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Cape Town, March 2, 2010

Hon. Ebrahim Patel. MP
Minister of Economic Development
120 Plein Street
Parliament
Cape Town

Re: Reform of the monetary system to introduce debt, interest and inflation free money

"Some people see things as they are and say why?
I dream things that never were and say, why not?" – RFK

Dear Minister:

Thank you for taking the time to see me. As we discussed, I am following up on what I told you with a written presentation. As you know, both my Leader and I have publically called for the nationalization of the Reserve Bank and the adoption of debt-free money, replacing banknotes with government notes.

At the outset, I must stress that what I have put to you or is set out hereinafter is not the product of my own thinking or analysis. The science behind it is the product of the work of two Nobel Laureates in Economics Milton Friedman and Friedrich von Hayek, *inter alia*. The most relevant work of Friedman on the matter is his "*A Program for Monetary Stability*", especially at pages 72 to 75. A copy of this book is enclosed for your easier reference.

The historical research on the formation of the monetary system and its function within society over the millennia has been dealt with in many pieces of literature. I am however particularly indebted to Patrick Carmack JD, who also assisted me with this presentation. His "*MoneyMasters*" and "*Money as Debt*" documentaries have had an enormous impact on worldwide consciousness and are attached hereto in DVD format. In addition to their educational value, they make delightful and enriching watching, especially *MoneyMasters*.

At the ideological and political level, the themes set out in this presentation are fuelling the libertarian movement in the United States centered around presidential candidate Ron Paul and the Campaign for Liberty which recently won the senatorial seat historically held by the Kennedy family.

This presentation also moves from an historical perspective and understanding of the dynamics of society which one may or may not share, and which is rooted in the teachings of Max Weber and Gaetano Mosca. Within it, is the belief that the present worldwide monetary system is not meant to, and does not intend to bring about the emancipation of the poor, and that hundreds of years from now the same huge differences we now have between rich and poor countries will continue to exist even though the floor may be progressively raised.

To many people, this may seem unavoidable or perhaps even necessary. However, I have approached you on account of my perception and hope that to you, as it is to me, this is not acceptable, and that the cause of mankind demands utilizing the present global economic crisis as the opportunity to begin breaking down the chains of monetary bondage which in modern times are the ultimate root cause of all social inequalities within countries and between countries.

The additional reason for this presentation lies in South Africa being uniquely positioned amongst all nations and countries to take the first bold step towards not only its emancipation but the emancipation of mankind. I do not want to burden this presentation with a complex explanation of why that be the case. I will just mention that having been part of the BIS-IMF-WB system for less than two decades, South Africa could find its way out of it on account of what it needs to do to achieve its economic salvation at this time of crisis. Furthermore, in the natural resources and precious metals it holds in its soil, South Africa has a virtual collateral which, as a pool of commodities, could create a new monetary standard against which it could issue sound money rather than fiat money.

The final preliminary consideration lies in the alternative facing South Africa at this crucial economic juncture. Minister Pravin Gordhan has committed us all to raising the national debt from R513 billion to R1.3 trillion within three years. This is on the assumption his optimistic projections of economic growth of 2.3% for this year, 3.2% for 2011 and 3.6% for 2012 actually materialize. Under his best case scenario, by 2015 the budget will be “stabilized” with a “mere” ongoing and compounding deficit set at 4% of our GDP. To me this effectively means that by 2015 our national debt will be at R1.7 trillion, which will involve a debt-servicing cost way in excess of our entire budget for education, which cost will be a perpetual one, as we now have no plan for the repayment of such national debt.

All this does not take into account our skyrocketing and out-of-control municipal debt and the ever-growing levels of debt within families and industries alike, which make it questionable talking about our national debt in terms of a percentage of an increasingly debt-ridden GDP.

