interest.⁷¹

The fact that access to credit has become increasingly easy while employment conditions have become increasingly uncertain has led some to speculate so far as to propose that these conditions are not accidental, but are in fact manipulated to bring the multitudes under the control of the banks.⁷²

⁶⁵ Federici, *supra* note 14 at 234.

⁶⁶ R Alton Gilbert, "Requiem for Regulation Q: What It Did and Why It Passed Away?" (1986) Federal Reserve Bank of St. Louis Working Paper 86/02 at 22, online: <files.stlouisfed.org/files/htdocs/publications/review/86/02/Requiem_Feb1986.pdf>.

⁶⁷ *Ibid.*

⁶⁸ *Ibid* at 23.

⁶⁹ John Atlas, "The Conservative Origins of the Sub-Prime Mortgage Crisis" (17 December 2007), *The American Prospect* (blog), online: <prospect.org/article/conservative-origins-sub-prime-mortgage-crisis-0>.

⁷⁰ Federici, *supra* note 14 at 234.

⁷¹ Randy Hodson, Rachel E Dwyer & Lisa A Neilson, "Credit Card Blues: The Middle Class and The Hidden Costs of Easy Credit" (2014) 55:2 Sociological Q 315 at 316.

⁷² Federici, *supra* note 14 at 234.

As proof, these scholars suggest that governments' decisions to bail out banks rather than working-class debtors made it clear that debt is designed to be a standard condition of working class existence.⁷³ Whether this is truly the case is clearly debatable; what is not debatable is that "debt, like a cancer, with time continues to grow."⁷⁴

Most people naturally assume interest is intrinsic to the lending process, though this was certainly not the case for the vast majority of history.⁷⁵ Though often taken for granted, the effects of interest on society are powerful and pervasive.⁷⁶ For example, some argue that interest continually fuels the need for endless economic growth, even when actual standards of living remain stagnant.⁷⁷ Though all of the factors identified previously have contributed to the decline of the middle-class to various degrees, the following section considers the role of central banking in the creation of money and argues that it is the indebted money created by the central banking system that plays the most significant role in the erosion of middle-class wealth.

III. CENTRAL BANKING AND THE CREATION OF MONEY

"Those who believe that the people are so easily led that they would permit the printing presses to run off money like milk tickets do not understand them. It is the innate conservatism of the people that has kept our money good in spite of the fantastic tricks which financiers play-and which they cover up with high technical terms. The people are on the side of sound money. They are so unalterably on the side of sound money that it is a serious question how they would regard the system under which they live, if they once knew what the initiate can do with it..." – Henry Ford⁷⁸

A brief examination of the creation of money and functions of banks is crucial to an understanding of economic policy and how the current monetary system operates to the detriment of the middle-class. To begin, we must address a deceptively simple question; what is money? British economist Geoffrey Crowther attempts to explain the conventional understanding of the surprisingly complex nature and origin of money in his seminal 1940 text, *An*

⁷³ *Ibid* at 235.

⁷⁴ *Ibid*.

⁷⁵ Bernard Lietaer, *The Future of Money: Creating New Wealth, Work and a Wiser World* (London: Random House, January 2001), electronic ed, online: <lietaer.com/writings/books/the-future-of-money/> at 56.

⁷⁶ *Ibid*.

⁷⁷ *Ibid*.

⁷⁸ Henry Ford, *My Life and Work*, (Fairfield, IA: 1st World Library, 2004) at 179.

Outline of Money.⁷⁹ He states “[e]verybody knows in practice what constitutes money, but few people would be prepared at a moment’s notice to define money, to indicate precisely what differentiates money from other articles or commodities.”⁸⁰ He equates the problem to a man who was asked to define an elephant and could only reply that he “would know one when he saw one.”⁸¹ In short, despite its obvious importance and widespread use, “money” is not universally, or easily, defined.⁸² A number of scholars identify this difficulty as a serious obstacle to scientifically understanding economic theory.⁸³ At this point it is necessary to briefly consider the history, origin, and basic functions of money.

A. HISTORY OF MONEY

It is generally accepted that the earliest commercial transactions began as barter.⁸⁴ Under this system, hunters could trade meat and skins with farmers for grain or produce, or later, wares of village craftsmen. However, the barter system yielded two significant problems. The first was the difficulty of settling on terms, particularly regarding less actively traded commodities.⁸⁵ This problem illustrates the first function of money; serving as a unit of account.⁸⁶

The second problem with barter is the difficulty of trading only what one possesses; John may have corn and want ox-hides, but Henry, who has ox-hides, may not want corn. This problem illustrates the second function of money; serving as a medium of exchange.⁸⁷ Using money as a medium of exchange allows John and Henry to exchange the goods they possess for money, and then exchange the money for the goods they want.⁸⁸

⁷⁹ Geoffrey Crowther, *An Outline of Money*, revised ed (London: Thomas Nelson & Sons Ltd, 1959); Geoffrey Crowther, *An Outline of Money*, electronic ed, online: <[krishikosh.egranth.ac.in/bitstream/1/2047740/1/46691.pdf](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2416229)> at 13].

⁸⁰ Crowther, *ibid* at 13.

⁸¹ *Ibid* at 13–14.

⁸² Michael McLeay, Amar Radia & Ryland Thomas, “Money in the Modern Economy: An Introduction” (2014), Bank of England, Q1 Bulletin at 24, online: <papers.ssrn.com/sol3/papers.cfm?abstract_id=2416229>.

⁸³ John Smithin, ed, “Introduction” in *What is Money?* (London: Routledge, 2002) at 1.

⁸⁴ Geoffrey Ingham, “‘Babylonian Madness’: on the historical and sociological origins of money” in John Smithin, ed, *What is Money?* (London: Routledge, 2002) 16 at 20.

⁸⁵ Crowther, *supra* note 79 at 14.

⁸⁶ Ingham, *supra* note 84 at 24.

⁸⁷ *Ibid* at 17.

⁸⁸ Crowther, *supra* note 79 at 15.

The barter system presented a third problem to the acquisition of wealth, namely, that of storage. Though one could become wealthy in acquiring many goats, hides, or wares, the problem of safekeeping these units becomes a concern. Fire or famine could decimate one's wealth, while birthing season, some months later, would inflate the "money" supply.⁸⁹ And so, money provides yet another solution, as a store of value.⁹⁰

Having established the basic functions of money, it is next necessary to examine the forms of money. In fact, literally anything, from goats to gold to green-coloured paper, may be used as money provided that it is accepted as means of exchange.⁹¹ It is often argued that this second function of money, that of serving as a medium of exchange, that is most crucial.⁹² In short, money is everything that is generally acceptable in the payment of debts.⁹³

B. THE VALUE OF MONEY

Having determined that anything may be "money," we must also consider how money obtains a value. Monetary scholars often note a deep-rooted psychological belief that the substance of money itself is intrinsically valuable.⁹⁴ This might stem from the fact that most early communities selected valuable substances, such as gold and silver, to use as money.⁹⁵ However, scholars note that it is more accurate to suppose that gold and silver were valuable largely because of their relative scarcity, rather than intrinsic value.⁹⁶ In this sense, gold and silver coins were used primarily because they were suitable for the purpose; they handled and stored easily, did not deteriorate, had the right degree of scarcity, and because mining was slow and difficult work, the supply could be counted on to remain relatively steady.⁹⁷ Difficulties of assaying and weighing appropriate measures eventually led kings to issue standard coins. This was a significant development because the value of the coins then also depended on the public's confidence in the king's honesty and ability to prevent counterfeiting.⁹⁸

⁸⁹ *Ibid* at 17.

⁹⁰ Ingham, *supra* note 84 at 21.

⁹¹ *Ibid* at 18.

⁹² *Ibid*.

⁹³ Crowther, *supra* note 79 at 36.

⁹⁴ Hutchinson, Mellor & Olsen, *supra* note 1 at 48.

⁹⁵ *Ibid*.

⁹⁶ Crowther, *supra* note 79 at 21.

⁹⁷ See e.g. Crowther, *supra* note 79 at 20 (author contrasts the scarcity of silver and gold to that of iron, which was too plentiful; platinum, on the other hand, was too rare to be minted).

⁹⁸ *Ibid*.

