

Gary Elkin
Gary Elkin on Mutual Banking
1994

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Part 1 of 2

This article discusses the idea of a zero-interest credit system, commonly known as “mutual banking,” which was first suggested by Pierre-Joseph Proudhon and later taken up by American individualist anarchists such as William B. Greene and Benjamin Tucker. We’ll first examine an anarchist analysis of the State which underpins the argument for mutual banking, then go on to see how an updated version of mutual banking, complete with Internet “e-money” transfer capability, would work in practice.

“Reduction of interest rates to vanishing point is itself a revolutionary act, because it is destructive of capitalism.” — Proudhon

The State as legalized goon squad

1. Anarchists point out that the State is, in effect, society’s biggest criminal gang, since its main function is to serve as a kind of goon squad, a protection and enforcement arm, for certain private racketeers called “bankers,” “industrial capitalists,” and “landlords.” I’ll use the United States government as an example, since it’s presently the most powerful goon squad in the world. As Chomsky (1988, 1993) has shown in great detail, US protection and enforcement activities in foreign countries is handled primarily by the military and CIA, whose job is to coerce foreign governments into allowing their citizens to continue being fleeced by the US-based racketeers mentioned above; whereas, domestically, the same racketeers are

protected by the courts, police, and prison system. In return for this protection, the US government receives a kickback from these clients in the form of corporate taxes, license fees, campaign contributions, bribes, etc. The “rackets” in question take the form of three major monopolies, which the State creates and sustains, namely:

1.
credit-and-currency-issuing monopoly, the basis of capitalist banking;
1.
capital-goods monopoly, the basis of industrial profiteering;
and
1.
land-and-buildings-monopoly, the basis of landlordism.

Following Benjamin Tucker (1972), I’ll refer to income derived from such monopolies as “usury,” a term that may thus be defined broadly as the exaction of tribute for the use of any object whose artificial scarcity and monopolization by an elite class are created and protected by the State. This definition widens the usual meaning of usury to include not only interest but profits and rents as well.

The State creates and sustains the first monopoly, of credit and currency, primarily through legislation that restricts allowable currency to a “legal tender” that can be issued only by the central bank. Banks (including credit unions, thrifts, etc.) are then required to transact all business — whether as cash, deposits, reserves, or extensions of credit (“loans”) — only in units of this currency. Moreover, in order to be granted a bank charter, numerous other conditions must be met, including the raising of a given amount of deposit capital in a specific period of time; proving to the banking authorities that another bank is necessary; showing that it has a viable chance of success, and so on (Morris and Hess 1974: 81).

Such laws, and the interpretive latitude given to those who enforce them, function effectively to restrict banking to an elite

organized by an ethically motivated radical community that has widespread public support and employs a variety of mass direct actions to defend itself stands an even better chance of maintaining its viability against State attempts to suppress it — particularly now, with the advent of e-money, which can be transferred using encryption codes that will make such transactions extremely difficult to trace.

class whose members have enough “standing” in the financial community to raise the necessary capital and convince the authorities that the proposed new bank represents no threat to the overall system of finance-capitalist exploitation. Hence this elite class is able to maintain a monopoly over the power to issue money as credit, and hence to exact monopoly fees for its use.

In turn, this State-protected monopoly of credit-issuing power is combined with other forms of action by the State (e.g. its protection of titles to unused and unoccupied land) in order to create further artificial scarcities: notably of land, buildings, and capital goods, which are expensive items that generally cannot be acquired without credit. These items are then also sold or rented out at high price by those who monopolize them. For example, the surplus value extracted by capitalists from workers can be viewed as a form of monopoly rent charged by those who own the means of production to those who need to use them to earn a living.

Although all monopolies are detrimental to society, anarchists like Proudhon and Tucker have maintained that the credit-issuing monopoly is by the most pernicious. This is not to say that capitalists’ exploitation of labor or landlords’ exploitation of tenants are any less evil in themselves than bankers’ exploitation of debtors. It’s merely to say that monopoly of the power to create money as credit is the main root from which the other two monopolies grow and without which they would wither and die. For if credit were not monopolized, its price (i.e. interest rates) would be much lower, which in turn would drastically lower the prices of capital goods, land, and buildings.

Therefore, if the State would stop protecting the credit-issuing monopoly — which is to say, if any group of people could legally form a “bank” and issue credit based on any form of collateral they saw fit to accept — the price of credit would fall to the labor cost of the paperwork involved in issuing and

keeping track of it. As banking statistics reveal, this cost is less than one percent of principal (Tucker 1972). Hence, as Proudhon emphasized, a fee which covers this cost and no more is the only *non-usurious* charge a bank can make for extending credit. To refer to this legitimate cost-covering fee as “interest” is to confuse the issue. Anarchist banking would in fact reduce *interest*, that is, usurious fees for credit, to zero.

“But,” I hear, “what about *risk*? Is there no risk in the anarchist’s world that would justify charging more for credit than the cost of paperwork and similar overhead?” As we’ll see in section 2, there is virtually no risk for a mutual bank, because the credit it extends is based on more than enough collateral to cover defaults. And, as is also discussed there, a mutual bank does not actually “lend” money, but instead *creates* it. Hence there is no excuse for mutual banks to charge interest as compensation for “postponing the use” of any previously existing money that was “lent.”

The beneficial results of a zero-interest credit system

Reduction of the interest rate to zero through mutual banking, along with an end to the State’s protection of titles to land not being occupied and used by its “owners,” would lower both profits and rents toward zero as well. Let’s consider profits first. Under mutualism, capitalists’ ability to extract surplus value from the labor of employees would be eliminated or at least greatly reduced, because many more workers than now would be able to obtain zero-interest credit and use it to buy their own tools and equipment, instead of renting them from capitalists at exorbitant rates.

