The Foundation for the Economics of Sustainability

Submission on the Evaluation of Community Banking and Local Provision of Banking and Financial Services in Ireland

April 15 2019

We welcome the opportunity to make this submission. We believe that community (or public) banking could form a central component of a healthy future Irish economy and, for reasons explained below, would argue that there is an urgent need to expand this sector in Ireland.

Summary

Feasta's currency group feels that making a significant investment in the development and exploration of Community Banking in Ireland should be a national priority because:

- there is a major opportunity to accelerate locally-arranged funding for locally-grounded businesses - a powerful political message
- the German Sparkassen model has shown that lending into the local productive economy is feasible, and that such community banking needs no bail-outs during financial crises
- such exploration can include the potential scalability of the interest-free lending model pioneered by JAK bank in Sweden - a model that directly addresses the emerging consensus that growth is a poor proxy for progress
- any funding channel that prioritises lending into productive use as opposed to speculation or asset purchases should be made a priority
- focus on lending into productive use facilitates the development of sustainable investment schemas - including the prioritisation of pro-environment 'credit guidance'
- strategically a more diverse banking system (as in nature) will be more resilient and sustainable than the current financial-system monoculture

Internationally we have an over-financialised economy. The original purpose of a central bank was to monetise sovereign debt so that the state was not reliant on borrowing from the private sector and could perform its primary role in allocating spending and investment according to national strategic priorities. This function has over the last 50 years progressively been taken over by the commercial banks and it is they who now effectively plan the Irish economy. Indeed, while Ireland is part of the Eurozone our central bank is forbidden to monetise debt, so no independent state action is possible on this front.

In this context, investment and development of a strong public banking sector is the most significant step the Irish government can take unilaterally to improve the quality of capital allocation in Ireland. What follows is a collection of supporting analyses showing this thinking in more depth and illustrating Feasta's efforts concerning the development of related ideas over the past 20 years, inspired by the thinking of its co-founder the late Richard Douthwaite.

Contents

1. What we mean by ‘community banking’

The consultation call does not give an exact definition of ‘community banking’, and the Terms of Reference also refer to ‘public banking’. We will treat the two as equivalent in this submission.

We consider community or public banking to be banking that follows the definition on the Public Banking Forum of Ireland website[1]:

“Public Banks are public welfare-oriented institutions and, instead of profit maximisation, their aim is the sustainable development of the real economy within their business territories.”

The website goes on to describe four long-established existing models of public banking that are currently operating in many different countries: the German Savings Bank model; the Co-op model; the Japan Post Bank model; and the Bank of North Dakota model[2].

Public banks under our definition do not need to be owned by the state, although they can be. They can also be owned by municipalities, as in the German model, or by their clients, as with credit unions.

As explained in section 4 below, we believe that two measures should be given serious consideration as part of any overall plan to expand this sector, as they would enable community/public banks to adjust to rapidly changing external circumstances and continue being able to serve the needs of local economies. These two (related) measures are: debt-free money creation; and interest-free lending options.

2. Public and community banking as a protective measure, given Ireland’s worryingly high level of financial risk

Ireland’s current financial situation is of grave concern to us. Financial analyst Tim Morgan, who has factored the spending of borrowed money and the production output that is required to fund the supply of energy itself into his GDP calculations - and who actually considers Ireland to be the most financially vulnerable country in the world - wrote in February 2019:

"...where Ireland is concerned….personal prosperity has declined by 7% since 2007, whilst debt per person has risen by 78%. The conclusion for Ireland is that debt now equates to 589% of prosperity (compared with 308% in 2007)."[3]

Given Ireland's extremely high ratio of aggregate public and private debt to GDP and its dependency on the fragile and unstable UK and US economies, we need to take rapid steps to stabilise our financial situation. Otherwise, if, as many are predicting[4], another global financial crash occurs, Ireland could very quickly end up in a far worse financial position than it was in after the crash of 2008.