A second significant point on the value of money is that value is determined by the relationship between supply and demand. Though gold and silver were initially chosen as money because they were scarce, and consequently valuable, merely selecting these substances as money raised the demand, and in turn, rendered them even more valuable.⁹⁹ Even in modern society, where people are familiar with paper money, the belief that paper money at the very least represents something valuable has persisted.¹⁰⁰

C. DEVELOPMENT OF PAPER MONEY

Crowther cites the invention of paper money as the most important step in the evolutionary process of money since the invention of money itself.¹⁰¹ This evolution occurred in gradual steps. As metal money suffered from the disadvantage of being easily stolen, rather than carrying physical money, traveling merchants developed the habit of carrying written evidence of their access and control of money.¹⁰² Initially, these documents merely served as temporary substitutes for money and could not be used to directly pay for purchases.¹⁰³ Over time, these documents themselves were used to directly pay for purchases, and the mere *claim* on money evolved into money itself.¹⁰⁴ However, this system was built on a foundation of trust. These paper certificates were generally attested to a person or body of known repute, confirming that the bearer of the certificate had deposited the specified sum of money and could authenticate creditors' claims.¹⁰⁵ Thus, these reputed bodies and individuals were the prototypical forerunner of modern banks.¹⁰⁶

The development of banking institutions' reputation for solvency marked the next significant step in the evolution of paper money.¹⁰⁷ Over time, experience demonstrated that only a small fraction of issued notes were presented for repayment in hard cash (or coins).¹⁰⁸ This made it possible for bankers to issue more notes than they had received in deposits.¹⁰⁹ Especially

⁹⁹ *Ibid* at 22.

¹⁰⁰ *Ibid* at 21.

¹⁰¹ *Ibid* at 32.

¹⁰² Walter Stewart, *Towers of Gold, Feet of Clay* (Don Mills, ON: Collins Publishers, 1982) at 32.

¹⁰³ Hutchinson, Mellor & Olsen, *supra* note 1 at 60.

¹⁰⁴ Crowther, *supra* note 79 at 29.

¹⁰⁵ *Ibid*.

¹⁰⁶ *Ibid*.

¹⁰⁷ *Ibid* at 23.

¹⁰⁸ *Ibid*.

¹⁰⁹ *Ibid*.

significant is that the additional notes could be issued not only in excess of deposits, but to *many times* the amount of deposits.¹¹⁰ Crowther illustrates the effects of this process in the following passage:

For example, let us suppose that bankers have found, by experience, that they will only be asked to cash one note of every twenty they have in circulation at any time. This means that they need to keep a reserve of cash equal to 5 per cent of the total notes outstanding. A prudent banker would probably double this reserve, so as to be on the safe side. But even then, he only needs £10 in cash in his till for every £100 in notes outstanding. In other words, when he receives £10 extra in cash from any source, he can issue £100 more in notes.¹¹¹

This is now known as the fractional reserve system. This was significant, because for the first time in its evolution, money could be “created” into existence and thus constitute a very real and very large addition to the total supply of money.

Initially, this innovation was both abused by its creators and unpopular with the general public.¹¹² Critics argued that the banks’ ability to create banknotes out of thin air was both dangerous and dishonest, and some of the earliest banks were forced to close when the public found out that they had issued notes in excess of cash reserves.¹¹³ On the part of the banks, Crowther acknowledges that banks were “frequently intoxicated” by their new power and issued notes in excess of prudent multiples of cash reserves such that they were sometimes unable to cash even the small fraction of notes presented for redemption.¹¹⁴

In light of this power to issue bank notes and credit and its subsequent drastic effects on the money supply, the state could not remain indifferent.¹¹⁵ As banknotes clearly had the power to threaten the whole economic structure of the state, various regulations were introduced, primarily with the aim of restricting issuance of notes in proportion to the bank’s capital, cash deposits, or both.¹¹⁶

At this point, notes were not considered a “sound” form of money unless they could be converted on demand into gold coin.¹¹⁷ However, occasionally

¹¹⁰ Stewart, *supra* note 102 at 20.

¹¹¹ Crowther, *supra* note 79 at 26–27 .

¹¹² *Ibid.*

¹¹³ *Ibid.*

¹¹⁴ *Ibid* at 28.

¹¹⁵ *Ibid.*

¹¹⁶ *Ibid.*

¹¹⁷ *Ibid* at 29.

the economic demands of war necessitated the convertibility requirement be suspended, for as long as war-time conditions demanded. By 1925, the distrust of paper money began to disappear, and in England legislation was passed to end the convertibility requirement of paper money.¹¹⁸

D. BRIEF HISTORY OF BANKS

Though today, “money” is almost exclusively the creation of banks, it is clear that this was not always the case. Accordingly, having traced the evolution of paper money, it is next necessary to examine the role of banks in the creation of money.

There are at least three ancestors of the modern-day bank. The first is the merchant, mentioned previously, whose reputation, or credit, enabled him to issue documents as money.¹¹⁹ In England, another forerunner of the modern bank was the goldsmith.¹²⁰ At a time when money consisted entirely of silver and gold, security was a pressing concern.¹²¹ As every goldsmith relied on a secure safe as an essential part of his business, over time it became natural for individuals to entrust their wealth to the goldsmiths in return for a receipt of the deposit. Like the merchant’s certificates, in time the receipts themselves were circulated as money. Thus, like the merchants (and later banks), goldsmiths were able to circulate deposit-receipts in excess of their actual deposits.¹²²

The final significant forerunner of the banker is the money-lender.¹²³ Despite their unpopularity and reputation for greed, money-lenders provided the useful and necessary service of lending, and thereby, increased the means of transferring capital between individuals.¹²⁴ Though early money-lenders merely lent out their own capital and profited from the rate of interest they charged upon the principal, over time it was increasingly convenient for clients to deposit their own savings with the money-lenders and earn a moderate rate of interest, while the money-lenders co-mingled these funds with their own, and profited on the difference between interest paid to lending clients and the higher rates charged to borrowing clients.¹²⁵ While Crowther asserts that

¹¹⁸ *Ibid.*

¹¹⁹ *Ibid* at 37.

¹²⁰ Hutchinson, Mellor & Olsen *supra* note 1 at 51.

¹²¹ Crowther, *supra* note 79 at 47.

¹²² Hutchinson, Mellor & Olsen, *supra* note 1 at 67.

¹²³ Crowther, *supra* note 79 at 26-49.

¹²⁴ *Ibid* at 41-42.

¹²⁵ *Ibid* at 42.

present-day banks retain the essential qualities of each the merchant, the goldsmith, and the money-lender, he concludes that the most crucial function of modern-day banks is providing convenient mechanisms for individuals to make non-physical transfers and payments.¹²⁶ He states “in providing this mechanism he [the banker] also provides, or ‘creates,’ the money itself... He has discovered the secret, for which the medieval alchemists strove, of manufacturing money.”¹²⁷

Today, banks create money in one of two ways. First, money is “created” every time a bank grants a loan.¹²⁸ Consider the example of a \$100 loan. Rather than physically transfer gold to the borrower, the bank is permitted by the state to either print off \$100 and hand it to the borrower, or more commonly, the bank may simply credit the borrower’s account by a sum of \$100. This transaction demonstrates the old banking maxim that “every loan creates a deposit” or, in other words, every loan creates “money” and thereby increases the money supply of a society.¹²⁹ Conversely, repaying the debt removes the money from existence, and shrinks the money supply.¹³⁰

The second way modern banks create money is through the purchase of securities on a stock exchange.¹³¹ For example, if a bank purchases \$100 of securities on a Stock Exchange and pays for them by crediting the seller’s account by \$100, the bank has increased its deposits by \$100.¹³² Even if the seller is not a customer of that particular bank, the seller merely deposits the cheque with some other bank.

Banks can also create money through the acquisition of other kinds of assets. For example, a bank can buy itself a new building merely by giving the

¹²⁶ *Ibid.*

¹²⁷ *Ibid.*

¹²⁸ Hutchinson, Mellor & Olsen, *supra* note 1 at 64–65.

¹²⁹ Crowther, *supra* note 79 at 43.

¹³⁰ Former Governor of the Bank of England, Sir Mervyn King, very simply described this process explaining: “When banks extend loans to their customers, they create money by crediting their customers accounts. For example, every bank mortgage in existence ‘creates’ a sum of money, and essentially places into circulation a sum of money equal to the amount of the mortgage. Conversely, when these deposits are used to repay a loan, the process is reversed, and the money effectively disappears from the economy.” See Andrew Jackson & Ben Dyson, *Modernising Money: Why Our Monetary System is Broken and How We Can Fix It* (London: Positive Money, 2012) at 22.

¹³¹ Royal Bank of Canada, Research Department, *How the Canadian Money Supply is Affected by Various Banking and Financial Transactions and Developments: A Set of Illustrations*, 4th ed (Montreal: The Royal Bank of Canada, 1971) at 10 [RBC Report].

