Response to Financial System Inquiry Interim Report

A root and branch review would attempt to stop the financial war against Australia, but the interim review shows an intention to intensify the brutality of the financial warfare being waged against the Australian economy and nation, and against Australians.

August 2014

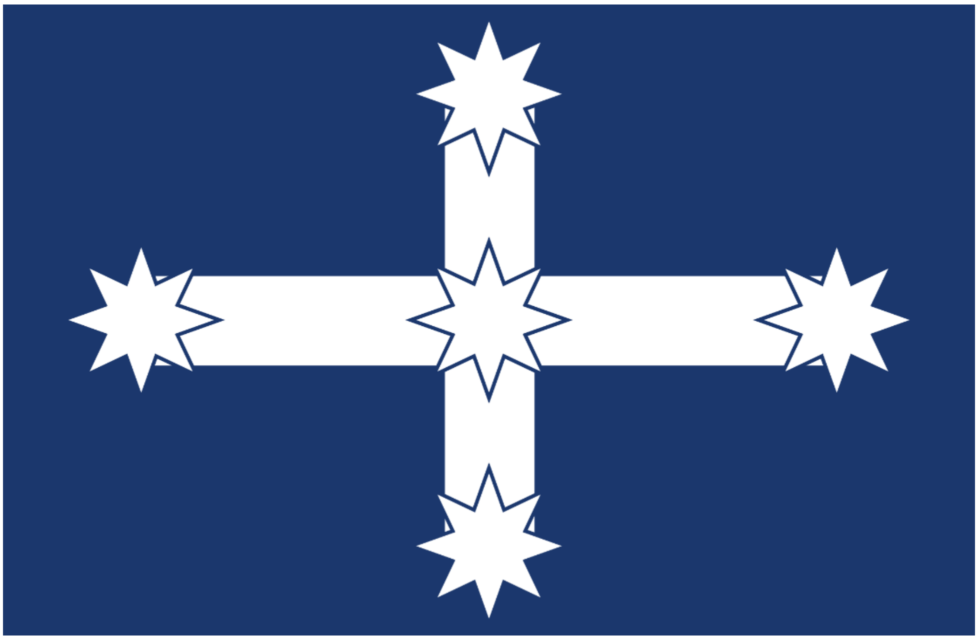
"…there was once a law in the United States which prohibited the type of speculation" [*…which vulture funds are engaging in against Argentina*]	**President Cristina Fernández de Kirchner, 25 July 2014 Chaco, Argentina speaking about how Glass-Steagall once prohibited the actions which vulture funds are now engaged in in the financial war against Argentina**
"…the coming forward of those nations that are best situated among the emerging nations to confront the current situation, means the reformulation of a new global order and Argentina will be, and is, present in it. "There are new actors who don't want to bash your head in, but rather want to cooperate with you to see if, together, we can get this huge car that is the world today, moving."	**President Cristina Fernández de Kirchner, 23 July 2014 Buenos Aires, Argentina speaking about the 16 July 2014 meeting of the BRICS heads-of-state with leaders of UNASUR, the Union of South American Nations**
"But, in a larger sense, we can not dedicate -- we can not consecrate -- we can not hallow -- this ground. The brave men, living and dead, who struggled here, have consecrated it, far above our poor power to add or detract. The world will little note, nor long remember what we say here, but it can never forget what they did here. It is for us the living, rather, to be dedicated here to the unfinished work which they who fought here have thus far so nobly advanced. It is rather for us to be here dedicated to the great task remaining before us -- that from these honored dead we take increased devotion to that cause for which they gave the last full measure of devotion -- that we here highly resolve that these dead shall not have died in vain -- that this nation, under God, shall have a new birth of freedom -- and that government of the people, by the people, for the people, shall not perish from the earth." […*not* *government of private finance, by private finance, for private finance – but that government of private finance, by private finance, for private finance shall absolutely perish from the earth*]	**President Abraham Lincoln19 November 1863 Gettysburg, Pennsylvania**
***Satire* VI, lines 347-8** **Decimus Iunius Iuvenalis (Juvenal)**	"Who will guard the guards?"
Matthew 21:12 **New International Version**	"Jesus entered the temple courts and drove out all who were buying and selling there. He overturned the tables of the money changers and the benches of those selling doves."

ANTONY

[*speaking of the havoc wrought on Australia by deregulation and the handing of Australia over to financial predators*]

O, pardon me, thou bleeding piece of earth,
That I am meek and gentle with these butchers!
Thou art the ruins of the noblest man
That ever livèd in the tide of times.

William Shakespeare *Julius Caesar* Act 3, Scene 1



Contents

Format of this submission

Responses are in boxes

Responses and comments are given in boxes like this one. Text which is not in a box like this one is a heading or a reference to the FSI interim report or a quote from the FSI interim report.

Warning

Australians did not opt to be part of a global speculative parasitical system – it was forced on them against their will

This response contains the elements of a root and branch review.

The economy needs to be run in a very different way so that Australia does not rely on foreigners for capital. What is capital, ultimately, but the power of the economy to produce? Current arrangements block the use even of existing productive potential with the skills available in the Australian workforce today. Why is China going to the moon but Australia is not? Why is Russia building out its empty regions but Australia is not? The answer is simply in the way those economies use money and credit to marshal their existing resources in an intelligent way. Australia's current arrangements give an overwhelming preference to speculation as the only way of deriving value. But, of course, speculation merely robs Peter to pay Paul.

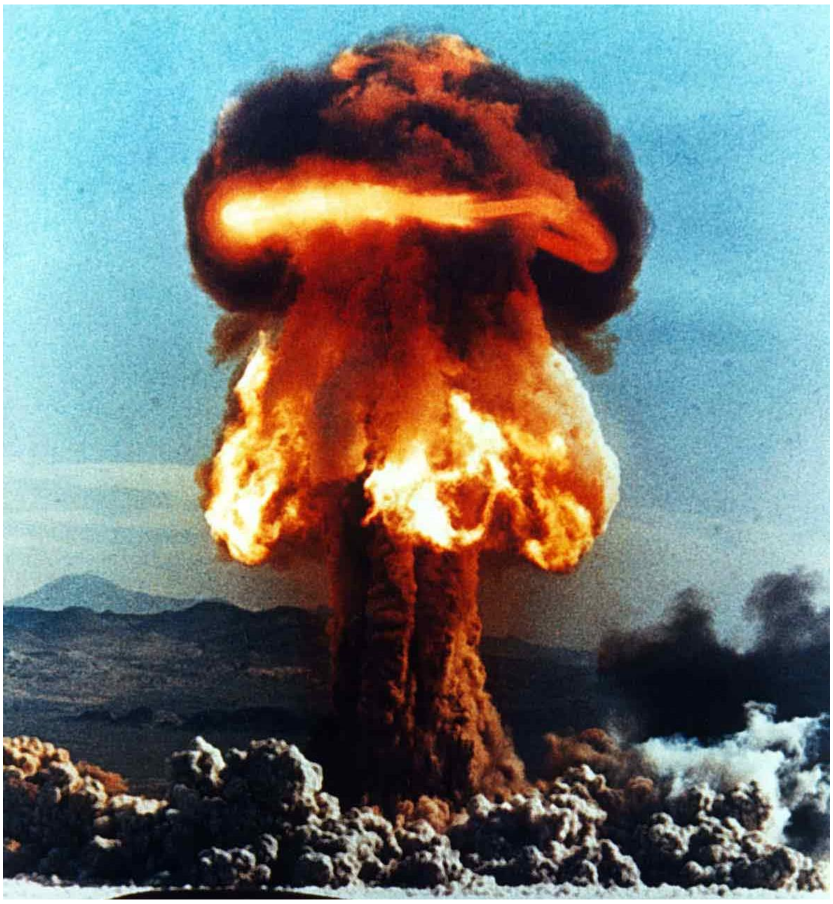
A root and branch review should be proposing some very different ways of running the economy. The financial system is at the heart of the way the economy runs. Why is the FSI proposing business as usual, with a few added extras like bail-in which anyway is only proposed in order to maintain the status quo for banks because otherwise their system might cease to function? If the argument for bail-in is that Australia is part of the global speculative parasitical (nominally, "financial") system, then the fact that we ought to be out of this system is all the clearer. A few obvious options are given in this response, and none of them are "experimental". By contrast, the concept of trying to maintain a strained system using bail-in and bail-out amount to extremely dangerous experiments which are bound to fail in their stated goals while causing immense suffering to ordinary people – which might be an unstated goal.