One could also throw into the equation the “what if” of a worsening of the economic crisis, the even greater impending risk of a global financial meltdown flowing from the possible collapse of the US bond market, the likely default of the Greek Government and the predicaments of those Spain, Ireland, Portugal and Italy now threatening the Euro’s future. No plan exists to deal with a situation which reasonable people recognize as unsustainable**.**

The proposal set out hereinafter, if followed through, will undoubtedly be painful for, and resisted by the banks and the financial sector, but will give the State the opportunity to pay off both the national debt and the municipal debt without having to borrow any money and without inflation or deflation. It will also enable the State to continue to have enough money to finance its social programs, develop an industrial base to sustain future economic growth and bring about the final social and economic emancipation of the people of South Africa. In this

process, South Africa may end up attracting short-term international criticism, but, if successful, it will be remembered in history as a world leader, as much as France is when looking back at the fateful days of the summer of 1779.

The elements of the proposed reform of the monetary system are basic and simple, even though their implications and reasons are not often self-evident, also because of the specialized knowledge the matter requires. The enclosed *Program for Monetary Stability* from Milton Friedman provides a background to some of the relevant facts and considerations.

Such elements are –

1. Transferring the power of *seignorage* and coinage from the Reserve Bank to the Treasury as it was done on many other occasions in the past and across the world, as more fully described in the enclosed *MoneyMasters* DVD.
2. Eliminating the fractional reserve system which presently enables banks to lend 97.5% more money that they actually have in their reserves, thereby effectively creating R97.5 of fiat money for each R2.5 worth of assets, in a system in which such assets are inclusive of IOUs, mortgages and other obligations and liabilities of others, and in an ever-growing exponential cycle of artificial money creation which the Reserve Bank is meant to contain by constraining money supply when implementing monetary policies.
3. Providing constraints on government in respect of printing of money, both in terms of its quantity and in terms of its use. The former is discussed below, while the latter is about ensuring that all government money issued by the Treasury is introduced within the system for real value, such as the payment of bills and salaries at all levels at market prices --ranging from ditch workers to State companies' CEOs-- and public procurement of items purchased only at real market value.

In this process the Reserve Bank may or may not need to be nationalized. In our South African situation the cost of nationalizing the Reserve Bank could be quite high as so many of its shares are in public hands. Having the Reserve Bank being privately owned creates a corporate governance nightmare, as the Governor and half of the Board members feel that they must pursue public interest even at the cost of disregarding the private interest of all the shareholders and the other half of the Board representing the shareholders. However, once the functions of monetary policies are removed from the Reserve Bank, which is the consequence of transferring the power of *seignorage* and the control over money supply from the Reserve Bank to the Treasury, the Reserve Bank could continue to exercise its other functions, such as the supervision of the banking system, thereby acting in a situation in which the conflict between public interests and private shareholder interests is greatly attenuated. In this context the need to rectify the present untenable situation by means of nationalization greatly subsides.

Under the foregoing conditions, the money being used in South Africa will no longer be private money but will be money belonging to the people, the country and its State, as it was during the US presidency of Washington, Jackson and Lincoln. Transferring the power of *seignorage* to the Treasury as set out hereinafter does not cause the value of money to change either from the viewpoint of its internal purchasing power or in point of exchange rates. This will be so much so if one takes the additional courageous step of making this new debt-free currency convertible against a basket of commodities, including South Africa's precious metals. This system combines all the benefits of the gold standard without any of its problems, and remains one of the best

guarantees against inflation caused by the debasing of the currency, which is the vilest form of tax on both poverty and savings.

The greatest difference between money issued by a central bank and money issued by the Treasury lies in the fact that the former is debt-based money while the latter is debt-free money. Today, whenever government needs R1 to finance a deficit, it needs to issue R1 worth of Treasury I.O.U.s if it cannot raise that R1 from its revenues. That borrowed Rand so raised always comes with a portion of interest and therefore the creation of that additional Rand within the overall money supply comes with the creation of a portion of debt. However, if the Treasury issues the same Rand by merely printing it –or more commonly by creating a Treasury deposit-- and using it in payment of goods and services it purchases in the open market at a fair market price, then that Rand is introduced within the overall money supply without debt.