¹³² Crowther, *supra* note 79 at 43.

builder bank deposits (or credit) as payment.¹³³ This ability to create money is significant in two ways. First is that the whole system depends on few of the deposits being pressed for payment.¹³⁴ Thus, banks are ultimately restricted only by their ability to maintain the confidence of the public.¹³⁵ This prompts Crowther to admit that the modern banking system depends on a paradox as “no banker could meet all his liabilities in cash if they were presented at once. In that sense every banker is insolvent. But the banker’s whole business depends absolutely upon his reputation for solvency, upon the public’s belief in his ability to pay every demand upon him...”¹³⁶ Similarly, Dorothy Rowe concludes that “[u]ltimately money is trust, which lives and dies only in human hearts and minds. Money systems, including our current one, are mechanisms and symbols that aim at keeping that trust alive.”¹³⁷

E. CENTRAL BANKS AND THE CREATION OF MONEY

The final piece of the puzzle in understanding the banking system is the role of central banks. In most countries, “currency” consists of notes issued by an institution known as a central bank.¹³⁸ Unlike the commercial banks most people rely on for daily banking services, a central bank is part of or connected to the government of a country and manages the country’s financial system. The right of issuing notes is generally reserved to this single institution.¹³⁹ The other major function of central banks is to serve as a ‘bankers’ bank.¹⁴⁰ In other words, each of a given country’s commercial, or “member”, banks keep accounts within the central banks which allows them to settle claims (“clearing differences”)¹⁴¹ between member banks.¹⁴² Essentially, the relationship between the central bank and member banks is equivalent to the relationship between member banks and the public.¹⁴³

¹³³ *Ibid* at 44.

¹³⁴ *Ibid.*

¹³⁵ *Ibid* at 45.

¹³⁶ *Ibid.*

¹³⁷ Dorothy Rowe, *The Real Meaning of Money* (London: Harper Collins, 1997) at 56, cited in Hutchinson, Mellor & Olsen, *supra* note 1 at 51.

¹³⁸ Crowther, *supra* note 79 at 63.

¹³⁹ *Ibid* at 63–66.

¹⁴⁰ *Ibid.*

¹⁴¹ *Ibid.*

¹⁴² RBC Report, *supra* note 131 at 52–55.

¹⁴³ Crowther, *supra* note 79 at 44.

Generally, member banks are required by law to maintain deposits in the central bank in proportion to their own deposits.¹⁴⁴ This means that the cash of the member bank consists partly of notes issued by the central bank and partly of deposits with the central bank. The key point is that both types consist of liabilities of the central bank.¹⁴⁵ This is important because, like any member bank, central banks can acquire assets by making “promises to pay.”¹⁴⁶ Thus, increasing the assets and liabilities of a central bank, in turn, increases the cash of member banks. This enables member banks to expand their assets and liabilities through the granting of loans or purchasing securities, and thus increase the money supply of the community.¹⁴⁷ Conversely, the money supply may be decreased by an inverse operation (i.e. by central banks decreasing assets and liabilities).¹⁴⁸

While the money-creating ability of member banks is restricted by the fact that it must retain a proportionate level of reserves to fulfill their promises to pay, as the sole issuer of currency, a central bank is quite literally only obligated to redeem promises to pay with further promises to pay.¹⁴⁹ Thus Crowther admits “[t]he power of the Central Bank to increase the total available amount of money would, therefore, seem to be subject to no limitation so long as the ultimate form of money, in which all others are redeemable, is merely one of its own promises to pay.”¹⁵⁰ Though some States impose restrictions by limiting the amount that central banks can issue, Crowther contends that the ultimate limiting factor of the central bank’s power to decrease the money supply is one of “nature” rather than “law”.¹⁵¹ This is because a central bank cannot call more loans than it has made, or sell more securities than it has bought. Thus, Crowther states “[a] definite limit is thus set to the central bank’s power of restricting credit and diminishing the amount of money in existence.”¹⁵²

In addition to member banks, the other “clients” of central banks are nations’ state governments. Crowther contends this is especially significant because war always results in the creation of large amounts of bank money.¹⁵³

¹⁴⁴ RBC Report, *supra* note 131 at 15.

¹⁴⁵ *Ibid* at 5.

¹⁴⁶ Crowther, *supra* note 79 at 56.

¹⁴⁷ RBC Report, *supra* note 131 at 10.

¹⁴⁸ Crowther, *supra* note 79 at 56.

¹⁴⁹ *Ibid* at 63.

¹⁵⁰ *Ibid* at 64–65.

¹⁵¹ *Ibid* at 63.

¹⁵² *Ibid* at 64.

¹⁵³ *Ibid* at 48.

Previous to central banking, governments were largely constrained to raising taxes or raising loans from the public to meet expenditures. However, these limits have now largely been erased as the central banking system requires banks to loan (and thus, create) to governments whatever amount remains to be raised.¹⁵⁴

The creation of new money by central banks is termed “monetary policy.”¹⁵⁵ Mainstream economists assure the public that a central bank exercises its great powers with a conscious regard for the best interests of the community.¹⁵⁶ However, skeptics argue that given the entire banking system’s dependence on central banking, that central banks are clearly able to exert their influence in ways that favour their preferred policy schemes.¹⁵⁷

F. SUMMARY

Today it is obvious that for most people, every choice is overwhelmingly determined by money. Deciding what college to attend, when to marry, how many children to have, where to live, and any number of smaller decisions people make every day are largely constrained by the amount of money available to an individual. Likewise, at the societal level, all political and economic policy decisions largely depend upon the availability of money.¹⁵⁸ Understanding the nature of money and the function of banks in the creation of money is essential to understanding how the monetary policy governing modern banking effects the economic system, which in turn affects nearly every aspect of life. However, as has been demonstrated, the money creation process is grossly misunderstood, not only by the common people, but in economic textbooks.¹⁵⁹ The greatest misconception is that banks merely lend out funds that depositors place within their savings accounts.¹⁶⁰ If that were truly the case, one might be forgiven for believing that banks are rightfully entitled to take a profit by repackaging the savers’ money and undertaking direct risk of default by borrowers. However, it is clear from the preceding examination of money that

¹⁵⁴ *Ibid* at 48–49.

¹⁵⁵ Philipp Bagus & Andreas Marquart, *Blind Robbery! How the Fed, Banks and Government Steal Our Money*, translated by John Bunch (Munich: Finanzbuch Verlag, 2016) at 42.

¹⁵⁶ Crowther, *supra* note 79 at 64.

¹⁵⁷ Bagus & Marquart, *supra* note 155 at 42.

¹⁵⁸ Frances Hutchinson & Brian Burkitt, “The Contemporary Relevance of Clifford Hugh Douglas” (1999) 70:4 Political Q 443 at 443–44.

¹⁵⁹ McLeay et al, *supra* note 82 at 1.

¹⁶⁰ *Ibid* at 2.

the reality of the modern economy is that banks are the sole “creators” of money.¹⁶¹

G. DEBT CREATED MONEY

“Of all the many ways to organize a banking system, the worst is the one we have today.” – Sir Mervyn King, Governor of the Bank of England (2003-2013)

According to a Bank of England bulletin, 97% of money in modern economies occurs in the form of bank deposits created through the process discussed above.¹⁶² Thus, virtually all of the money in existence has been created through bank credit, or in other words, debt.

When banks create money through credit, the newly created money carries an even greater debt in the form of interest.¹⁶³ Crowther argues “[w]hen a bank increases its notes or deposits, it increases its liabilities, and it is only right that it should be compensated for doing so.”¹⁶⁴ While this may be so, what Crowther glosses over is that risk of such liabilities are relatively low, though the payoff is obviously very high. Meanwhile, on the other side of the same transaction, the compounding effect of interest on debt-created money makes it extremely difficult for middle and lower means borrowers to eliminate or reduce the burdens of personal and household debt.¹⁶⁵ In fact, at face value it is impossible. Bearing in mind that virtually all money is created by debt, it is a logical certainty, that when a bank loans money into existence, it effectually creates an unpayable debt. Consider a \$100 loan at 6% interest; the bank has created only \$100 but demands payment of \$106. While some individual borrowers might be able to obtain the additional \$6 (also lent into existence with interest to other borrowers), others will necessarily fail and default unless more bank-credit is created through loans and further debt. Thus, if debt-created money remains essentially the sole source of money, it is obvious that over time the borrowers as a whole will never be able to pay back the principal plus interest.¹⁶⁶

It is obvious that bank created money always carries a debt in the form of interest. One might be forgiven for assuming that if all members of society rely on debt-based money, that subsequently all members of society, regardless of means or income, would suffer any detriment in equal proportion. However,

¹⁶¹ *Ibid.*

¹⁶² *Ibid.*

¹⁶³ Jackson & Dyson, *supra* note 130 at 22.

¹⁶⁴ Crowther, *supra* note 79 at 47.

¹⁶⁵ Jackson & Dyson, *supra* note 130 at 23.