Foreword: what is at stake

As the Western-centred global financial system collapses, those who stand to lose control will not hesitate to flip over the chessboard rather than allow the dirigistic pro-human development model of the BRICS, and other Asian and allied nations, to forge ahead and set an example in every field of legitimate human endeavour including water, maglev, nuclear and space engineering, and more.

Those who stand to lose control will readily do their best to trigger nuclear holocaust which will destroy both East and West, and dramatically reduce the human population. Such efforts currently are live with provocations being engineered against Russia and China, as well as the engineered chaos in the Middle East to create a long war which makes survival difficult, and rules out for the foreseeable future the possibility of civilisation thriving in the Middle East and beyond. Do you really think ISIS and their Western backers will be content with sowing chaos in the Middle East?

Nominally ‘Western’ players are in war against West and East alike – their war is against humanity.



Conspiracy theory? Nup, it’s just the way Empires have always conducted themselves.

Therefore – ditch the current monetarist-oriented financial system in favour of a credit-driven policy of large scale development projects. When civilisation thrives, people including politicians don’t brook imperial genocidal endeavours. The FSI has an opportunity to create a lasting legacy for the future of Australia and to set an example for the world, by preparing a blueprint for a system that promotes financial stability and economic development, rather than speculation and parasitism.

Executive summary: responses and comments

Executive summary, interim report xxiii

Superannuation efficiency and policy settings

Principally as a result of Government policy, the superannuation system is large and growing rapidly. It is an important source of funding for long-term capital formation, which is important for national productivity growth.

Observation

> There is little evidence of strong fee-based competition in the superannuation sector, and operating costs and fees appear high by international standards. This indicates there is scope for greater efficiencies in the superannuation system.

Your observation is a red herring and is based on destructive premises

Your observation refers to private sector players taking advantage of Australians by charging excessive fees on monies that the government forces Australians and Australian businesses to set aside. However, you do not take notice of the fact that the private finance system as a whole takes advantage of compulsory superannuation by redirecting a large proportion of those monies into the stock market and other vehicles which benefit private financial interests. Equities are a default for a large proportion of Australians' compulsorily acquired monies. Where is the growth in equities expected to come from when the underlying physical economy and labour force are being ignored at best, and cannibalised for financial returns at worst? You can only cannibalise so far before you're eating your own legs.

Compulsory superannuation is acting as a kind of 'bail-in' for the private financial system. Worse than bailing in deposits, you are bailing in monies in advance by even before they have been earned as a kind of tax which is directed not to government but to private financial interests. Many wage earners become stock market speculators without even knowing it, if they do not pay attention to how their compulsorily acquired money is used.

The debates which were used to persuade Australians to accept compulsory superannuation refer to the need for compulsory superannuation to address Australia's infrastructure deficit. However, little or nothing is being done to address Australia's infrastructure deficit now. Essentially, compulsory superannuation was introduced based on lies. Australians and Australian business fulfilled their end of the bargain by coughing up a significant and growing proportion of their income in compulsory superannuation, but the reasons why that is done are forgotten. Essentially, private finance has got their hands on it, and now that's all that matters. The discussions and reasons given before the introduction of compulsory superannuation are conveniently forgotten.

Executive summary, interim report xxvii

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Increase the ability to impose losses on creditors of a financial institution in the event of its failure.
- Strengthen regulators' resolution powers for financial institutions, and invest more in pre-planning and pre-positioning for financial failure.
- Further increase capital requirements on the financial institutions considered to be systemically important domestically.
- Ring-fence critical bank functions, such as retail activities.

About 'no change to current arrangements': high cost, positively destructive, no benefit

To continue current arrangements is to maintain a destructive policy framework which will continue to have destructive effects.

Lack of significant investment in advanced infrastructure on scale, will continue. Significant investment infrastructure amounts to at least 10 per cent of GDP; the bulk of economic activity should be in building new basic economic infrastructure; the number one factor which reduces the cost of the activity of private enterprise is government built and supported basic economic infrastructure in: health, education, transport, power, water; 10 per cent of GDP is the absolute minimum; in a country like Australia in which infrastructure has been neglected for decades, 40-50 per cent of GDP should be spent on infrastructure.

The basic measure of economic development is the ability of the country to support people; undeveloped landmass amounts to unfulfilled economic potential; some land can naturally support people whereas other land – such as mountainous terrain – naturally supports fewer people; all land can be uplifted to support more people though to differing degrees; the more advanced the civil, mechanical, electrical and other engineering and scientific capabilities at the disposal of a people, the more the ability of land whatever its terrain can be enhanced to support people; thus, the basic measure of economic development is potential relative population density.

Australia is ranked 100th in population density at 3.06 people per square kilometre; by this basic economic measure, Australia is more backward than Angola, Algeria, Papua New Guinea, Somalia, Niger, Mali, Bolivia and Chad.

Note that by this measure Russia too is less than those countries, as Russia is ranked 97th and Russia recognises this as a major strategic weakness and an urgent problem to be addressed; Russia is planning a city in the North Pole[1] which will enhance its capability to populate the eastern region of the country; moreover Russia is in the process of building cities in the underpopulated eastern regions. Rather than following that lead, Australia follows the lead of linear dollars-and-cents monetary cost-benefit analyses and, naturally as a result, does nothing.

Australia has less of an excuse than Russia, because greening desert is a much more advanced area of engineering than greening snow and ice plains. Indeed, much of what today is the

[1] http://www.archdaily.com/186334/russia-plans-ice-city-in-arctic-circle/

United States of America was desert before human settlers transformed the continent. Why is Australia content to remain backward and how can we be satisfied with a financial system that institutionalises Australia's status as, by some measures, one of the most backward continents on earth?

Governments cutting back on services to citizens due to false and illusory budget constraints are another destructive effect of not changing current arrangements. In the USA life expectancy is declining, as it is in many Europe countries. Australia has adopted a similar model to those jurisdictions aside from some relatively minor differences such as 'twin peaks' in regulation. As a result, in policy, Australia is following those other Western jurisdictions into the abyss in lack of availability of health, education, housing, food and other necessaries to the population. Saying 'Yes we have problems but Australia is still a great place to live and I would rather than be here than anywhere else' simply says that your life purely on a personal level is comfortable, and casts aside any understanding of 80 per cent of the population and the direction in which 100 per cent of the population is moving, and it also casts aside any principled consideration of the concept of physical economy, and of the role of economy, government, the financial system, and credit.

Current definition of value excludes real value and thus is destroying Australia economically, politically and even militarily

The 'lack of economic viability' of major infrastructure investment means that this financial system has defined human development out of existence. The same goes for the space programme that Australia no longer has, and all of the maglev transport, nuclear power and water engineering projects that Australia is not engaging in. By presuming a need for return in financial terms, you effectively are saying that humankind may not develop. If this attitude was held over the last thousands of years, then the world's population will be miniscule and would be living largely like they lived back then. There would have been no ancient Greece, China, India or other ancient civilisation on whose shoulders we stand. There would have been no Florentine Renaissance, no steam power, no precision machining of steel, or any of the other critical points which allowed us to get to where we are today.

Since the 1960s, the Western world has not generated any fundamental technological achievement. Thus, for the last 50 years, we have been eating on the achievements of the past. This is directly related to the FSI because the FSI interim report is based on a linear monetarist conception economic value which does not recognise fundamental physical realities of economic progress and, indeed, advocates the minimisation of value to the economy generated by the progress that has been achieved today.

Again, this is not beyond the scope of the FSI. It is directly on point to the FSI's remit because the current financial system is institutionalising not only stasis but backwardisation because not even can current standards be maintained under the current model. The current financial system is destroying civilisation or, at least, the part of civilisation which it encompasses, namely, the Western world. This is why the FSI needs to start again, and take a completely new look at the current financial system.

If you do not want to consider what they are doing in China, Argentina and Russia to develop their physical economies, there is plenty of material by Western writers. For example, Richard Carey, Henry C. Carey and Friedrich List wrote prolifically on the stuff of which the American and

German 'industrial miracles' were born. There is no mystery or spontaneity in economic development. It is a product of deliberate policy and a financial system which supports and serves economic development is a critical component. Similarly, economic and financial destruction, and even financial chaos, are the product of deliberate policy.