While community banking cannot solve Ireland's debt crisis by itself, it would provide a safer alternative to commercial banks in turbulent financial times. For example, in the wake of the 2008 crash, the German public banks were largely unaffected by the crisis:

"*Considered in isolation, the [public banks] came through the crisis virtually unscathed and required virtually no state aid. The structure of the network protected them from direct exposure to risk products and the debt market. Depositor confidence in the deposit guarantee scheme (and in the German government) saved them from the threat of a run on their resources. Their regional roots, which ensure stable resources and comfortable margins, allowed them to absorb the defaults caused by the economic slowdown`'*[5].

Moreover, judging by their performance elsewhere, community banks should be of considerable help in the urgently-needed general shift to a less speculation-driven and more community-oriented Irish economy. This is discussed further below.

3. Community banking as a means to stimulate local economies

This excerpt from the late economist and Feasta co-founder Richard Douthwaite's 1998 book *Short Circuit: Strengthening Local Economies In An Unstable World* is at least as relevant now as at the time of its original publication:

" ….the economic system has positive feedback: prosperous parts of the world get more investment because better returns can be had from projects there, which makes them still more prosperous, while poorer areas have what capital they possess taken away. As a result, the poorer areas fall further behind and people living in them are forced to leave to seek work wherever investment is going on. They take up residence in the expanding areas and add their spending to its rising income flow, generating further investment possibilities. A major cause of the emigration of young people from rural Ireland is that their parents have allowed their savings to be invested away from home.

"Economically, this population shift is an undesirable, inefficient outcome because it leads to vacant housing and under-utilised assets in declining areas, and overcrowding and congestion in the prosperous ones. Unfortunately, however, conventional economics is based on the assumption that there will always be negative feedback in the shape of diminishing returns and not a positive feedback like the investment-causing-a-population-shift-and-hence-more-investment case we are discussing. The discipline is therefore ill-equipped to recommend ways to stop the flow. W. Brian Arthur, professor of population

studies and economics at Stanford University, is one of the few members of his profession to have tried to work out what happens when a positive feedback occurs. He described his results in New Scientist in 1993:

"Increasing returns have interesting implications for the characteristics of economies. There are many possible patterns of world production and consumption, so it is not possible to predict which one will occur. The particular pattern that falls into place builds up organically - that is, new firms and industries grow on what is already there. This is partly the result of historical accidents - who set up what firms where and when. Once in place, such concentrations become hard to dislodge; they are 'locked in'. The resulting pattern probably does not coincide with the best allocation of resources. Even if all countries start with equal concentrations of each industry, the slightest tremble in the marketplace tilts the outcome to an asymmetric one. So with positive feedback in the form of increasing returns, the economy acquires very different properties: multiple potential production-consumption patterns, unpredictability, history dependence, lock-in, inefficiency and asymmetry.

"When I first came upon these properties I was surprised - and fascinated - by them. They showed that there were theoretical reasons, not just practical ones, why the economy is unpredictable. But mere hints of these ideas alarmed economists of previous generations. In 1939, the English economist John Hicks warned what would happen if they tried to incorporate them into mainstream economics: "The threatened wreckage is that of the greater part of economic theory."[3]

"Arthur points out that many parts of the economy - the high-tech sector in particular - do not run into diminishing returns. "To produce a new pharmaceutical drug, computer spreadsheet program or passenger jet, perhaps hundreds of millions of pounds have to be spent on research and development. Once in production, however, incremental copies are comparatively cheap" he writes. "Once a product gets ahead of its rivals it gains further cost advantages and can get even further ahead. High technology is subject to increasing returns."

"Governments obviously need to counteract the effects of increasing returns, of positive feedback, if they wish to have an even spread of a wide range of economic activities throughout their territories and prevent the concentration of economic power in very few corporate hands. However, most mainstream economists are strongly opposed to such strategies and react to proposals to, say, subsidise emerging domestic producers facing competition from established giants overseas by warning that such a course would limit the workings of the free market and thus lead to gross inefficiencies. However, this response ignores the widespread evidence that gross inefficiencies are generated by the market itself and that intervention might be needed to correct them. It also ignores the historical evidence that the governments of virtually every continental European country provided protection for their infant industries to enable them to counteract Britain's head start during the Industrial Revolution.