¹⁶⁶ Alain Pilote, “Society Must Create its Own Money” (1 May 2010), *Michael Journal* (blog), online: <michaeljournal.org/articles/social-credit/item/society-must-create-its-own-money>.

this is not the case. Bagus argues that when new money is produced, there is a redistribution in favor of those who receive the new money and spend it at the old, still lower prices to the detriment of those who receive the new money later and see prices rise faster than their income.¹⁶⁷ As we have seen, in our current monetary system, money is created at very little cost to banks through the extension of credit. Bagus explains that those actors, who receive the new money first, namely, governments and the financial system, benefit by receiving a higher percentage of these loans, and profit at the cost of those who do not. Furthermore, this advantage increases proportionately with wealth as loans are more easily obtained with increased collateral.¹⁶⁸ Conversely, a poor person has more difficulties to get a loan in normal times because he does not own assets. Bagus concludes that thus, the monetary system itself is one often neglected reason for an increasing wealth inequality.¹⁶⁹

Beyond directly contributing to inequality, the current banking system has repeatedly wreaked havoc in world markets and resulted in numerous substantial economic crises. Many suggest that the problem has reached epidemic proportions; between 1970 and 2011 there have been an estimated 147 banking crises around the world.¹⁷⁰ UK Financial Services authority Lord Turner explicitly stated; “The financial crises of 2007/08 occurred because we failed to constrain the private financial system’s creation of private credit and money.”¹⁷¹ Accordingly, modern critics of the debt-based monetary system argue “repeated breakdowns, in very different countries and times, under different regulatory environments, and in economies with very different degrees of development, signal some underlying structural problem.”¹⁷²

Despite clear and overwhelming evidence that the modern financial system is inherently flawed, very few have attempted to scrutinize the heart of the problem, that is, money creation through bank issued credit.¹⁷³ Lietaer et al describe the current monetary system with the following metaphor:

¹⁶⁷ Philipp Bagus, “Our Monetary System Favors the Rich and Hurts the Poor” (24 July 2016), *Mises Institute* (blog), online: <mises.org/blog/our-monetary-system-favors-rich-and-hurts-poor>.

¹⁶⁸ *Ibid.*

¹⁶⁹ *Ibid.*

¹⁷⁰ Jackson & Dyson, *supra* note 130 at 21.

¹⁷¹ *Ibid* at 23.

¹⁷² Bernard Lietaer et al, “Is Our Monetary Structure a Systemic Cause for Financial Instability? Evidence and Remedies from Nature” (2010) 14:3 *J Futures Studies* 89 at 90 [Lietaer et al, “Monetary Structure”].

¹⁷³ Jackson & Dyson, *supra* note 130 at 22–23.

You are given a car without brakes and with an unreliable steering wheel. And you are sent across the Alps or the Rockies. When you crash, you are told that you are a bad driver; or that your road maps are out of date. And everybody is endeavouring to get that same car back on the road, with as little change as possible... predictably until the next crash. Indeed, such a car is not fit for driving; it has structural problems which, if not fixed, will predictably cause other crashes.¹⁷⁴

Calls for reform come from a small but passionate minority. They argue that until politicians and policy-makers are willing to admit that the causes of these repeated financial crises lay with the current financial system, society will not be able to properly assess and correct monetary policy in order to avoid future financial devastation.¹⁷⁵

A principal of organizational design holds that any system is perfectly designed to yield the results it produces.¹⁷⁶ Applying this logic to the problem at hand, it is fair to assert that if the current monetary system achieves vast inequalities, benefiting a small number of individuals while the majority fall further and further behind, then these problems will continue as long as the current monetary system continues.

Having demonstrated that debt-created money lies at the heart of the middle-class crisis, the final section of this paper contends that a solution can be found with the creation of debt-free money. Part IV examines Major C.H. Douglas's theory of Social Credit which radically proposed replacing the current monetary system with a new system of debt-free money based on the real value of the goods and services a society produces.

IV. C.H. DOUGLAS AND SOCIAL CREDIT

In the twilight hours of WWI, C.H. Douglas captured the attention of beleaguered lower and middle-classes across the industrialized world¹⁷⁷ when he made the radical proposal that "the State should lend, not borrow."¹⁷⁸ This is the exact opposite of how the current banking system currently creates money. Rather than creating the nation's money through bank credit, that is,

¹⁷⁴ Lietaer et al, "Monetary Structure", *supra* note 172 at 90.

¹⁷⁵ Ann Pettifor, "The New Green Deal" in J Barry & L Leonard, eds, *Global Ecological Politics*, vol 5 (Bingley, UK: Emerald Group Publishing Limited, 2010) 19 at 21.

¹⁷⁶ Ted Ball & Liz Verlaan-Cole, "Linking System Design to System Performance: A Systems Dynamic Perspective" (Fall 2006) in *Managing Change*, 2 at 3.

¹⁷⁷ See E Bell, *Social Classes and Social Credit in Alberta* (Montreal: McGill-Queen's University Press, 1994) at 35-36.

¹⁷⁸ CH Douglas, *Economic Democracy*, reprint (Sudbury: Bloomfield, 1974) at 121-22 [Douglas, *Economic Democracy*].

society's debt, Douglas argued that the state should issue social credit which would entail no debt and no interest. Recognizing that every political and social endeavor of the State on behalf of society depended almost entirely on obtaining the monetary means necessary for implementation, Douglas further argued that the financier "usurps the function of the State."¹⁷⁹ As a result of this novel idea, Douglas's economic philosophy was actively discussed and enjoyed widespread populist support throughout the UK, the Dominions, and the USA during the interwar years.¹⁸⁰ His innovative ideas resulted in the successful election of the Alberta Social Credit party to form the provincial government, while his submissions were considered in several government inquiries in Canada, England, and New Zealand.¹⁸¹ Despite the determined opposition of orthodox economists, party politicians, and the national and international presses, Social Credit ideas were embraced and debated by ordinary people seeking economic democracy in their respective localities.¹⁸²

Since then, Douglas and his theories have been largely ignored by mainstream economics,¹⁸³ and his economic philosophy of social credit has been ranked as "heretical" even by radical economists.¹⁸⁴ Douglas did merit two brief, if condescending, mentions in Keynes' seminal *General Theory*.¹⁸⁵ However, if Douglas is remembered at all today, it is generally with a violent degree of criticism or ridicule.¹⁸⁶ Hutchinson and Burkitt note that an economic thought has rarely attracted such vehement condemnation across so wide a range of political opinion.¹⁸⁷ They further note this vitriol verges on the irrational considering that the majority of critics argued that the economic

¹⁷⁹ *Ibid.*

¹⁸⁰ Frances Hutchinson & Brian Burkitt, *The Political Economy of Social Credit and Guild Socialism* (London: Routledge, 2001) at 155 [Hutchinson & Burkitt, *Political Economy*].

¹⁸¹ J M Pullen & G O Smith, "Major Douglas and Social Credit: A Reappraisal" (1997) 29:2 *History Political Economy* 219 at 219.

¹⁸² Hutchinson & Burkitt, *Political Economy*, *supra* note 180 at 155.

¹⁸³ Pullen & Smith, *supra* note 181 at 219.

¹⁸⁴ Frances Hutchinson, "An Economic Silence: Women and Social Credit" (1997) 20:2 *Women's Studies Intl Forum* 321 at 322.

¹⁸⁵ John Maynard Keynes, *The General Theory of Employment, Interest, and Money*, International Relations and Security Network, online: <files.ethz.ch/isn/125515/1366_KeynesTheoryofEmployment.pdf> at 24, 184.

¹⁸⁶ Hutchinson, *supra* note 184 at 322.

¹⁸⁷ *Ibid.*

theory espoused by the Social Credit movement was entirely lacking in validity and best dismissed as a harmless diversion.¹⁸⁸

As an attempt to correct the imperfections of orthodox economic theory Burkitt and Hutchinson acknowledge that the various tenants of social credit have been individually scrutinized and subsequently rejected by mainstream economists as implausible or unworkable.¹⁸⁹ However, they contend this rejection occurred not because the tenants are incorrect, but because considered in isolation the tenants are simply not compatible with the current economic and monetary systems.¹⁹⁰ Instead, they contend that the tenants of social credit must be considered collectively and that when properly considered as a whole, social credit presents a workable *alternative* to the current monetary system.¹⁹¹ The tenants of Douglas's economic philosophy of social credit will now be examined in turn.

A. A + B THEOREM

The unlikely inspiration of Douglas's economic theories resulted from his observations while working as an engineer from 1918-1919 at the Government Aircraft Factory at Farnborough, UK.¹⁹² It was here that Douglas first considered that in any given week, the total wages and salaries of the workers were not equal to the value of the goods the workers produced that week.¹⁹³ Though this is obviously true, what struck Douglas as most significant was that this was the case in every factory every week. In turn, this indicated that unless extra money is injected into the system, the amount of purchasing power distributed in the form of wages and salaries during any week can never be sufficient to buy the product in that time period.¹⁹⁴ To explain this phenomenon, Douglas formulated his controversial A + B Theorem.¹⁹⁵ He described it thus:

In any manufacturing undertaking the payment made may be divided into two groups:
Group A: Payments are made to individuals as wages, salaries, and dividends; Group

¹⁸⁸ Brian Burkitt & Frances Hutchinson, "Major Douglas' Proposals for a National Dividend: A Logical Successor to the Wage" (1994) 21:1 Intl J Social Economics 19 at 21 [Burkitt & Hutchinson, "National Dividend"].