Current economic thinking which is dominated by monetarism rather than science and physical economy is leading Australia to destruction. Why would you read Adam Smith and those who follow in Smith's footsteps? Adam Smith was tasked by Lord Shelburne of the East India Company to pen a tract which justified the Company's rapacious practices in the colonies. That is how 'On the wealth of nations' was written. The subtitle should have been '…and how to impoverish them'. By that time, the affairs of the East India Company and the government of Britain as a nation were intertwined and, in many ways, the East India Company and the British Empire were one and the same. The kind of writing typified by Adam Smith's is not about economics but about destruction. The 'current arrangements' of today's financial system are in line with that destructive agenda. The FSI is an opportunity to start again – it is a root and branch review, after all. Why would the FSI continue a destructive agenda unless the FSI were itself in agreement that destruction is appropriate? And if destruction is the intention, what can those with such intentions call themselves, and what business does such an intent have in advising the government of Australia or the government of any nation?

About: 'Increase the ability to impose losses on creditors of a financial institution in the event of its failure'

If by creditors you mean depositors, this has high cost and zero benefit. Depositors cannot 'bear losses without creating systemic risk' because depositors are the system. Your definition of financial system needs to be broadened to the people whom the financial system serves, or should serve. People deposit their money in banks under compulsion, because salaries and wages must go into a bank account. People should not be subject to the risk of their deposits being taken due to poor business decisions. Depositors should the first in line to be paid, and if the bank has nothing even to pay the first in line full, then the government should step in and pay the depositors even if the bank no longer continues to exist. Thus, this would not be a bank bailout but a government protecting its citizens which is one of the core purposes of government.

If by creditors you mean counterparties in speculative transactions such as derivatives contracts, then such creditors should be put at the end of the queue in a bank failure.

In the event of bank failure, and immediately even before any bank failure, banks activities should be separated along Glass-Steagall lines.

About: 'Strengthen regulators' resolution powers for financial institutions, and invest more in pre-planning and pre-positioning for financial failure'

If this implies the ability to implement bail-in, then this has huge costs and no benefits as far as the ultimate purposes of banking, credit and finance are concerned.

It is not a regulator's role to be making decisions about how to resolve a failed institution, nor even to provide advice on such to government. A regulator whose primary aim is to 'save' a bankrupt institution may provide advice which is at odds with wider social imperatives and the interests of the real economy. Institutions should not be saved at all costs, but the interests of the wider community which are tied to that institution – in particular, depositors – do need to be protected. This is a political question which a regulator with a specific mandate is not qualified to advise on. Depositors are citizens and nearly all voting citizens are depositors. Bail-in cannot be permitted without a specific legislative mandate which is supported by the voting public. For a regulator to be able to make a decision 'on the fly' to do this or that, whatever it may be, supposedly in the interests of 'financial stability' or the 'financial system', is at odds with any principle of sound government.

It is at odds with sound government and legitimate government for unelected officials in collaboration with the BIS and other international bodies and fora to make plans for bail-in in advance. Many of these plans were made without significant publicity. It might be too much to say that bail-in plans have been made in secret because evidence of the plans appear on the public internet, but there has hardly been a public debate. There has hardly been any statement in election campaigns about bail-in in Australia. Neither Liberal nor Labor in the most recent Federal Election discussed bail-in. Yet it is a matter of crucial importance for every citizen.

Providing strong resolution powers to bodies other than the legislative bodies causes extreme decisions to be made in the heat of a crisis. Decisions which are not right in principle, in that they are not good for the real economy and they set dangerous precedents for the interests of the real economy, can be pushed through without adequate thought.

Rather than strengthening powers of resolution, why not ensure that the government uses its existing power to create credit? **Such credit is not 'monopoly money' because the productive work done, the skilled generated and finally infrastructure assets produced back the credit, and raise the productive powers of labour and of the economy far in excess of the initial dollars issued to pay it back. Nor is the credit issued inflationary when it is used to increase the productive power of the economy in this way. Such public credit can be directed into public infrastructure works to ensure a growing economy. Arguably, we have trillions of dollars in monopoly money floating in the markets today because those dollars do not have any physically productive purpose or intent, and moreover because the monopoly money circulated by the private banking system largely or primarily aims at speculation rather than raising the productive power of the economy it is highly inflationary.**[2] This will reduce the risk of bank failures because the economy with its physical production powers improving will be put into a healthy underlying state and, in any case, if the economy is growing and if depositors are protected (see other material in this response), then the impact of the occasional bank failure will be minimal.

Separating risky investment banking from traditional commercial banking will reduce the risk of failure. Again, collapses of investment banks would have minimal impact on the real economy. Collapses of commercial banks would be few and far between, and depositors would be made good by such collapses by a government guarantee.

The role of regulators in dealing with collapses should be relatively straightforward because the actions would be planned in advance. Collapse of an investment bank would like any other

[2] The passage in bold is repeated several times in this response because it is so important.

bankruptcy. Collapse of a commercial bank would invoke government guarantee of every cent of depositor funds. There would be little for regulators to do.

A strong legislative framework would remove the need for regulators to have strong resolution powers or, at least, there would be no need for resolution powers to be any stronger than they are now. The regulator role would be to implement and administer the law, rather than exercise broad discretionary power.

About: 'Further increase capital requirements on the financial institutions considered to be systemically important domestically'

The current system mixes together both beneficient and essential banking functions on the one hand with destructive and predatory financial practices on the other. Therefore, the current system cannot be considered as a unitary whole. Thus, the concept of 'systemically important' is a cynical sleight of hand because it presumes that everything that currently is done within the current financial system is worth continuing and worthy of protection.

You need to re-think what 'the system' is. Since Glass-Steagall removed the distinction between a hedge fund and a retail bank, the system equally comprises predatory and destructive vulture capital alongside savings and deposit-taking, and commercial lending. This kind of system is not worth saving. Therefore, protecting institutions which are 'systemically important' in the literal sense of the current system should not be a priority.

Rather, you need to consider which parts of the system are important. Then measures need to be introduced to protect what is important to the beneficient parts of the current system. To introduce an open slather 'systemically important' category across the entire system fails to take into account that much of the current system is, effectively, illegitimate and so ought not to be protected.

The act of dividing the current system into beneficient versus destructive might in some cases splitting existing institutions, because many of today's Australian financial institutions have both savings, deposit and commercial lending on the one hand and, simultaneously, the same institution runs predatory and socially destructive activities. The recent Commonwealth Bank financial advice scandal is a case in point. The predatory 'financial advice' should never have been conducted by the same institution as that which conducts savings, deposits and commercial lending. Predatory 'financial advice' should only be given by independent companies which clearly do not have the integrity or protections of savings, deposits and commercial lending. Similarly with institutions which conduct derivatives, stock market and foreign exchange speculation. Such activities should not be conducted by the same institutions as both which conduct savings, deposits and commercial lending.

About: ‘Ring-fence critical bank functions, such as retail activities’

Again, the idea of the ‘ring fence’ assumes from the outset that beneficient and essential functions such as savings, deposits and commercial lending may and shall continue to take place within the same system as predatory and destructive activities such as hedge fund operations, and derivatives, forex , commodities and stock market speculation. These two categories of activities do not need merely to be ring fenced but completely separated into separate systems.

You have only raised the inadequate concept of ‘ring fence’, and have done even that in a non-serious way, but have failed to consider the higher principles involved in the Glass-Steagall separation. This has been done in the interim report even though it is well known that the Vickers Report which introduced the ‘ring fence’ concept has been thoroughly criticised as being inadequate.

Chapter 1: responses and comments

1-21, interim report pdf page 67

This paragraph:

> Evidence suggests there is no case to make significant changes to Australia's regulatory framework.

lacks logical foundation and adopting it is dangerous.

About: 'Evidence suggests there is no case to make significant changes'

A systemic collapse needs to happen once only to wreak havoc. Bail-in would not solve the problem but would impose losses on ordinary people who never wanted to be part of an unproductive parasitical speculative global financial system, and the system would remain essentially unproductive, parasitical and speculative.

The fact that the GFC has not hit Australia yet implies nothing about whether or not it will happen in the future. On the contrary, if a principles-based analysis concludes that all the indicators for a collapse exist, then the fact that it has not happened yet is evidence that when the collapse comes it will be all the worse. The report repeatedly insists some entity failures are inevitable and not all can be prevented. Here, I refer to systemic collapse. That is on the collapse criterion. What about benefit criteria? See the next box.

Evidence demonstrates that major change in the financial architecture is needed

What about criteria on what benefits the financial system is not delivering or assisting or promoting? The financial system is an instrument of great power which can deliver enormous benefits in national-building, science, engineering and social outcomes. Sure, benefits have been delivered, but a certain amount of benefit will be delivered simply due to the power of the financial tools we are considering, regardless of how poorly or self-interestedly those tools are being wielded.