"The idea of intervening in the market by restricting capital flows is particularly unacceptable to many economists because it would prevent investors moving their money to wherever it can gain the highest return. "A standard view would argue that the greatest national benefit is achieved if savings are put to the most productive use" Professor Honohan wrote….. In the context in which he used it, 'profitable' might well be substituted for 'productive'.

"The existence of positive feedback means it is not just movements of capital across national boundaries which are harmful. Substantial, continuing capital flows from one part of a

country to another are destabilising too, leading to prosperity in one area and decline in another."[6]

The extensive research of banking experts such as Richard Werner[7] and Ellen Brown[8] demonstrates the potential of community banks to help democratise finance and enable communities to flourish.

Feasta member Jacqueline Mathewes, who lives in Germany, comments

"The Volksbank [public bank] cooperatives usually deal with local SMEs and private customers and finance local projects (farming, startups, environmental etc)....These banks are excellent as each bank within the cooperative network is an independent entity and is de facto managed and run according to its members' interests. Every account holder holds a share in the bank. As a member of the representative assembly, we meet every year, report on and go through the financial statement and business activities of the previous business year and take votes on the targets and direction of bank business for the coming year. These banks are subject to "Cooperative Law" here in Germany. Trust in these banks is high, as they are not equated with the usual "shark-like" commercial banks, who do willy nilly business and do not adhere to their customer's wishes. They invest in the local economy."

4. Community banking to ease the transition to a sustainable (growth-neutral) economy

As mentioned in section 1 above, there are two additional features which we believe to be very important to consider for Ireland's public banking system: debt-free money creation; and interest-free banking.

If the first of these, debt-free money creation, is taken to mean debt-free *euro* creation, then it is not currently within the power of the Department of Finance or indeed the Central Bank of Ireland (and, despite what many believe, the ECB is not directly responsible for the issuance of the vast majority of euros either). Nonetheless, we outline here our reasons for advocating a change in money-creation methods, and why we believe that this is important for readers of this submission to bear in mind.

The present situation whereby commercial banks create 97% of money (euros in Ireland's case) on a basis of debt is highly problematic. To quote Richard Douthwaite again, this time from his book *The Ecology of Money*:

"Creating money on the basis of debt ….makes the economic system fundamentally unstable. The system is always balanced on a knife-edge. If bank customers borrow too little, the economy moves into recession and, unless corrective action is taken, the positive feedbacks...(such as people's natural reluctance to borrow and spend) will kick in and produce a catastrophic depression. Indeed, the main reason that a serious depression has not developed in Western Europe and North America since the 1930s is that semi-automatic corrective mechanisms have been unwittingly incorporated into the system. One of these, unemployment pay and the social welfare system generally, has been a particularly important means of preventing crashes. It has ensured that, whenever the rate of joblessness has increased, larger amounts of money have automatically been transferred to the people who spent all of it immediately. This is a very effective way of compensating for

the loss of spending power. Another corrective mechanism is that whenever the economy has turned down, many people and firms have been forced to increase their bank debts involuntarily, simply to survive. This has increased the money supply to everyone else. However, if an economic shock was sufficiently severe, these twin buffering mechanisms would be overwhelmed and a serious depression would develop.

“Another fundamental problem with the debt method of creating money is that, because interest has to be paid on almost all of it, the economy must grow continuously if it is not to collapse. Perhaps the best way of explaining this is to use the question asked when gold was the main currency. Since the gold being borrowed did not increase itself and very little was being mined, where was the extra amount of gold to come from to pay the interest when both principal and interest had to be paid at the end of the year? Obviously, as borrowers could only obtain the extra gold they needed by bringing about situations in which others had less, lending money at interest necessarily meant that borrowers either had less gold themselves after paying interest, or that they had impoverished someone else. As either outcome was socially undesirable, both the Roman Catholic Church and Islam condemned usury - all forms of money lending at interest no matter how low the interest rate - as immoral.