¹⁸⁹ Hutchinson, Mellor & Olsen, *supra* note 1 at 128.

¹⁹⁰ *Ibid.*

¹⁹¹ *Ibid* at 128-29.

¹⁹² Douglas, *Economic Democracy*, *supra* note 178 at 12.

¹⁹³ Hutchinson & Burkitt, *Political Economy*, *supra* note 180 at 11.

¹⁹⁴ *Ibid* at 12.

¹⁹⁵ CH Douglas, *Monopoly of Credit*, 3rd revised ed (Belfast: KRP Publications, 1951) at 35 [Douglas, *Monopoly of Credit*].

B: Payments made to the other organizations for raw materials, bank charges, and other external costs. The rate of distribution of purchasing power to individuals is represented by A, but since all payments go into prices, the rate of generation of prices cannot be less than A plus B. Since A will not purchase A plus B, a proportion of the product at least equivalent to B must be distributed by a form of purchasing power which is not comprised in the description grouped under A.¹⁹⁶

In short, Douglas argued that this theorem described a gap in purchasing power, which under our current monetary system, must be filled with either exports or bank credit.¹⁹⁷ Many economists (though not all) have generally dismissed the A + B theory on grounds that A and B payments overlap over time.¹⁹⁸ Keynes argued that the theorem did not “allow for the possibility that these [B] provisions being offset by new investment in other directions as well as by increased expenditure on consumption.”¹⁹⁹

In reply to his critics, Douglas reiterated his proposition that:

...the wages, salaries and dividends distributed during a given period do not, and cannot, buy the production of that period; that production can only be bought, i.e., distributed, under present conditions by a draft, and an increasing draft, on the purchasing power distributed in respect of future production, and this latter is mainly and increasingly derived from financial credit created by the banks.²⁰⁰

Despite abundant fierce criticism, even today scholars such as Hutchinson, Mellor and Olsen argue that the A + B theorem was essentially an accurate description of the relationship between production and the distribution of money incomes over time.²⁰¹ The theorem merely illustrates that repayment of debt plus interest necessitates an increase in financial credit at an accelerating rate in order to distribute the proceeds of technical progress.²⁰² In other words, the difference between the final price of products and the wages paid to produce those products, must be borrowed. Additionally, as technology increasingly replaces labour, and accordingly, decreases wages paid to workers, the need to borrow increases.

¹⁹⁶ *Ibid* at 36.

¹⁹⁷ Pullen & Smith, *supra* note 181 at 221.

¹⁹⁸ *Ibid*.

¹⁹⁹ Keynes, *supra* note 185 at 184.

²⁰⁰ CH Douglas, “The Douglas Theory; a reply to Mr. J.A. Hobson” (London: Cecil Palmer, 1922) at 5, online: <archive.org/details/douglastheoryrep00doug/> [Douglas, “Douglas Theory”].

²⁰¹ *Supra* note 1 at 139.

²⁰² Burkitt & Hutchinson, “National Dividend”, *supra* note 188 at 22.

Hutchinson, Mellor and Olsen acknowledge that while some may quibble with details, that Douglas's basic observation still holds true.²⁰³ In short, Hutchinson, Mellor and Olsen argue that in this regard, Douglas's views mirror former Austrian Finance Minister and Harvard professor, Joseph Schumpeter's, in that unlike orthodox economic theory, both correctly recognized that commodities exist in two time periods, the one in which they are produced, and the one in which they are consumed.²⁰⁴

Furthermore, though he does not cite or credit Douglas, there is a remarkable similarity of reasoning in Professor John Smithin's assertion that money, credit creation, and the cost of acquiring financial resources themselves are an integral part of the economic process.²⁰⁵ Smithin contends that orthodox (Keynesian) economics persistently denies the importance of money and monetary factors in determining economic outcomes.²⁰⁶ Smithin alleges that there has been a specific determination within the field of orthodox economics to create a science that ignored money, as evidenced by common catch-phrases describing money as "neutral" or as "a veil."²⁰⁷ Consequently, he argues current economic theory has ignored the importance of money and economic factors in determining economic outcomes.²⁰⁸ In other words, the fundamental object of orthodox economics concentrates merely on real exchange of goods and services, and it is assumed that the role of money in these dealings is merely to facilitate transactions.²⁰⁹ Smithin argues that this mainstream view intentionally de-emphasizes the importance of money in normal economic circumstances, but has remained more or less unchallenged among traditional economists.²¹⁰ Smithin labels this view "real analysis" as it rests on the assumption that all important features of the economic process can be understood in terms of the barter exchange of real goods and services, and their cooperation in production.²¹¹ In contrast, he advocates for "monetary analysis" which recognizes and seeks to account for the fact that employment and production outcomes depend on monetary calculations.²¹²

²⁰³ *Supra* note 1 at 140.

²⁰⁴ *Ibid* at 141.

²⁰⁵ Smithin, *supra* note 83 at 2.

²⁰⁶ *Ibid* at 1.

²⁰⁷ *Ibid*.

²⁰⁸ *Ibid*.

²⁰⁹ *Ibid* at 2.

²¹⁰ *Ibid*.

²¹¹ *Ibid*.

²¹² *Ibid*.

One of the primary criticisms of orthodox economists against Douglas's theory is that it is "inflationary".²¹³ Carefully examined, this criticism is both hypocritical and incorrect; hypocritical in the sense that the current system openly relies on inflation, and incorrect in that the sense, that despite, the almost unintelligible complaints made against it, Douglas's A + B theorem correctly identifies a very real problem. Furthermore, inflation occurs not merely as an increase of the money supply, but rather when the increase of the money supply *over a particular time period* exceeds increases in the real value of the economy *over the same time period*.²¹⁴ This is a very important point because Douglas sought to base the money *directly in proportion to the real value*²¹⁵ of the economy.²¹⁶

Though orthodox economists have attempted to dismiss Douglas's A + B theorem, and with it, the resulting radical transformation of the monetary system he suggested, it is clear that Douglas's theory, in fact, shares common ground with respected and innovative economists of both past and present. In light of this critique of the current monetary system, Douglas's economic theory is valuable as it acknowledges the inherent flaw the circular flow model of the economy as assumed by orthodox economic theory and proposes a solution.²¹⁷

B. BANKS AND CREDIT

Douglas bases his argument on the undisputed fact that money is not "made" by any industry. He cites the obvious example that a potato farmer grows potatoes, not money, and that if this farmer is fortunate enough to sell his potatoes, he merely trades them for money which someone else had previously.²¹⁸ In this example, it is clear that money merely represents purchasing power, and that this comes not from the production of any industry, but from the banking system itself.²¹⁹

Recognizing the indispensable importance of credit to the functioning of modern society in financing both private production and government

²¹³ Pullen & Smith, *supra* note 181 at 219.

²¹⁴ Ashton S Phillips "Bank Created Money, Monetary Sovereignty, and the Federal Deficient: Toward a New Paradigm, in the Government Spending Debate" (2014) 36:3 Western New England L Rev 221 at 225.

²¹⁵ For the sake of ease, the "real value" can be loosely thought of as a nation's Gross Domestic Product.

²¹⁶ CH Douglas, "Social Credit", Chapter II - Sound Money, at 9-10, online: <socialcredit.com.au/uploads/2161895805.pdf>.

²¹⁷ Hutchinson, Mellor & Olsen, *supra* note 1 at 128.

²¹⁸ Douglas, *Monopoly of Credit*, *supra* note 195 at 27.

²¹⁹ *Ibid* at 28.

operation, Douglas contends that financial institutions ultimately have the final determination in the allocation of society's resources.²²⁰ Consequently, the banking system is far from a neutral facilitator of exchange, but is, in fact, central to political economy.²²¹ Under the present system Douglas claims "[t]he modern State is an unlimited liability corporation, of which the citizens are the workers and guarantors, and the financial system the beneficiary."²²² Douglas asserts that it is merely a statement of fact which is made clear by examining the nature and origin of money in the modern State.²²³

Crowther and mainstream economists assure the public that "a Central Bank exercises its great powers with a conscious regard for the best interests of the community."²²⁴ But if this is true, how is it that governments and the majority of individuals have become increasingly indebted and must now endure large-scale transfer of their incomes to the money-lending class?²²⁵

Douglas is certainly not unique in his criticisms of debt-based money. Indeed, this has been a central focus of notable thinkers including David Hume,²²⁶ and has been a point of chief concern for the Austrian school of economics. Typically, critics of the current debt-based monetary system advocate a return to the gold-standard.²²⁷ More recent critics have also floated bit-coin as an alternative to debt-based money.²²⁸ Gold is particularly attractive to proponents because, unlike debt-based bank credit, which is both artificial

²²⁰ Hutchinson, Mellor & Olsen, *supra* note 1 at 129.