So – what about all of the benefits that are not being delivered? Consider:

1. Affordability of healthcare, education, housing and food all are in decline for eighty per cent of the population.
2. Government is cutting back on essential functions based on the perception of a need to reduce government debt and balance its budget.
3. Major infrastructure projects in magnetic levitation rail, high-speed shipping and power generation are not being undertaken.
4. Major government initiatives in aerospace and robotic manufacturing are not being undertaken.
5. Australia is shutting down manufacturing plants including machine tool manufacturers.

These processes which are well underway and have been for decades demonstrate that the current financial system is not working. Major change is needed. It is the role of the financial system to facilitate, support and – indeed – promote the reverse of the above five destructive processes. The fact that those processes are underway is evidence of the failure of the current financial system, and is evidence that major change is needed.

Evidence includes what is absent as well as what is observable. As soon as one considers that which could have been, but which is not, then one begins to observe positive evidence of what is absent in the form of the destructive processes that are underway to cause more absence of what is beneficient.

The five destructive processes listed above all can readily be reversed with the national banking and public credit approach to banking. **Such credit is not 'monopoly money' because the productive work done, the skilled generated and finally infrastructure assets produced back the credit, and raise the productive powers of labour and of the economy far in excess of the initial dollars issued to pay it back. Nor is the credit issued inflationary when it is used to increase the productive power of the economy in this way. Such public credit can be directed into public infrastructure works to ensure a growing economy. Arguably, we have trillions of dollars in monopoly money floating in the markets today because those dollars do not have any physically productive purpose or intent, and moreover because the monopoly money circulated by the private banking system largely or primarily aims at speculation rather than raising the productive power of the economy it is highly inflationary.**[3] These would amount to major change in the current financial system. However, such changes would not be radical or extremist. Rather, the evidently and demonstrably destructive financial system that exists today is radical and extremist.

1-23, Productivity

What is productivity?

The interim report has not mentioned the most powerful driver of productivity: large scale infrastructure public works. This ensures that the interim report lacks credibility on the question of productivity. You may say that you are relying on the Productivity Commission (PC), but the PC also lacks credibility because despite its name it clearly does not have any interest in productivity because it does not consider or make recommendations on the most obvious drivers of productivity:

1. Hydrological civil engineering, such as the Snowy Mountains Scheme, Tennessee Valley Authority, Three Gorges Dam, the planned Brahmaputra River Redirection, and the NAWAPA XXI project
2. Space exploration and engineering: the Apollo lunar landing project delivered the last net gain to the US economy since WW2, returning at least $8 for every $1 spend
3. Power plant construction, particularly nuclear fission power plants with passive safety mechanisms
4. Fusion research: yet funding has been being cut for the last 30 years with the positive intent to prevent fusion power from ever coming online
5. Nuclear research which crosses many fields
6. High-speed land-based transport infrastructure such as maglev rail including vacuum tube technology

[3] The passage in bold is repeated several times in this response because it is so important.

It is not enough for the FSI to say that it must rely on the expertise of the PC. The gap in ignoring the importance of large scale infrastructure public works in driving productivity is so evident that the FSI is entirely justified in going beyond the limited output of the PC.

By ignoring these drivers of productivity and growth, and the natural financing mechanisms, the FSI has entered the domain of those who are positively and consciously inhibiting human advancement and development. It is not a big step, or a long bow, to therefore place the FSI and its intent into the domain of those who wish to reduce the human population – also known as genocide – because by enforcing and perpetuating a private financial system which constrains the availability of finance and resources for human purposes, the inevitable result will be the backwardisation of civilisation, and population reduction. I am sure that the FSI does not consciously wish to enter such a hall of infamy but the present path inevitably provides such admission.

The purpose of finance being salutary human development is not new and date to the earliest days of anything resembling modern finance. The FSI needs to read the Report to Congress of 1791 *On the subject of manufactures* because it explains the necessary role of credit in developing infrastructure, industry, manufacturing and science. In some ways, that paper is the seminal work on the purpose and role of finance and credit in a modern economy. Today, the power of credit is being misused to grind infrastructure projects, industry, manufacturing and scientific efforts out of existence. Any root and branch review of the Australian financial system would attempt to restore the role of credit in promoting infrastructure, industry, manufacturing and science. The FSI interim report, however, shows the FSI intent to maintain and perhaps even intensify the misuse of the financial system to destroy rather than to create.

The obsession with debates on cost versus benefit using linear measures of progress denominated in dollars and cents indicates a refusal to understand the non-linear nature of economic development and human progress in general. Certain kinds of investment produce exponential growth because they change the foundation and fundamentals of how the economy works. A significant investment in horse-drawn transportation ultimately reaps a negligible benefit compared with the same investment in developing the internal combustion engine. Similarly, an investment in solar power will produce a negligible benefit compared with the same investment in nuclear power. Chinese investment in fusion research and mining Helium-3 as fusion fuel from the moon will generate returns which exceed anything Australia’s mining companies could generate by the same investment in their Australian mining efforts. Tradition cost-benefit analysis cannot take into account the larger context nor the broader dynamic.

1-24: Retirement incomes and ageing, 4-4: Demographic challenges, 4-10: Longevity risk

To your thinking, people living longer is a disaster – do you want concentration camps?

Government cuts in healthcare and social services are going to reduce life expectancy. On the one hand, you are implementing measures to take from the population on the basis of assumed increasing life expectancy – measures such as increasing the retirement age, making the government pension harder to get, and increasing compulsory superannuation. On the other hand, you are reducing or eliminating the social services, healthcare services and life opportunities which might have caused increased life expectancy but which now will not.

You might say that this is beyond the scope of the FSI but it is not. The FSI takes constrained government budgets as a platform assumption on which much of the other thinking is based. The FSI takes compulsory superannuation and the need to fund an ageing population as a given. Increased life expectancy is interwoven with arguments for compulsory superannuation and the supposed costs of an ageing population.

Nowhere does the FSI refer to the fact that the focus on balancing government budgets will actually reduce life expectancy, unless the obsession with balancing budgets is accompanied by the introduction of other measures such as public credit to generate real secular growth in the physical economy and the productive power of the labour force with leaps forward in infrastructure. When life expectancy is reduced, will the retirement age concomitantly be reduced? When life expectancy is reduced, will there be a concomitant reduction in the amount of income compulsorily redirected to private financial interests as superannuation?

Chapter 2: responses and comments

Infrastructure financing 2-72

Submissions do not raise significant financial system issues that directly relate to infrastructure financing. Where issues are raised, these relate more to issues covered elsewhere in this report, such as the development of the corporate bond market. The major issues submissions raise relate to infrastructure project selection and design, and the implications for the pipeline of greenfield projects. This is consistent with the Productivity Commission's recent draft Public Infrastructure report. The Commission found:

> *There is no shortage of private sector capital that could potentially be deployed to finance public infrastructure in Australia. Private capital markets will finance most projects at the 'right price'.69*

The upshot is that infrastructure is not going ahead – so in effect there is a shortage of capital

If private capital markets will only finance at the 'right price' and as a result infrastructure projects are not going ahead, then there is a shortage of capital for infrastructure finance which is caused by the demands of private finance.

'Potentially deployable' private sector capital is not very helpful at all.

Infrastructure projects are not going ahead in any significant degree. Private finance is not up to the task, whatever the reasons those who control private sector capital might give.

It is necessary to move to a public credit and national banking model which is explained elsewhere in this response. **Such credit is not 'monopoly money' because the productive work done, the skilled generated and finally infrastructure assets produced back the credit, and raise the productive powers of labour and of the economy far in excess of the initial dollars issued to pay it back. Nor is the credit issued inflationary when it is used to increase the productive power of the economy in this way. Such public credit can be directed into public infrastructure works to ensure a growing economy. Arguably, we have trillions of dollars in monopoly money floating in the markets today because those dollars do not have any physically productive purpose or intent, and moreover because the monopoly money circulated by the private banking system largely or primarily aims at speculation rather than raising the productive power of the economy it is highly inflationary.**[4] Large public works projects return enormous dividends over the long term, meaning 30-50 years, or two to three generations, by changing the platform on which the economy operates. Measuring the return of infrastructure in the terms that private finance uses is inappropriate and ignores what public infrastructure works achieve.

Private finance model for infrastructure is not working – need to move to national banking

The Commonwealth Bank Act 1911 (Cth) provides a model for an institution which can finance public infrastructure works without the constraints imposed by private capital sources.

[4] The passage in bold is repeated several times in this response because it is so important.

With a national bank, the government issues credit to itself, and so the problem of government debt is done away with. There is no reason why private finance should have a monopoly on the issuance of credit, particularly to government. On the contrary, the government has the final say in matters of credit as established by the Royal Commission on Monetary and Banking Systems 1936. Even though that was before the current reserve bank was established, the question is a constitutional question and the Reserve Bank Act does not change the constitution.