“Just because we now use paper currencies doesn't mean that the problem of "where is the interest to come from?" has disappeared. Borrowers can only obtain enough money to pay their interest bills without reducing the amount of money in circulation if they, or other borrowers, borrow an adequate amount more. As a result, under the current money creation system, the amount of money in circulation has to rise, year after year, by a sum at least equivalent to the amount being removed from circulation by the banks as a result of interest payments. The amount removed is equal to the profits left to the banks after they have paid dividends to their shareholders in the country concerned, invested in new equipment and premises and met all their wages, salaries and other operating costs there. These profits will be held in accounts in the banks' own names and unless they are put back into circulation (by being spent or lent), the amount of money in circulation will fall. As a result, the business sector will show a loss and cut back its investment and borrowing, thus pushing the whole economic system into decline. The only thing to prevent this from happening would be that, by chance, the country's foreign earnings or capital inflow rose by enough to compensate for the interest lost.

“The fact that the amount of money in circulation usually has to increase each year to enable interest to be paid means that the total value of sales in the economy has to go up too if the ratio of the money supply to the volume of trading is to stay constant. The required increase in sales value can come about in either, or both, of two ways: inflation and expansion. If there is no increase in output during the year, the increased amount of money in circulation could simply push up prices, or allow firms to increase them. This inflation would provide businesses with enough additional income to pay their increased interest bills. The alternative is that the output of the economy grows by enough to require the monetary increase. This is the expansion. Of course the most likely outcome is a combination of inflation and expansion to restore the balance between the value of trading and the value of money.

“This analysis means that, due to the way money is put into circulation, we have an economic system that needs to grow or inflate constantly. This is a major cause of our system's continuous and insatiable need for economic growth, a need that must be satisfied

regardless of whether the growth is proving beneficial. If ever growth fails to materialise and inflation does not occur, the money supply will contract and the economy will move into recession. Politicians naturally do not want inflations and recessions occurring during their periods in office so they work very closely with the business community to ensure that growth takes place. This is despite the damage that continual expansion is doing both to human society and the natural world."[9]

It is important to note that, despite many claims to the contrary, attempts to decouple GDP growth from fossil fuel consumption and other forms of extreme environmental degradation have had, at best, extremely limited success, and this is likely to remain the case[10].

As the late currency expert Margrit Kennedy explained in her book *Interest and Inflation-Free Money*,

"*Continual economic growth…..results in the depletion of natural resources. That means, in the present monetary system, we have a choice between ecological or economic collapse."*[11]

To achieve a sustainable economy, we therefore need to achieve a transition from our current growth-dependent financial system to a growth-neutral one.

An increasing number of analysts are calling for a shift to debt-free money issuance by an accountable public body. One scenario might be for future community banks to be given the authority to create euros on a debt-free basis. As mentioned above, this is not feasible within the current regulatory framework. However, we would advise policymakers to reflect on possible emergency measures that might be helpful in the wake of a financial crash, such as the issuance of debt-free scrip or community currencies.[12]

In Germany, the Public Banks are currently allowed to create money on a debt basis (albeit within strict guidelines). Given the problems with debt-based money outlined above, we believe a more stable model for community banking in Ireland (and elsewhere) would be that followed by the interest-free banking system of the JAK system in Scandinavia[13].

5. *Extension of banking licenses to include credit unions*

Credit unions have enormous potential for stimulating the Irish economy, but their ability to do so at present is restricted by their being unable to obtain banking licenses and thus being forced to rely heavily on the major commercial banks in order to be able to operate. The CEO of a Dublin-based credit union (who wishes to remain anonymous) told Feasta that within the present regulatory framework "we're at the mercy of the commercial banks for providing services to customers".

Feasta member Anne Ryan comments that whenever standing order or direct debit payments are made to a local farm which has a credit union account, the transactions have to go through one of the big banks. This makes it impossible to keep track of who has paid what.

Conclusion

We believe community/public banking to have enormous potential for addressing both social and environmental challenges, particularly if it employs interest-free frameworks. We urge the Department of Finance to take action to enable the sector to expand (including credit unions) and allow it to play a much more dynamic role in the Irish economy.