²²¹ *Ibid.*

²²² Douglas, "Douglas Theory", *supra* note 200 at 17.

²²³ *Ibid.*

²²⁴ Crowther, *supra* note 79 at 48.

²²⁵ W F Hixon, "John Maynard Keynes" in John Cunningham Wood, ed, *Critical Assessment*, (New York: Routledge, 1994) 405 at 407.

²²⁶ Hossein Askari & Noureddine Krichene, "100 Percent Reserve Banking and The Path to a Single-Country Gold Standard" (2016) 19:1 QJ Austrian Economics 29 at 30.

²²⁷ *Ibid.*

²²⁸ See Saifedeen Ammous, "The Bitcoin Standard: The Decentralized Alternative to Central Banking" (Hoboken, NJ: Wiley, 2018).

and easily manipulated, gold is limited in supply and cannot be created out of thin air.²²⁹ In this sense, proponents argue that gold is “sound money.”²³⁰

Douglas acknowledged and responded to this argument in the following passage:

...anything I have to say on the subject—is that it is not a problem of value-measurement. The proper function of a money system is to furnish the information necessary to direct the production and distribution of goods and services. It is, or should be, an "order" system, not a "reward" system. It is essentially a mechanism of administration...²³¹

In other words, though Douglas agreed with proponents of the gold standard that the current debt-based money system is deeply flawed, he argued it is essentially a problem of money *distribution*, rather than money *value*. In short, Douglas presented a unique alternative economic theory that bases money on the real or productive wealth of an economy.²³² This idea emerged from Douglas's belief that technological advances are a cumulative progress which should be inherited by all members of society. He called this the common cultural heritage.²³³

Douglas contended that every technological advance builds upon the progress of past generations. As such, Douglas argued that the benefits of this cultural heritage should be equitably distributed throughout society as a

²²⁹ See Llewellyn H Rockwell, “Introduction” in *The Gold Standard: Perspectives in the Austrian School* Llewellyn H Rockwell Jr, ed, (Auburn, AL: Mises Institute, 1992) at vii – viii.

²³⁰ Ammous, *supra* note 228 at 50. Though this is enticing in theory, in the author's opinion, the gold standard is neither a practical, nor an equitable solution. It is not practical because it doesn't allow for the expansion of the economy without deflation. Because the world's population and economy will almost certainly grow faster than the world's supply of gold, in order to fit the increasing real value of products (or GDP) to the relatively stable quantity of gold, prices will have to fall and will necessarily result in deflation. Consequently, this solution is also not equitable because as the price of goods and services deflate, the wealthy will see the purchasing power of their savings rise, while the wages of middle-class workers will decrease and merely maintain purchasing power. Accordingly, the benefits of the gold standard would disproportionately favour people who already have money. Though those living from pay-check to pay-check would see some benefit from the elimination of inflation, the real-value of wages would stay more or less the same. Though the gold standard might provide some degree of benefit to all, it appears the wealthy would see a greater degree of benefit than middle and lower classes.

²³¹ Douglas, *Monopoly of Credit*, *supra* note 195 at 23.

²³² *Ibid* at 9.

²³³ Hutchinson, Mellor & Olsen, *supra* note 1 at 128.

common inheritance.²³⁴ Douglas's argument is essentially presented in the following statement:

When labour supplied the whole of the power by muscular effort and so forth, I think it would have been a fair and equitable thing to say that labour produced all wealth either by hand or brain. But we of the Western world are the inheritors of a magnificent culture which we ourselves did not produce, but which largely was handed down to us from previous inventors, engineers, organisers and so on. We are merely the administrators of that cultural inheritance, and to that extent that cultural inheritance is the property of all of us, without exception.²³⁵

Unlike many orthodox economists of his day, Douglas did not see employment as an end in itself.²³⁶ Douglas believed that the modern technology of industrialized societies had advanced to a point where the material needs of all citizens could be satisfied without the labor of all citizens.²³⁷ He further argued that benefits of science and technology should be considered a "cultural heritage," the benefits of which should be enjoyed by all citizens.²³⁸

In this respect, Douglas was greatly influenced by Thorstein Veblen, an early thinker in the American school of institutionalist economists.²³⁹ Veblen is notably remembered for his assertion that, in industrialized society, there is no such thing as an isolated, self-sufficing individual. Rather, Veblen argued:

Production takes place only in society – only through the co-operation of an industrial community. This industrial community may be large or small... but it always comprises a group large enough to contain and transmit the traditions, tools, technical knowledge and usages without which there can be no industrial organisation and no economic relation of individuals to one another or to their environment... There can be no production without technical knowledge...²⁴⁰

This reasoning demonstrates that the true basis of wealth is a combination of natural resources and a common cultural inheritance flowing from the imagination, insights, inventions, discoveries and learning accrued over past generations, coupled with present efforts.²⁴¹ Douglas believed that potential

²³⁴ *Ibid.*

²³⁵ CH Douglas, "The Monopolistic Idea", speech delivered at the Melbourne Town Hall, Australia on 22 January 1934, online: polskawalczaca.com/library/ALOR%20-%20Monopolistic%20Idea.pdf.

²³⁶ Bell, *supra* note 177 at 38.

²³⁷ *Ibid.*

²³⁸ Hutchinson, Mellor & Olsen, *supra* note 1 at 95.

²³⁹ Hutchinson, *supra* note 184 at 323.

²⁴⁰ Thorstein Veblen, *Essays in Our Changing Order* (London: Transactions Publishers, 1998) at 34; cited in Hutchinson, Mellor & Olsen *supra* note 1 at 148.

²⁴¹ Hutchinson & Burkitt, *Political Economy*, *supra* note 180 at 60.

real wealth is communal in origin in the sense that without the common cultural heritage comprised of the accumulation of technological innovations, and the myriad inventions of materials, machines, and processes developed by past generations, there would be no wealth for individuals or groups to appropriate for their own use on the basis of their “ownership” of capital or labour.²⁴² He consequently argued that the right to determine the extent, nature, and distribution of future production should belong to all citizens.²⁴³

C. TECHNOLOGY AND THE UNEARNED INCREMENT

In the years immediately following World War I, Douglas predicted both an exponential growth in production arising from technological change and an increase in inequality due to unemployment following the introduction of labour-saving technologies.²⁴⁴ Douglas reasonably points out that the effects of technological advances greatly reduce the need for human labour, illustrating that “if one unit of human labour with the aid of mechanical power and machinery will produce ten times as much as the same unit working without such aid, it is obvious that there will either be ten times as much production or only one-tenth the amount of labour will be required.”²⁴⁵ Douglas illustrated the complex relationship between advancing technology, consumption, and labour as follows:

Either the requirements of the population [i.e. consumption] must increase at the rate at which the capacity for production increases, and at the same time the financial mechanism must be adjusted to provide for the distribution of the production, or a decreasing number of persons would be required in production. Unless the wages of this decreasing number of individuals collectively rises to the amount which, previously distributed to a larger number of workers... either costs and prices must fall or an increasing proportion of the goods must be unsold to the person who produced them.²⁴⁶

Douglas argues that unrestrained by the financial system, the resources of modern production would be sufficient to provide for the material desires of the whole population of the world at the expense of a small and decreasing

²⁴² Burkitt & Hutchinson, “National Dividend”, *supra* note 188 at 22.

²⁴³ *Ibid.*

²⁴⁴ *Ibid* at 19.

²⁴⁵ Douglas, *Monopoly of Credit*, *supra* note 195 at 28.

²⁴⁶ *Ibid* at 32–33.

amount of human labour.²⁴⁷ To remedy loss of wages resulting from loss of human labour required for production, Douglas contends that under the current economic system, employment as an agency of distribution, wrongly considers distribution of wages for *labour* performed (e.g. effort), and alternatively argues that distribution should be a function of *work* performed (e.g. what is produced).²⁴⁸ Under Douglas's system the entire community benefits from advancing technology in earning a constant rate of income for a constant rate of production, with a decreased level of effort.²⁴⁹

D. THE UNEARNED INCREMENT AND THE NATIONAL DIVIDEND

To summarize, Douglas made the following observations; 1) debt-based money disproportionately benefits banks by granting them the privilege of creating the nation's money by merely lending it into existence, which allows them to profit from the interest charged; 2) additional money must be borrowed to create the money to pay the interest of the previously created (borrowed) money; 3) to maintain relative stability, debt-based money results in inflation; 4) inflation erodes the purchasing power of the working middle-class' wages and savings; 5) technological advances reduce the human labour required for production; 6) present technological advances are built on the accumulated technological advances of past generations; 7) the price of a product must account for the cost of raw materials, the operating expenses of production, and labour costs, in addition to a profit margin; and 8) the wages of all workers alone will never be sufficient to purchase all the products made by those workers.