Submissions note a shortage of profitable infrastructure projects to invest in. Industry Super Australia states:

> *Industry SuperFunds have already made clear that they would make infrastructure investment of up to $15 billion over the next five years if appropriate projects were made available. Reform of the bid process could well see them accelerate or even increase that projected level of investment.70*

A number of submissions suggest that funding for infrastructure has become more expensive since the GFC. Interest rate spreads on infrastructure projects have increased, including in Australia, Canada, the United Kingdom and the United States.71 However, this mainly reflects the general re-pricing of risk.

Private finance model for infrastructure is not working – need to move to national banking

Effectively this means that part of the income of all Australians is being compulsorily seized and turned into a weapon of predatory financial practices. If Super funds could find investments in illegitimate, and perhaps destructive, activities which returned high profits then they would engage in them. Compulsory superannuation has turned into an extension of standard private sector financial practices which neglect the physical economy.

Where do you expect investment opportunities to come from when there is no investment in the physical economy? When there is no upliftment of the overall physical economic infrastructure of this country, how do you expect anything except parasitical activities to provide significant returns? But parasitical activities feed off the host, by definition, so the process destroys the very nation which belongs to the people from whom a proportion of income is being seized into superannuation.

This might leave offshore investments. But offshore investments may be parasitical too. If they are not, then what beneficial economic activity is happening offshore that you can invest in and earn a decent return from, which could not happen in Australia?

By failing to turn your mind to how to grow the pie, you are continuing trying to take a piece of a shrinking pie from someone else. Economics is not a zero-sum game.

When we go back to early days of rail in Australia, the private sector wanted to run horses and carriages on tracks because the return from investing in steam trains to run on those tracks was not attractive. If it was up to the notions of private financial returns, then we would still be using horse and carriage, and there would be no Sydney Harbour Bridge.

Essentially this means that private finance is not qualified to be entrusted with the compulsorily acquired and forced savings of Australian workers. It would be better to have private finance playing a subsidiary role within a government-directed or dirigistic model which operates for the national benefit.

The proposal for national banking and public credit is an obvious one. The FSI's mandate covers the overall approach to finance, not just private finance. You do not have a mandate to consider only private finance. All modes of finance must be considered for the FSI to be credible and for you to fulfil your mandate.

By considering only private finance and its modalities, you are demonstrating that you are acting as a rubber stamp for the system of deregulation and pure private finance, which is worse than failed as it is demonstrably destructive.

You indicated your premises upfront: 'Evidence suggests there is no case to make significant changes'.

FSI is promoting an extremist ideology of private finance which is anti-human and anti-nation

Private finance has shown that it is not up to the task of nation building. Private finance has shown that its own parameters actually are at odds with the very concept of nation building.

The FSI quoted this passage from the Productivity Commission (PC):

> There is no shortage of private sector capital that could potentially be deployed to finance public infrastructure in Australia. Private capital markets will finance most projects at the 'right price'.

without critical comment and is passively accepted by the FSI.

Yet the passage shows that if hospitals, schools and even human beings themselves do not return the right price then we can do without them. This is not drawing a long bow but is the direct implication of what you are saying.

How can we fail to build power plants, water infrastructure and transport infrastructure if opportunities are not available at the right price? A human reader, or a reader who thinks in terms of the basic needs of human beings, cannot fail to be aghast at how boldly the FSI proclaims an anti-human policy.

If you refuse to invest in infrastructure because projects which return appropriate returns are not available, and if you say that therefore we should not undertake infrastructure projects, then you are saying that the basic needs of human society can justifiably be ignored. It is not many short steps for you to also say that even infrastructure maintenance is unnecessary if the cost of a few train derailments – for example – does not exceed the cost of preventing them.

You are espousing a policy of population reduction and national devolution to a lower or inferior condition. A government commissioned report is no place to promote such ideas.

The same thinking was found in those English courts which declared that the captain of a slaver ship was justified in throwing his human cargo overboard when otherwise investors would have incurred the cost of losing the ship to seizure by anti-slave police. Reducing all economic and social considerations to dollars and cents leads to practices which are barbaric. A government commissioned report is no place to promote such ideas.

Investments in infrastructure are viewed by some as being illiquid. Infrastructure investment could be facilitated by developing liquid, tradable claims on infrastructure projects. This could provide greater scope for retail and institutional investors, including superannuation funds, to invest in infrastructure.

Infrastructure projects and liquidity

Why is the private financial system obsessed with converting infrastructure into liquidity? This demonstrates a lack of commitment to the concept of nation-building which is a long-term undertaking in which the physical power of the nation is uplifted, and the capabilities of the people and economy of the nation are developed. These are much more valuable than liquidity and, indeed, liquidity is only ever a means to physical ends. The fact that the private financial system is hooked on liquidity shows that it is not qualified to take on the role of financing infrastructure and national banking is needed. The government has the power to establish a national bank and issue its own credit, as opposed to borrowing from private bankers, for the purpose of infrastructure project. Indeed, the power to create credit is too important to be the exclusive domain of private bankers given their demonstrated lack of concern for national development and social good.

The Inquiry seeks further information on the following area:

> What are the impediments to the development of liquid, tradeable claims on infrastructure projects?

Infrastructure projects need not come with liquid, tradeable claims

A national bank with public credit would do fine in financing infrastructure. Private finance is not interested in financing public works infrastructure projects on any reasonable or realistic terms.

Why would we want to spend time analysing 'the impediments to the development of liquid, tradeable claims on infrastructure projects'? Why would we want to reduce such impediments? Who could possibly want to turn infrastructure projects into a target for speculation? Only financial parasites who prey off of the stuff of human life and national development would want to do that. Such pursuits are not legitimate activities in the financial system of any civilisation, but are the obsession of marauders who are trying to sack civilisation, and permit minimum infrastructural and national development only to the extent that they can carve off a slice by adding another private tax on citizens for the use of infrastructure.

Infrastructure is not developed by money – it is developed by scientists, engineers and workers. Why should those who merely sign cheques, shake hands, make phonecalls and play with spreadsheets control who benefits from infrastructure? Private finance does not do science, engineering or physical work.

We need more impediments against the development of liquid, tradeable claims on infrastructure projects. Infrastructure projects ought to be financed by national banking and public credit alone. **Such credit is not 'monopoly money' because the productive work done, the skilled generated and finally infrastructure assets produced back the credit, and raise the productive powers of labour and of the economy far in excess of the initial dollars issued to pay it back. Nor is the credit issued inflationary when it is used to increase the productive power of the economy in this way. Such public credit can be directed into public infrastructure works to ensure a growing economy. Arguably, we have trillions of dollars in monopoly money floating in the markets today because those dollars do not have any physically productive purpose or intent, and moreover because the monopoly money circulated by the private banking system largely or primarily aims at speculation rather than raising the productive power of the economy it is highly inflationary.**[5]

Anyone who thinks below the day-to-day conventions of buying and selling knows that money is merely a way of organising who spends their time on what. So why not organise it in a way that the majority of the workforce spends their time on useful long-term development projects, rather than short-term cash chasing? Of course, if you are obsessed with liquidity, then by definition you are a short-term cash chaser. If you understand that the foundation of economics is science driver and infrastructure projects, then you will realise that money and credit merely are putty to be used by intelligent policymakers to promote upward evolution in science and human power over nature. This means that, in the context of today's scientific understanding, we ought to be embracing nuclear science, space science, maglev land-based transport systems, vast hydrological schemes and such like.

The projects and the initiatives are ready to go. The private financial system and its intention to suck and destroy are holding humanity back. The refusal of government to commandeer its constitutional and/or sovereign power to create credit for national benefit are holding us back. A root and branch review would recognise this and, rather than perpetuating the 'current arrangements' as the interim report suggests the FSI is bent on doing, rather the FSI would be promoting radical change towards a government-drive credit system that promotes national development.

You want to be remembered in a thousand years for doing something good with your life? This is your chance.

You want to be remembered, or preferably forgotten, for being a destroyer or, at best, a waste of space? This is your chance for that too.

[5] The passage in bold is repeated several times in this response because it is so important.

2-75 Government

In broad terms, governments' main source of funds is tax revenue, and governments use funds to provide services, make transfer payments and fund gross fixed capital formation. For the Australian Government, spending on social security and welfare comprises over one-third of total expenditure.73 Spending on health, defence and education together accounts for close to another third.74 Fixed capital investment is another significant component of Government expenditure.