If Parliament through the Treasury has the legal, constitutional and policy power and discretion to create R1 of debt, or for that matter R1.7 trillion worth of debt, it also have the power to create R1 or R1.7 trillion worth of debt-free money. By the same power with which the Treasury would issue such money, the Treasury can retrieve and effectively destroy it, the same way it retrieves and pays off debts, or in the way in which the Reserve Bank now reduces money in circulation when the money supply is excessive and to avoid inflation. In so doing the Treasury would perform the same function as the Reserve Bank does, but would do so in a system which has transferred monetary policy and monetary tools from the private hands where they now lie into the hands of government and in the public interest.

At present government spends what it wishes and borrows the deficit. After the proposed monetary reform, government would still spend what it wished --exactly the same, not enhanced-- except there will not be any debt associated with expenditures. Capping government expenditures is a different issue. Inflation would only result from deficit spending, exactly as now. The nation would have no debt, nor any debt payments draining the Treasury.

The second required element of the reform is the abolition of the fractional reserve system. In fact, the principal objection to shifting from banknotes to Treasury or government notes is increased inflation. I believe that the South African required reserve ratio ["RRR"] is 2.5%. Unless the RRR is raised to 100% at the same time as the shift to Treasury notes takes place, the debt-free Treasury notes will be deposited in banks. The banks will then use them as the base to multiply money supply just as they do with money issued by the Reserve Bank. That would cause additional inflation.

For example, if at present our government runs a deficit of R400 million in a given year, the Reserve Bank would purchase Treasury's IOUs ["Treasuries"] on the open market with R10 million which the Reserve Bank simply creates. The Reserve Bank would then hold such R10m in Treasuries as a balance-sheet asset. Such R10m, so created, is next deposited in or credited to the banks of the sellers of the Treasuries. The banks then lend out 97.5% of that retaining 2.5% as reserves. The borrowers of the R97.5m then deposit that in banks, which banks retain again 2.5% of such 97.5% as reserves, viz. R2.4375m, and lend out R95m. And so it goes through stage after stage of re-deposit and re-loan, until the banks have loaned out a total of R390m and have R10m in reserve. Thus our Reserve Bank created $1/40^{th}$ (2.5%) of the new money in our economy while private banks created R390m which they loaned at interest. Accordingly, private banks derive 97.5% of the benefit of money creation, rather than the government, which created only 2.5%.

That is outrageous and unjust, as it quickly concentrates wealth and economic power in the hands of the major banks and their owners. However, the economy as a whole has increased the money supply by the R400m needed to finance the deficit, which is accomplished by that new money ultimately being used to purchase Treasuries to the tune of R400m, viz. R10m purchased by the Reserve Bank plus R390m purchased by the holders of the new money the banks created as loans. So credit markets and interest rates are stabilized, as the action of the Reserve Bank in creating R10m has ultimately resulted in R400 being added to the money supply, which is absorbed by the sale of the R400m needed to fund the deficit. However, there is an inflation effect of R400m since the money supply has been expanded by that amount, which is the result of a R400m deficit. But the injustice is that, except for 2.5%., our government did not derive the benefit of *seignorage* on the creation of R400m, the banks did,

With the proposed reform of the monetary system, our Treasury would create all new money, i.e. the aforesaid R400m. That money would be used directly by the government to pay bills such as R400m worth of items budgeted for by Parliament over and above our tax revenue. That is straightforward and simple. However, unless fractional reserve banking is simultaneously abolished by raising the RRR to 100%, once the R400m is deposited in the banks from those who are paid by the government for the deficit items, banks could loan out R390m, retaining R10m in reserve on the strength of the fractional reserve system. That would in turn be deposited and re-loaned, and eventually the R400m would be expanded by the banks to R16billion, which would cause hyper inflation.