In light of these observations, Douglas argued that banks should not be allowed to maintain their monopoly of money creation, and instead proposed that the power to create money be returned to the government so that a

²⁴⁷ *Ibid* at 11: Note – While some may take umbrage to this suggestion, consider research repeatedly indicates that the world currently produces enough food to feed 10 billion people; see Eric Holt-Giménez et al, “We Already Grow Enough Food for 10 Billion People ... and Still Can't End Hunger” (2012) 36:6 *J Sustainable Agriculture* 595. The authors illustrate the poverty and inequality (i.e. lack of purchasing power), rather than simple lack of food are the true causes of hunger.

²⁴⁸ Hutchinson, Mellor & Olsen *supra* note 1 at 138.

²⁴⁹ Without the constant need to increase production, Hutchinson and Burkitt suggest that a Social Credit based economy would also entail many sustainable environmental benefits; see Frances Hutchinson & Brian Burkitt, “Towards a Re-evaluation of the Role of Finance in the Causation of Environmental Degradation” (1997) 2:1 *Local Environment* 7.

permanent, debt free money supply could be established in proportion to the “demand of the community as a whole for goods and services.”²⁵⁰

Recognising that the money supply must expand in proportion with the real wealth produced by a nation, Douglas proposed paying a National Dividend which envisaged a direct allocation of income by the State to all citizens.²⁵¹ Just as shareholders are entitled to earn dividends on investments, so argued Douglas, could citizens of a state share the benefits that are produced as a society.²⁵² Douglas equated the relationship of a tax-payer of a nation, to that of a shareholder,²⁵³ or as a “tenant-for-life.”²⁵⁴ In short, he argued that citizenship in a nation should entitle each member “to draw a dividend, certain, and probably increasing, from the past and present efforts of the community, of which he is a member.”²⁵⁵

Putting all the pieces together, Douglas summarizes his theory of social credit in the following passage;

If we imagine a country to be organised in such a way that the whole of its natural born inhabitants are interested in it in their capacity as shareholders, holding the ordinary stock, which is inalienable and unsaleable, and such ordinary stock carries with it a dividend which collectively will purchase the whole of its products in excess of those required for the maintenance of the "producing" population, and whose appreciation in capital value (or dividend-earning capacity) is a direct function of the appreciation in the real credit of the community, we have a model, though not necessarily a very detailed model, of the relationships outlined. Under such conditions every individual would be possessed of purchasing-power which would be the reflection of his position as a "tenant-for-life" of the benefits of the cultural heritage handed down from generation to generation. Every individual would be vitally interested in that heritage, and his clear interest would be to preserve and to enhance it.²⁵⁶

V. SOCIAL CREDIT – A SOLUTION FOR THE MIDDLE CLASS

A. REDUCING THE INTEREST BURDEN AND NATIONAL DEBT

Douglas argued the current debt-based banking system was largely responsible for creating undesirable inequities between classes largely due to

²⁵⁰ Douglas, “Douglas Theory”, *supra* note 200 at 9.

²⁵¹ Burkitt & Hutchinson, “National Dividend”. *supra* note 188 at 19.

²⁵² Douglas, *Monopoly of Credit* *supra* note 195 at 110.

²⁵³ *Ibid.*

²⁵⁴ Douglas, “Douglas Theory”, *supra* note 200 at 11.

²⁵⁵ Douglas, *Monopoly of Credit*, *supra* note 195 at 111.

²⁵⁶ Douglas, “Douglas Theory”, *supra* note 200 at 9.

the national debt.²⁵⁷ Most conspicuously, borrowing debt-created money from private banks created a national debt system in which the government, (meaning the taxpayer), is obligated to pay large interest payments on a principal that cost the bank next to nothing to create.²⁵⁸ This is especially problematic given that governments could have provided the required funding by issuing social-based credit rather than relying on debt-created bank credit, which would relieve future generations of the enormous burden of national debt servicing.²⁵⁹ Certainly, this burden is approaching bone-crushing proportions for a middle-class already struggling to make ends meet. A 2016 Fraser Institute research bulletin recently determined that the Canadian government spent \$60.8 billion on interest payments for the 2014/2015 fiscal year.²⁶⁰ This amounted to 8.1% of total revenue, constituted a larger portion of public spending than the Canada and Quebec Pension Plan at \$50.9 billion, and rivaled combined primary and secondary education spending at \$62.2 billion.²⁶¹ In light of these numbers, it is clear that a social-credit based monetary system would lift a considerable weight off the shoulders of the middle-class in eliminating national debt and associated servicing payments by drastically reducing the tax burden.

B. ELIMINATING CONFLICTS BETWEEN PRIVATE AND PUBLIC INTERESTS

It is equally clear that far from providing steady growth of sound money, the current debt-fueled central banking system has instead produced chronic inflation which erodes the savings and salaries of the middle-class while driving up costs and expenses.²⁶² In effect, inflation is a tax which deprives the laboring middle-class from a considerable portion of its contribution to the real GDP of a country by transferring free wealth to governments, debtors, and speculative investors.²⁶³

²⁵⁷ Bell, *supra* note 177 at 229.

²⁵⁸ *Ibid.*

²⁵⁹ *Ibid.*

²⁶⁰ Charles Lamman et al, "The Cost of Government in Canada, 2016" (January 2016), Fraser Institute Report at 1.

²⁶¹ *Ibid.*

²⁶² Lawrence H White, Viktor J Vanberg & Ekkehard A Köhler, *Renewing the Search for a Monetary Constitution: Reforming Government's Role in the Monetary System* (Washington, DC: CATO Institute, 2015) at 6.

²⁶³ Askari & Krichene, *supra* note 226 at 35.

However, as has been discussed in the previous section, inflation actually benefits banks as they are the first in line to receive newly created money, allowing them to purchase, borrow and lend based on pre-inflation prices.²⁶⁴ Stated bluntly, the more money the central banking system can create, the more profit banks make.²⁶⁵ Banks have been able to “work both sides of the street at once,”²⁶⁶ on the one side providing debt-created money and thereby driving inflation, and then on the other side, raising interest rates, and thereby, their profits, to “cure the disease they bring...”²⁶⁷ Similarly, the siren call of profit often presents banks with the temptation to engage in risky lending practices.²⁶⁸

In short, the current central banking system allows banks to operate despite an obvious conflict between the interests of the bank, and the interests of the public.²⁶⁹ On one hand, governments grant central banks the lucrative privilege of regulating and creating the money the public depends upon to keep the wheels of the economy turning, but on the other hand, allow the banking system to directly profit from inflationary policies completely adverse to public interest. The social credit system would benefit the community at large, rather than banks disproportionately.

C. MITIGATING THE EFFECTS OF FREE TRADE AND TECHNOLOGICAL ADVANCES

Today, the loss of middle-class jobs to free trade and technological advancement is a problem because “jobs” are considered as ends, in and of themselves, rather than as one possible means to obtain the necessities of life. It is taken for granted that purchasing power must be allocated primarily through earned wages.²⁷⁰ Douglas saw the automated writing on the wall over 100 years ago, and rather than viewing unemployment as a tragedy or

²⁶⁴ Nicholas Freiling, “The Dark Side of Monetary Inflation” (10 January 2013), *Hans Economics* (blog), online: <hanseconomics.com/2013/01/10/the-dark-side-of-monetary-inflation/>.

²⁶⁵ Stewart, *supra* note 102 at 215.

²⁶⁶ *Ibid* at 214.

²⁶⁷ *Ibid*.

²⁶⁸ Gilbert, *supra* note 66 at 23

²⁶⁹ Pullen & Smith, *supra* note 181 at 235.

²⁷⁰ RA, “Understanding seemingly meaningless work” (21 August 2013), *The Economist* (blog), online: <economist.com/blogs/freexchange/2013/08/labour-markets-0>.

advocating “capital sabotage,”²⁷¹ Douglas embraced the power of technology to free people from the shackles of labor.²⁷² He believed that the true wealth of a society is based on a common inheritance of knowledge and natural resources handed down from one generation to the next. Accordingly, Douglas proposed that under a system of social credit, all citizens are entitled to a national dividend regardless of employment status.²⁷³ This payment would not be dependent on earned income, but would take the form of directly issued consumer credits.²⁷⁴ In short, if debt-based bank-credit money can be created from essentially nothing, then debt-free social credit money can be just as easily created and based on the real wealth of society.²⁷⁵ In this way, the issuance of debt-free consumer credits in the form of national dividends would supplement wages and allow consumers to purchase what society has already produced without incurring consumer debt.²⁷⁶

VI. CONSTITUTIONALITY OF SOCIAL CREDIT

Though governments, academics, and common people alike appear to take the central banking system for granted, it is clear that the constitutions of many western countries explicitly grant governments the exclusive power to coin, print, and regulate money. Article I, § 8, clause 1 of the United States Constitution grants Congress the power “[t]o coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures.”²⁷⁷ Similarly in Canada, section 91 of the Constitution Act of 1867 grants the Canadian legislature the exclusive powers over currency and

²⁷¹ From 1934-35 Social Credit literature repeatedly addressed food destruction as a remedy to aid unemployment. Examples included: 5,000 lambs were driven into the sea in New Zealand, 1934; in United States Roosevelt allocated \$33 million to ‘pig-sow slaughter’, \$350 million to ‘corn-hog production control’ and \$102 million to wheat acreage reduction; ten million gallons of wine was poured away in Portugal. See Hutchinson & Burkitt, *Political Economy*, *supra* note 180 at 151-52.