Governments account for shortfalls in revenue over expenditure by issuing debt. Net issuance of Commonwealth Government Securities (CGS) increased sharply after 2007–08 as the budget moved into deficit with the onset of the GFC.75 The stock of CGS on issue is expected to increase to $360 billion by the end of 2014–15, which would be equivalent to 0.2 years of GDP.76

'Revenue' is not the only way of getting things done, you know

The government's main source of funds should be national banking credit. All it would take is for the government to say the word, and the government would have a supply of credit for national infrastructure projects which would only be limited by the ability of the people of Australia to undertake those projects. Essentially, the limitation is not in credit but in the cultural, engineering and scientific capabilities of the population to bring concepts of the future to fruition. This includes all manner of transport, power, water, manufacturing and space projects, as well as projects in any other field of endeavour.

The FSI does not mention this critical source of credit. Why? It would not be an experiment but has been done before and with great success. This is precisely how Australia was able to rapidly industrialise, and join the Allies to defend herself in WW2. The Commonwealth Bank acting as a national bank purchased approximately 80 million pounds per year of Treasury Bills from the Commonwealth government. This was the equivalent of the Commonwealth government's entire annual expenditure in the years shortly before Australia became involved in WW2 which was in 1942. Moreover, due to careful controls, there was almost no wartime inflation. What worked in war could work even better in peace for civil projects, and the Commonwealth Bank Act 1945 made the wartime powers of the federal government and Commonwealth Bank permanent. However, this was blocked by private banking interests and their superiors who did not want, and still do not want, Australia to be sovereign or to develop.

A nation has the ability to issue credit backed by itself. Contrast this with the issue of credit by institutions engaged in risky derivatives transactions and lending heavily into property bubbles. Even compared with traditional commercial and savings banks, the faith and credit of a nation exceeds that of any bank. A national government's credit creation power is exercised either by the legislature directly or by an instrumentality such as a national bank.

The FSI has not mentioned the critical role of national banking, but the issue must be addressed and national banking must be proposed, for any financial system inquiry in any context to be complete and credible.

2-76 Role of government in the financial system

The CGS market plays a very important role in Australia's financial system. The CGS market is highly liquid. It provides a risk-free interest rate curve that other debt instruments can be priced from. The Australian Office of Financial Management recently extended the length of the CGS yield curves to 20 years, which provides a benchmark for longer-dated debt securities.

Around 70 per cent of CGS on issue is held by non-residents.77 Investor confidence in the Australian sovereign debt market reflects the relative strength of Australia's public finances and the Australian economy more broadly.

CGS (and state government debt securities) represent a major source of high-quality liquid assets (HQLAs) for the financial system. HQLAs are unencumbered assets that can be readily converted to cash with little or no loss in value, even in stressed market conditions. To manage liquidity requirements, financial institutions (particularly banks) require holdings of assets that can be converted to cash, sometimes at short notice. Financial entities active in derivatives markets also require HQLAs to use as collateral in derivatives transactions.78

You have it backwards – it is not the role the CGS plays for the financial system that matters but the role that the financial system plays for the CGS

Why do Australian CGS exist? Not to provide investment opportunities to financial interests. It is to finance large scale capital works. The fact that investment opportunities are provided is the quid pro quo, but not the original reason for the existence of the CGS. A government issues debt for the functions of government, not so that privateers can profit from the government though that might be a consequence. Or is it? The way the FSI interim report puts it, one would think that the cart is pulling the horse along. The proof seems to be in the pudding – large scale capital works in this country in the last three decades are extremely rare, if they exist at all. So how is the economic capacity of Australia to increase? One does not issue debt just for operations, but for capital works. Operations are funded from revenue, and debt is used for capital investment. But where is the capital investment? It does not exist. The only conclusion can be that the CGS system is purely to give private interests, yes some of those are indeed Australia financial interests, a stake in Australia.

The Commonwealth government is a sovereign government not a trading desk

It is quite unbelievable that you mention that 70 per cent of CGS are held by foreigners without batting an eyelid. Why do we need to enter these kinds of long term agreements with foreigners? I am not expressing 'extreme right-wing xenophobia'. These kinds of agreements give external players a stake in Australia's future, which may not be a bad thing, but frequently these debt holdings are used by Australian governments as an excuse – nay, not an excuse, a reason – to cut this or that, to not do this or that, or to introduce this is that austerity measure, tax, etc. Yet the commitments for foreigners are entirely unnecessary and provide no benefit at all. Why is this so?

Australia's skilled labour, ability to manufacture, ability to engage in public workers, and so on is not increased or decreased by entering into contractual agreements with foreigners. Why? Because Australia physical economic power is what is within Australia's borders. Sure, we can buy advanced machinery from abroad to increase our productive capacity, but we are barely doing that even with these major financial commitments abroad.

Being part of some club

Essentially, commitments are being made to foreigners just so that we can feel a part of the club which is the global financial system. Unfortunately, that system is in pretty bad shape, which is why the BRICS nations are opting out of it. The global financial system is largely the trans-Atlantic situation which a few other nations included such as Japan, Australia, Singapore and a handful of others.

At least half of humanity is not benefiting from this system, which is why the BRICS countries are opting out of it. In fact, the BRICS countries have been excluded from it. And why would they want to be included? Where is the actual physical economic development taking place in Australia, Western Europe, Britain, the USA and Canada? When is the last time a major dam was opened? A civilisation-stretching space project completed which captured the world's attention? Where are the maglev rail systems? Where are the new generation clean and safe nuclear power plants which already can be built but are not being built? Where are the manufacturing plants? So – nor are Australia, Western Europe, Britain, the USA and Canada benefiting very much in a physical economic sense from the current system either. Even in the limited measure of dollars and cents, only austerity and bail-in are offered.

Given the reality, it is surprising that the FSI interim report barely suggests any change at all. Rather, the FSI interim report is actively seeking and constructing reasons to do nothing.

The Commonwealth government has sovereign credit-creating power, it is not merely a trading desk

It is quite unbelievable that you mention that 70 per cent of CGS are held by foreigners without batting an eyelid. Why do we need to enter these kinds of long term agreements with foreigners? I am not expressing 'extreme right-wing xenophobia'. These kinds of agreements give external players a stake in Australia's future, which may not be a bad thing, but frequently these debt holdings are used by Australian governments as an excuse – nay, not an excuse, a reason – to cut this or that, to not do this or that, or to introduce this is that austerity measure, tax, etc. Yet the commitments for foreigners are entirely unnecessary and provide no benefit at all. Why is this so?

Australia's skilled labour, ability to manufacture, ability to engage in public workers, and so on is not increased or decreased by entering into contractual agreements with foreigners. Why? Because Australia physical economic power is what is within Australia's borders. Sure, we can buy advanced machinery from abroad to increase our productive capacity, but we are barely doing that even with these major financial commitments abroad.

Essentially, commitments are being made to foreigners just so that we can feel a part of the global financial system.

An Australian government bank can issue credit directly to the government, credit that is created for the purpose of physical infrastructure. The physical economic assets that are thus created then provide the backing for the credit issued.

The 1936 Royal Commission on Banking confirmed that the Commonwealth government is the highest power with regard to finance and credit, and there is no limit to what the Commonwealth government can do in the Australian context.

It is not credible that the FSI panel is not aware of these powers. Therefore, the fact that the FSI is harping on about yield curves shows an intention to obfuscate, and to continue the agenda of not advancing Australia with economic development. On the contrary, the FSI thinks it is a great thing that Australian is beholden to foreign financial interests.

A root and branch review would change the current arrangements so that the Australian government issues credit to itself with which to undertake economic development projects.

Government must be the primary force in banking not only in banking regulation and supervision

If there are five things we have learned from the last hundred years, they are that:

1. Government must be the primary and dominant force in banking, including in the issuance of credit for industrial, public works and scientific enterprises.
2. Private finance is utterly incapable of running a financial system.
3. When government abrogates its responsibility to be the primary force in credit and finance, the system quickly metamorphoses under the guiding hand of private financial interests into a weapon squarely aimed at destroying nations.
4. When government abrogates its responsibility to be the primary force in credit and finance, the system tends towards its own bankruptcy and destruction, and threatens to bring humanity down with it.
5. Thirty years of private finance running the show has sown more than enough destruction for a root and branch review to sit up, take notice and recommend a revolutionary change towards government issued and directed credit, and Glass-Steagall.

An Australian government bank can issue credit directly to the government, credit that is created for the purpose of physical infrastructure. The physical economic assets that are thus created then provide the backing for the credit issued.