Feasta (the Foundation for the Economics of Sustainability) *is an open-membership think tank. Its aims are to identify the characteristics (economic, cultural and environmental) of a truly sustainable society, articulate how the necessary transition can be effected and promote the implementation of the measures required for this purpose. It is a member of the Irish Environmental Network, the Environmental Pillar and Stop Climate Chaos Ireland.*

Resources (in addition to those listed in the endnotes below)

The Public Banking Alliance website: http://publicbankingalliance.ie/

David Korten on community banking: https://davidkorten.org/the-new-economy/money-rules/

International Movement for Monetary Reform: https://internationalmoneyreform.org

Endnotes

[1]http://republicirelandbank.com

[2]http://republicirelandbank.com/?page_id=2.

[3]*https://surplusenergyeconomics.wordpress.com/2019/02/18/147-primed-to-detonate/*

[4]Predictions that another global financial crisis is imminent:

Global Policy Watch: https://www.globalpolicywatch.org/blog/2018/06/14/warnings-global-financial-crisis/

Ann Pettifor: http://www.stuff.co.nz/business/money/102939290/ann-pettifor-predicted-the-global-financial-crisis--now-shes-predicting- the-sequel

IMF: https://www.zerohedge.com/news/2017-10-30/second-crash-warning-imf-%E2%80%93-time-its-about-vol

Ahmed Nafeez on China Risk: https://medium.com/insurge-intelligence/the-next-financial-crash-is-imminent-and-chinas-resource-crisis-could-be-the- trigger-be108b2731e9

Prof Robert Reich: https://www.newsweek.com/robert-reich-we-might-be-heading-crash-bad-1929-opinion-1101869

Gordon Brown – UK: https://www.theguardian.com/politics/2018/sep/12/we-are-in-danger-of-sleepwalking-into-a-crisis-gordon-brown

Prof Nouriel Roubini: https://www.theguardian.com/business/2018/sep/13/recession-2020-financial-crisis-nouriel-roubini

Bond Market: https://www.rt.com/business/410317-bond-market-crash-prediction/

Stock market: https://www.thestreet.com/opinion/why-a-global-stock-market-crash-is-coming-14566852

Banks: https://www.ineteconomics.org/perspectives/blog/how-the-largest-banks-are-leading-us-to-a-new-financial-crisis

David McWilliams - Ireland: http://www.davidmcwilliams.ie/we-may-be-on-verge-of-a-global-financial-crisis/

Niall Ferguson – S-China morning post: http://www.scmp.com/comment/insight-opinion/article/2120679/another-global-financial-crisis-imminent-and-here-are-four

Real News Network: https://therealnews.com/series/the-next-global-financial-crisis-is-inevitable

[5] https://economic-research.bnpparibas.com/html/en-US/German-Sparkassen-model-follow-4/29/2016,28761

[6] https://www.feasta.org/documents/shortcircuit/Short_Circuit.pdf

[7] https://professorwerner.org/

[8] http://www.ellenbrown.com

[9] https://www.feasta.org/documents/moneyecology/chapterone.htm

[10] Research on the difficulties with decoupling pollution and resource overuse from GDP growth: https://www.sciencedirect.com/science/article/pii/S1462901118308803?dgcid=coauthor

https://foreignpolicy.com/2018/09/12/why-growth-cant-be-green/ , http://www.inderscienceonline.com/doi/abs/10.1504/IJGEI.2012.051687 https://www.resilience.org/stories/2015-10-13/the-decoupling-debate-can-economic-growth-really-continue-without-emission-increases/

[11] http://userpage.fu-berlin.de/~roehrigw/kennedy/english/chap3.htm

[12] See for example the section on the 'harp' in http://fleeingvesuvius.org/2011/04/07/a-three-step-emergency-plan-for-ireland/

[13] https://www.feasta.org/documents/review2/carrie2.htm
https://monneta.org/en/the-jak-bank-model/