Therefore, the reform must include both an increase of the RRR to 100% and the Treasury issuing all new money. This could be legislated to happen in 12 increments over one year. That would mean that the 2.5% RRR would be increased by 8.125% each month, so that by the end of the year it would reach 100%. At that point banks could create no new money and only the Treasury could do so. There would be no inflation, nor deflation. The money supply would be stabilized and the boom-bust cycle caused by fractional reserve banking would end.

This brings us to the other leg of this reform. If the banks must gradually increase their reserves to 100% over a year, where will they get the funds needed to increase their reserves? The answer lies in paying off the national debt. Because 97.5% of our money is created as debt, there is a direct relationship between the RRR and the national debt, which is in the money created by the banks representing a measure of the borrowings by government, viz. the "Treasuries". Thus the two sums are always roughly equivalent, meaning that if the Treasury were to create Treasury deposits (or print money - either way) and pay off the holders of the Treasuries (*i.e.,* retire all outstanding Treasuries), it would be creating roughly the same amount the banks would need to transition to full reserve (100%) banking, as the sellers of the Treasuries, deposit their sales proceeds in the banks.

The two legs of this aspect of the monetary reform requires legislation which (a) incrementally raises the RRR of banks to 100% over a one-year transition period, and (b) authorizes the Treasury to create Treasury-issued money or government issue currency or accounts sufficient to pay/retire the entire national debt. These two legs need to occur concurrently.

Having regained control of the national money from the private banks, spending and money-creation has to be reined in. There are three good proposals on how best to do this. The first two relate to stabilizing the quantity of paper or fiat money.

The first consists of fixing a fixed rate of growth selected from zero to 3% to avoid any deflation, thereby avoiding harming the debtor class. This is akin to our government's present growth projections, such as in GEAR, save for it being a real decision and action than a mere policy.

The second consists in selecting a very narrow range of fluctuation, i.e. 0-3%, so as to approximate population and average productivity growth. Milton Friedman advocated a constitutional amendment fixing monetary growth in a narrow range.

The third and best solution is the adoption of commodity-based money, which in our case would probably best be gold initially and be amplified later to increase the standard with a "basket" of commodities inclusive of several precious and semi-precious metals.

Stabilizing money supply is critically important, after regaining control if it. Theoretically a paper or fiat money would be the ideal, but one must concede to the Austrian school's viewpoint that government can never discipline itself. The commodity-based approach creates a limit. This limit needs not to be limited to the amount of national gold or other commodity, which by definition is finite, but can be increased over time with other commodities and even anything else which at any given time is widely recognized as tradable national assets, such as, for instance, carbon credits.

This reform would enrich the nation and remove the national debt. But it would also diminish the bankers' stranglehold over the political system and their ability to corrupt it. Admittedly, this poses a major political difficulty, considering that all our parties receive contributions from banks. In addition, South Africa should withdraw from the BIS, IMF and World Bank which will create an initial international outcry and political pressures on us all. Yet this is the only real pain of this operation, consisting, as it does, in a major political cost and in the harm to the bottom lines of banks and other portions of the financial sector which are parasitical in respect of the real economy and real growth. There would be no real pain for industries, workers and families, who are those who really matter. In this the sublime beauty and compelling nature of this proposal ultimately lie.

There is much more that can and should be said in respect of this proposal. If you see the wisdom of taking this matter further, I will expand on it and/or bring in experts to do so, and will gladly provide you with a draft Bill containing the legislation required to implement this reform.

Beside carbon-coping it to my Leader, I will not share this letter with others or make it a public issue, so as to ensure you maximum political maneuverability in a matter of national interest and way above party politicking.

Very truly yours,

Mario GR Oriani-Ambrosini, MP

c.c.: Prince Mangosuthu Buthelezi. MP