The 1936 Royal Commission on Banking confirmed that the Commonwealth government is the highest power with regard to finance and credit, and there is no limit to what the federal government can do with respect to credit in the Australian context.

It is not credible that the FSI panel is not aware of these powers. Therefore, the fact that the FSI is harping on about yield curves shows an intention to obfuscate, and to continue the agenda of not advancing Australia with economic development. On the contrary, the FSI thinks it is a great thing that Australian is beholden to foreign financial interests.

A root and branch review would change propose new arrangements so that the Australian government can use its own credit-issuing power to undertake economic development projects.

2-81

The Inquiry seeks further information on the following areas:

• What effect is the implementation of the Basel III capital and liquidity regimes in Australia expected to have on the cost of funds, loan pricing and the ability of banks to finance new (long-term) loans? How large are these effects expected to be?

The question presumes FSI results indicating your findings are determined in advance

By asking this question, you are presuming that the existing system will largely remain in place. This means that the FSI has abrogated its responsibility to conduct a root and branch review. The effect of Basel III capital and liquidity regimes in Australia on cost of funds, loan pricing and the ability of banks to finance new (long-term) loans presumes that existing money and debt arrangements under the auspices of the global financial system of private banks will remain in place.

Clearly only private financial firms, including private banks, which currently are, in effect, the establishment of the global financial can estimate how large the effects will be. Your question clearly is directed at those organisations. If the effect is greater than desired, then you might delay implementation or reduce the stringency of those regimes. If not, then you will argue that implementation of Basel III can continue at about it current pace.

But what if the current model of private financial organisations having a monopoly on finance and decisions to lend is redundant and bankrupt? You are failing to even consider that.

• What share of funding for ADIs is expected to come from larger superannuation funds over the next two decades? What effect might this have on bank funding composition and costs? What effect will this have on the ability of ADIs to write long-term loans?

Superannuation funds have become just another plain vanilla funding source: bail-in

You are saying that superannuation funds are expected to provide a source of funding and liquidity for the financial system. In effect, you expect that superannuation funds provide an injection of new capital, forced out of workers' wages and employers' payroll, into the financial system. Moreover, you are leaving the decision of the extent to which this occurs on the private players in the financial system including ADIs themselves as well as the private custodians of superannuation funds. Superannuation funds have become a plaything of the private financial system. This question

National banking in which the government has the power to issue long-term credit for projects and initiatives of long-term national benefit could be the main source of bank funding composition. Why have you not considered this?

National banking in which the government has the power to issue long-term credit for projects and initiatives of long-term national benefit could be the main determinant of the extent to which ADIs can write long-term loans. Why have you not considered this?

Rather than considering legitimate and more powerful options, you are content to accept a forcibly acquired portion of wages and payrolls as a legitimate new component of ADIs' funding sources, and you are content to accept it without even justifying yourselves.

FSI, why are you being so passive about the possibilities?

You have the ability to define new kinds of credit into existence, through countless national projects can be undertaken. We could even undertake a new space programme like the Chinese, Indians and Russians are doing, and like the Americans did before NASA was gutted by the Bush and Obama administrations. Why are you sitting around asking people to tell you where ADI funding is going to come from, when it is your job to tell the government that government has the power to create its own credit. Arguably, by relinquishing its role in credit creation, the government is causing into question the constitutionality of how it runs its own and the nation's finances. Consider it this way – if the government has the power to control law and order, and it fails to do so, how can that government regard itself as legitimate?

Unfortunately, FSI, you choose to be hawkish about bail-in and also generally hawkish about the status quo, but completely passive on the most exciting and powerful finance and credit options available to build Australia. It's a shame and it doesn't have to be that way.

Chapter 3: responses and comments

Ring-fencing 3-20

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Ring-fence critical bank functions, such as retail activities.
- The Inquiry seeks further information on the following areas:
- Is there a case for introducing ring-fencing in Australia now, or is there likely to be in the future?
- If ring-fencing is pursued, what elements should be protected and from what risks? For example, should deposit-taking functions be protected from proprietary trading. Is one of the models used overseas appropriate for Australia?
- How 'high' should any ring-fence be? Do ring-fenced activities need to occur in entirely separate financial institutions, or could they be part of a group structure that has other business activities? Within a group, what level of separation would be necessary?
- Are there ways to achieve the same benefits as ring-fencing without the costs of structural separation?

3-21

Box 5.1: International approaches to ring-fencing

United States — The 'Volcker rule'

The Volcker rule aims to reduce banks' exposure to speculative investments that could put depositor funds at risk. It does this by prohibiting banks (including foreign banks) from engaging in proprietary trading. They cannot buy or sell assets for speculative reasons for the bank's own purposes — only on behalf of a client — but they can still undertake hedging activity to manage their risks. The Volcker rule also prohibits banks from investing in hedge funds and private equity funds.

United States — Glass-Steagall Act

Operating prior to the GFC, for most of the 20th century the Glass-Steagall Act required that commercial banks and investment banks be separate entities. Its goal was to protect deposits in commercial banks from being exposed to the riskier activities conducted by investment banks. This provision of the Act was repealed in 1999.

United Kingdom — Vickers

Following the Independent Commission on Banking (the Vickers report), the United Kingdom is in the process of introducing ring-fencing of United Kingdom banks' core activities, ensuring that core services can continue, even if the risky parts of the business get into difficulty. This requires core financial services, such as retail deposits and overdrafts, to be placed in a separate subsidiary within a holding company, ring-fenced from any securities trading and other risky activities. Ring-fenced subsidiaries must be separately capitalised, with each meeting the regulator's capital and liquidity requirements, and should be legally, financially and operationally independent.

European Union — Liikanen

Current proposals in the European Union ban proprietary trading and, potentially, separate particular trading activities from deposit-taking entities. This draws on recommendations in the Report of the European Commission's High-level Expert Group on Bank Structural Reform (the Liikanen report). Hedging, trading on behalf of clients and trading for cash management purposes would still be allowed. If the regulator required a function to be separate, the function would need to be legally and operationally distinct from the rest of the bank.

Separation is not a question of degree – separation is not a 'ring fence'

You have not considered the question of separation adequately. Glass-Steagall is not a 'ring fence' but is a complete separation.

By arguing about 'how high should the fence be' you are eliminating discussion and consideration of the principle of separation. You have already failed to understand or consider the principle of separation. In order to avoid doing so, you have jumped straight to the question of 'degree of separation'. The important question is not how high the fence should be. Complete separation does not involve a fence, it involves three different universes. The universes of commercial banking, investment banking and financial activities that do not fall into either of these two spheres. Investment banking comprises speculative, gambling and other banking activities which are not linked to useful economic endeavour and which are positively socially harmful. Investment banking is not so much defined by what it is but by what it is not, since new exotic activities can be devised by crafty minds to fall outside of any boundaries circumscribed by a positive definition of 'investment banking'. Socially useful activities like general insurance, life insurance, and long-term saving and investment (such as superannuation, annuities, growth bonds, etc.) are neither commercial banking nor investment banking, and should also be conducted only by entities which are completely separate from commercial banks and investment banking entities.

The lack of separation *causes* scandals like the CBA financial advice scandal. The CBA as a commercial and savings bank should not be offering financial advice to people. Aside from a plain vanilla savings account, the CBA's only investment option should be gold bars. Offering advice on investments any more complex than that is illegal under a separation between savings and investment banking.

With the publicity given to the CBA financial advice scandal, and the egregious nature of what appears to have happened, it is astonishing that the FSI has not considered what policy allowed the scandal to occur. This is an even more egregious omission on the part of the FSI when the FSI is promoting the line that people should be providing for their own retirement. In addition, compulsory superannuation forces people to put a large proportion of their income into private investments. Yet at the same time, people cannot trust the advice they are receiving. Moreover, the once reliable name of banks like the CBA are being misused in the deregulated environment to provide poor advice and sometimes advice which is even worse than poor. Essentially, you are beating up Australians on both sides. Australians are forced to put money aside for retirement, even though the public pension system ought to provide support in old age, and at the same time, impartial advice which is in the interests of the client is not readily available. One might say it is readily available, but essentially it is a lottery for people since it is impossible to know whether the advice being received can be trusted.

Wall Street interests caused repeal of Glass-Steagall

Glass-Steagall was repealed in 1999 under pressure from Wall Street principally represented by Rubin and Summers in the Clinton administration. The repeal of Glass-Steagall is hardly a policy statement on its value in ensuring financial stability.