²⁷² Douglas, *Monopoly of Credit*, *supra* note 195 at 106-107.

²⁷³ Hutchinson, Mellor & Olsen, *supra* note 1 at 146.

²⁷⁴ Douglas, *Monopoly of Credit*, *supra* note 195 at 147.

²⁷⁵ *Ibid.*

²⁷⁶ The amount of the nation dividend would vary with how much society produces; for an outline on how the National Dividend would be calculated see Louis Even, “Social Credit is Not a Monopoly of the State” (10 October 2016), *Michael Journal* (blog), online: <michaeljournal.org/articles/social-credit/item/social-credit-is-not-a-monopoly-of-the-state>.

²⁷⁷ Indeed, Abraham Lincoln clearly expressed his opinion that “[t]he privilege of creating and issuing money is not only the supreme prerogative of Government, but it is the Government’s greatest creative opportunity.” (Quoted in Philips, *supra* note 214 at 221).

coinage;²⁷⁸ banking, incorporation of banks, and the issue of paper money;²⁷⁹ bills of exchange and promissory notes;²⁸⁰ interest;²⁸¹ and legal tender.²⁸² Though few seem to have seriously considered replacing the regulation and issuance of currency back in the hands of government, it is abundantly clear that government not only has the power, but perhaps the responsibility to do so.

A. OBJECTIONS: FROM THE BANKING SECTOR

Furthermore, given the diminished power and profit of banks under a social-credit based monetary system, it is extremely likely that any real push for a social credit-based system will be met with fierce opposition from the banking sector. Douglas himself recognised the extreme hostility frequently aimed towards social credit theory and frequently referred to this violent antagonism in terms of a conspiracy of elite bankers against the interests of the common people.²⁸³ Though these theories are often remembered with wry ridicule, it can hardly be denied that bankers were among the most prominent critics of social credit, nor can it be denied that this group has the most to lose and least to gain from monetary reform. It is, of course, extremely unlikely that the banking sector will ever embrace monetary reform that so threatens its power and wealth. In any event, fear of opposition should not excuse those who recognise the abundant merits of social credit from seeking much needed monetary reform.²⁸⁴

²⁷⁸ *Constitution Act, 1867* (UK), 30 & 31, c 3, s 91(14), reprinted in RSC 1985, Appendix II, No 5.

²⁷⁹ *Ibid* at s 91(15).

²⁸⁰ *Ibid* at s 91(18).

²⁸¹ *Ibid* at s 91(19).

²⁸² *Ibid* at s 91(20).

²⁸³ Pullen & Smith, *supra* note 181 at 224-25.

²⁸⁴ It is clear that the current debt-based system primarily benefits banks who profit from interest and disadvantages the middle and working classes who struggle under the yokes of inflation and rising debt. Though Douglas demonstrated that banks are neither necessary, nor beneficial for the purpose of creating money, banks would serve a very useful function if strictly limited to acting as an intermediaries for payments and investments. This could be done by moving to a 100% reserve system, which would limit banks to loaning no more than that its total deposits. For more information on the structure and benefits of 100% Reserve Banking, see Askari & Krichene, *supra* note 226.

B. OBJECTIONS: INFLATION

One of the most common arguments against government-created money is that such a process will only result in inflation.²⁸⁵ The argument is that if government had the power to print money to finance its expenses, this would quickly destroy the value of its currency by triggering runaway inflation.²⁸⁶ Such arguments miss that the point of social credit which is to print money specifically based on the *real wealth* produced by a society. Furthermore, inflation is not a necessary result of governments spending printed money. In fact, inflation occurs only when the rate of increase in money supply over a particular time period exceeds the rate of increase in the real value of the economy over the same time period.²⁸⁷

Likewise, if the government spends its printed money on projects that increase the real wealth of a nation (Gross Domestic Product), such as improvements in infrastructure, energy production, or healthcare technology, the inflationary effect of printing the money to pay for these projects should be tempered or even eliminated to the extent that the increase in the real value of the economy is proportionate to the increase in the money supply.²⁸⁸ In fact, it is the current system of arbitrarily dispersing new money into the economy, though perhaps stimulating economic activity in the short run, that is likely to cause inflation in the long run.²⁸⁹ In short, whether printing money causes price inflation depends not simply, if at all, on the *quantity* of money created but on *how* the money is spent.²⁹⁰ As social credit theory is based on printing money directly in proportion with the value of wealth society produces, risk of inflation is, in fact, considerably less than the current central banking system which aims at 2% inflation annually.²⁹¹

²⁸⁵ Phillips, *supra* note 214 at 225.

²⁸⁶ *Ibid.*

²⁸⁷ *Ibid.*

²⁸⁸ *Ibid* at 225–26; inflation can also occur where the volume of money remains the same following an event that destroys real wealth, such as war or natural disaster, or any other event which results in same amount of money “chasing” fewer goods and services.

²⁸⁹ *Ibid* at 226.

²⁹⁰ *Ibid.*

²⁹¹ See Bank of Canada Media Relations, News Release, “Joint Statement of the Government of Canada and the Bank of Canada on the Renewal of the Inflation-Control Target” (24 October 2016), online: <bankofcanada.ca/2016/10/renewal-of-the-inflation-control-target-2016/>.

VII. CONCLUSION

Certainly, there is no shortage of scholars or economists calling for drastic systematic change, but these calls have largely fallen on deaf ears. In an effort to explain the general resistance to monetary change, critics repeatedly liken the current system to an “orthodoxy”²⁹² or religion; for example:

[T]he gospel still is that...there is no salvation outside the dominant financial systems and banking practices...²⁹³

The result is that organizations such as the IMF, the World Bank, and each country's central banks continue to reinforce monetary traditions that attempt to achieve monetary stability safeguarding of the monopoly of the existing money creation process.²⁹⁴

Explaining the failure of orthodox economic theory to alleviate the intensifying effects of growing economic disparities, Burkitt and Hutchinson suggest:

In the standard paradigm of orthodox economics, resource endowments determine personal wealth and personal income distribution. These endowments are taken as “given” exogenous variables, at least to economists. Consequently, remedies for inequalities in the distribution of wealth and income fall largely outside the purview of the positive science of neoclassical economics...²⁹⁵

Though Douglas maintained that major changes to the monetary system are both possible and necessary, he also acknowledged that a number of psychological obstacles lie in the path to reform. Most pertinent, he argues, is “fear of the unknown.”²⁹⁶ In *The Monopoly of Credit*, C.H. Douglas suggested that though most mainstream economists are intellectually honest and endeavor to contribute solutions to the world's economic problems, they ultimately fail to do so because the current monopoly of credit by banks is so entrenched within their hearts and minds they are simply unable to think outside the central banking framework.²⁹⁷ However, Douglas contended that throughout history the individual determination to survive has been constrained not so much by physical limits as by human action. He asserted:

²⁹² Lietaer et al, “Monetary Structure”, *supra* note 172 at 104.

²⁹³ Bernard Lietaer et al, “Money and Sustainability: The Missing Link” (2012) *The Club of Rome: EU*, Chapter Report at 1.

²⁹⁴ Lietaer et al, “Monetary Structure”, *supra* note 172 at 104.

²⁹⁵ Burkitt & Hutchinson, “National Dividend”, *supra* note 188 at 19.

²⁹⁶ Douglas, *Monopoly of Credit*, *supra* note 195 at 5.

²⁹⁷ *Ibid* at 4.

[T]he cave-man probably found his chief difficulty less in the lack of game, or in his peculiar housing problem arising from a shortage of eligible caves, than in the fact that his neighbor, instead of exploring new territory and finding an additional cave, preferred to take measures to expel him from the sites already developed. Not, I think, so much because he liked fighting, as for lack of ability to conceive of the existence of enough caves.²⁹⁸

If as a society we are determined to save the middle-class and put an end to extreme income inequality, we must abandon orthodox monetary theory. Through his theory of social credit, Douglas has presented the framework to implement a permanent, debt-free money supply which can be expanded to meet the needs of a growing population and economy, and harness the benefits of advancing technology for all. Just as the middle-class is losing the most under the current debt-based bank credit system, they could expect to benefit the most from a debt-free social credit system.

²⁹⁸ *Ibid* at 87.