Consider what the repeal of Glass-Steagall means. It means that things which were illegal for 66 years, from 1933 to 1999, are now legal. Glass-Steagall was passed in the midst of the collapse which led to the Great Depression. Since the legalisation of those activities, the Western world has lurched from one financial collapse to another. There is a large body of literature on what has happened to the financial system and society since the repeal of Glass-Steagall. There is also a large body of literature on the inadequacy of the Volcker rule and Dodd-Frank as alternatives to Glass-Steagall.

An inquiry with the influence of the FSI cannot dismiss the importance of Glass-Steagall and all of the evidence and principles-based reasoning, and rather side with the Wall Street interests which agitated for the repeal of Glass-Steagall. Much of this information already has been submitted to the FSI.

If the FSI has intent to make recommendations in the interests of financial stability, then the FSI knows what to do. If the FSI fails to do so, then it will only be a result of deliberate intent.

Those who want stability want Glass-Steagall back

There have been repeated calls for Glass-Steagall in the USA from government and the banking community, and also from the UK including from the Bank of England. The proposals of the Vickers report have been criticised as being inadequate and not up to the task of restoring stability to the financial system.

Legislation to reinstate the Glass-Steagall was introduced in the United States Congress in 2009, the Senate in 2010, and again in the House in 2013. The latter two were introduced by the bipartisan combination including Democrat Maria Cantwell and Republican John McCain. Andy Haldane, Executive Director Financial Stability at the Bank of England gave an engaging speech entitled ‘The dog and the frisbee’ in August 2012 at the Federal Reserve Bank of Kansas City's 36th economic policy symposium ‘The Changing Policy Landscape’ Jackson Hole, Wyoming explaining the necessity of re-introducing Glass-Steagall.[6]

[6] http://www.bankofengland.co.uk/publications/Pages/speeches/2012/596.aspx

3-16 Capital requirements

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Further increase capital requirements on financial institutions considered to be systemically important domestically.

More and more capital is not the answer – returning to the purpose and role of finance is

Requiring more and more capital holdings is a tacit admission of an ignorance of the purpose of the financial system: to administer credit to drive economic growth. It appears that there is a lack of understanding of this primary of credit, too.

The financial system is not a fortress of capital. Indeed, this 'capital' which you speak of is merely bits and bytes in computers anyway. The financial system should be aiding flow. Credit fills the delay between production and consumption. Production means all of the many long-term processes and projects in production, including scientific research, engineering, large scale public works, manufacturing, and the rest. Some of these processes take years or decades. The power of consumption, on the other hand, once having been issued cannot be taken away and there is no control over when consumption occurs. The credit system should supply the gap as a priority for national security and economic progress, because otherwise producers will not choose to engage in long-term planning out of fear of collapse during the interim between planning for production at the outset and the final purchase of the goods ultimately produced.

The purpose of hoarding bits and bytes which have the force of law because they are called 'money' is entirely divorced from the role of credit in enabling economic growth. Yet it is the primary role of the financial system, perhaps the only role of the financial system, to execute this function.

Hoarding 'capital' is by-the-by. It may be contrary to the function of the financial system, because it amounts to a refusal of the financial system to supply that interregnum and thus aid in the financial collapse of producers.

So much capital would not need to be hoarded if the systemic links between the investment banking (essentially, illegitimate) system and the commercial banking system did not exist. If the investment banking (essentially, illegitimate) system died, it would be of no consequence to the real economy. Commercial banks would be invested in physically productive endeavours and so there would be few cases of failure of those kinds of banks. Investment banks would come and go regularly, but that would not matter to anyone except those who were prepared to take on the risks associated with intensive speculative activities.

Australia has a property bubble and Australia's banking system is sitting on top of it

Property bubble – read about the banking crisis of the early 1890s. This was caused by heavy lending into property. The bubble collapsed and several banks were unable to continue to operate. The government of the NSW colony guaranteed 50 per cent of deposits in banks in NSW so that people and the economy could get back on its feet. Thus, even in those early days, property bubbles could bring down banks. Have we not learned from that? Even the IMF have assessed property market as suffering a bubble condition. The bubble plagues mortgagors and would-be homeowners who cannot afford to buy. Arguments that there is no bubble amount to the kinds of arguments that Greenspan made in favour of the American real estate prices in the midst of the American property bubble in the 1990s: 'there is a shortage of land', essentially. Yet even new releases of land by government for house building are overinflated from the outset simply as a way of using the misery of young homeowners with huge mortgages to help prop up government in the failed economic system resulting from economy policy forced on Australia from the Hawke government onwards. Meanwhile, vast tracts of land that could be used for industrial purposes remain empty. Even built industrial property increasingly is empty.

Creating and continuing to inflate the property bubble is a natural consequence of the financial system being dedicated to speculation and illusory value. The alternative is easy – focus on productive investment. While those who want to promote the property bubble have introduced measures like negative gearing and the first home buyers grant, the reverse should be being done. Property speculators 'investors' should not be encouraged by negative gearing, limits on property investment should be introduced whereby a family should not be allowed to own more than one investment property, and foreign ownership of Australia residential real estate should not be permitted. Such restrictions are not extreme, but are the norm in socially-oriented countries.

The alternative, which currently is unfolding, is banks following an unimaginative and destructive strategy of piling into residential real estates. It is destructive because homes should not be a means of financial gain any more than food should be: homes are where people live where families grow. The property bubble is pitting Australians against each other and against foreign owners in the struggle to acquire increasingly less affordable real estate. It is destructive for banks because their assets increasingly are based on prices driven by speculation.

3-12 Recovery and resolution preparedness, and bail-in

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

• No change to current arrangements.

• Increase the ability to impose losses on creditors of a financial institution in the event of its failure.

The Inquiry seeks further information on the following area:

Is it possible to reduce the perceptions of an implicit guarantee for systemic financial institutions by imposing losses on particular classes of creditors during a crisis, without causing greater systemic disruption? If so, what types of creditors are most likely to be able to bear losses?

Under your bail-in proposals, banks arguably are no longer worthy of the name ‘bank’

First of all, referring to depositors as ‘creditors’ or even worse as ‘unsecured creditors’ is a cynical sleight of hand. It is not enough to say, ‘Well, they are, aren’t they?’ No, they aren’t. Depositors are not creditors. In fact, like compulsory superannuation, people are forced to ‘lend’ (if they are creditors) to banks because since the Hawke Government it has been compulsory to pay wages and salaries into bank accounts. Again, you are beating people up at both ends. People are forced to ‘lend’ to banks and people can be ‘bailed in’ forcefully too.

Moreover, the history of the banking since the Glass-Steagall separation was introduced in the USA has been more or less one of banks being relatively safe, even in Australia where regulation ensured a kind of safety akin to a Glass-Steagall separation even though there was no law actually called Glass-Steagall in Australia.

By deregulating you have changed the nature of banks, so that banks are no longer worthy of the name ‘bank’. Essentially, you need to create a new kind of institution which is safe for people to deposit their money and which provides basic banking services. Sure, maybe all the ATMs and the whiz-bang netbanking will not be available, but that is a small price to pay to avoid the risk of deposits, which can include life savings, being ‘bailed in’.

The proposal to bail in is itself an admission of failure of this system. Therefore, there is need for a root and branch review, but we do not seem to be getting that.

Guarantee deposits

All deposits should be guaranteed by the government. This is incredibly finite, because deposits are finite – unlike derivatives debts, potentially – and the risk of needing to act on the guarantee is unlikely with a Glass-Steagall separation. When you insist on banks being able engage in complex gambling, essentially, clearly the risk of failure is greatly increased. With separation between commercial banking and investment banking, there can still be failure of commercial banks but these are less likely. Further, the system is less interconnected with a separation, which reduces the systemic consequences of a failure.

Yes deposits should get special treatment because these are linked to people which are the reason why the economy and why the financial system exists. The debts incurred by speculative activity including derivatives activity are not on that same footing. Debts of the financial system to itself, within the confines of the financial system, are extraneous and superfluous.

You need to go back to the basics of economics, which is the science of physical economy, to understand that speculative activity is not legitimate economic activity. Transactions taking places and people being busy with spreadsheets, telephone calls, writing computer software, and what-not, does not necessarily imply useful economic activity is taking place. It is possible that such activity acts in a parasitical way on the wider economy, particularly on the population of humankind in Australia and even beyond.

People writing software to help design roads, bridges, railway lines, dams and power plants does aid the physical economy. Workers actually engaged in building that infrastructure, and capitalists building and operating automobile, maglev and reactor factories for a profit do aid the physical economy. Similarly with agricultural science and agricultural activity. Yet these aspects of the physical economy are shrinking and are getting less support, even while the parasitical aspects of the economy are being supported and encouraged. Your proposals assist that trend.