Although, at the start of the new system, not everyone would have enough collateral to obtain credit, many more people would be able to do so than now. This would result

Mutual-dollar income is arguably in the same category.

But even if a mutual barter clearinghouse does manage to get established, it would be a mistake to believe that the banking industry would take this threat lying down or that it might fail to use its tremendous political clout in an attempt to destroy the new credit system through legislation. No doubt we’ll then witness a barrage of propaganda and scare tactics designed to convince people that mutual credit is “unsound” and “unsafe,” and therefore should be outlawed.

There are a number of strategies that can be used to respond to this challenge. For one thing, as many idealistic lawyers as possible must be recruited to the anarchist cause. Although cynics may be inclined to regard the phrase “idealistic lawyer” as an oxymoron, a few such beings are rumored to exist in legal-aid clinics, government regulatory agencies, extra-governmental watchdog organizations, and even private practice. (Clarence Darrow, for example, was an anarchist.) Sharp legal minds can help organize test cases, court challenges, and efforts to repeal any obstructive laws that may be passed. For another thing, anarchists will be ready to engage in civil disobedience by ignoring any obstructive laws that may be placed in their way. So, while legal efforts are being mounted in its defense, the alternate economy can still function as an underground system.

As Morris and Hess (1975: 73) report, unlawful underground credit systems already exist in many ghetto areas, based on funds collected through illegal gambling. In such systems, many of the small stores in the area take bets and use the cash profit to extend credit to the large welfare population. In addition, “the numbers runners and controllers are known to lend funds to their better customers who are temporarily short on funds (and the custom is that the loan is interest-free).” It would appear that if an underground zero-interest credit system based on organized crime can maintain its existence in statist society, a mutualcredit system

Since mutual credit-money does not exist prior to its creation by the clearinghouse, no depositors have to “postpone the use” of any of their money when the clearinghouse extends credit. Nor does the clearinghouse itself have to forego the use of any money that *it* has on its books. This is one reason that it will charge only a small service fee to cover the cost of the labor involved in issuing and keeping track of credit, plus other overhead.

Defending clearinghouses from the State

Once a clearinghouse is up and running, the government can be expected to step in and try to kill it. Chartering clearinghouses as nonprofit charitable organizations is admittedly a best-case scenario. But of course there is no guarantee that it will be possible in this way to circumvent banking laws whose purpose is to prevent the threat to commercial banking that schemes such as mutualism represent. Nevertheless, even if clearinghouses are not able to obtain nonprofit status, they may still be able to function legally as barter associations of a special kind. Besides the fact that mutual dollars are actually a variety of barter dollars, another factor on which arguments for their legality can be based is that they are not circulated as tangible monetary tokens (i.e. coins or bills). The attempts of earlier American anarchists to start mutual banks were quashed on the grounds that their currency violated legal-tender laws. However, this was before the days of credit cards and electronic credit transfers. As we’ve previously observed, some barter organizations today already use barter cards to transact business in barter dollars — a practice that is certainly close to what is being proposed here. So far the IRS has not been able to suppress the use of barter dollars, but has merely insisted that barter-dollar income be reported for tax purposes in the same way as regular-dollar income.

in a huge increase in the purchase of capital goods, which in turn would create a huge demand for labor. Such a demand would then raise employees’ wages toward equivalence with the surplus value produced by their labor. For this reason, workers would be able to save much more of their earnings than is presently the case, until soon virtually any person or group of persons, if they so desired, could accumulate enough wealth to use as collateral, obtain credit, and buy their own tools and equipment.

In this situation it would be absurd for workers to pay someone else (i.e. a capitalist) more for the use of tools and equipment than a fee equal to their depreciation and maintenance costs plus the cost of the taxes (if any) and utilities involved in housing them. Then, as Tucker (1972) noted, an employee would be in a position to say to his or her employer: “Here, boss, you are a good business manager, and I am willing to continue to work under your superintendence on a strictly equitable basis; but unless you are willing to content yourself with a share of our joint product proportional to your share of the labor and give me the balance for my share of the labor, I will work for you no longer, but will set up in business for myself on the capital which I can now obtain on my credit.” With their vastly increased bargaining power, employees in this situation would be able to demand and get workplace democracy.

Of course, on a purely individual level, a dissatisfied employee of the sort described above would be limited to starting up a relatively small-scale business that did not require a huge capital outlay. However, it’s important to emphasize that *groups* of workers could pool their mutual credit and start larger-scale collective enterprises. By a similar line of reasoning it can be shown that a zero-interest credit system, combined with an end to the State’s protection of titles to land not being occupied and used by those who claim to “own” it, would lower rents toward zero as well — that is, toward equivalence

with the maintenance, utilities, and other costs absorbed by the owners of rental property.

But these are not the only social benefits that would accrue from mutual banking. Other positive effects would be the elimination or alleviation of the business cycle and of the tendency toward high inflation, both of which are largely attributable to the current “fractional reserve” method of expanding the money supply for political purposes. In addition, mutual banking would greatly reduce the financial pressure responsible for much of the current “grow-or-die” philosophy of business, which is destroying the biosphere. Contrary to popular belief, when a commercial bank makes a so-called “loan” it does not actually allow the “borrower” to use a sum of money that the bank already possesses on deposit (the usual meaning of “to lend money”). What it actually does is to *create new money*, as credit, by the process of fractional reserve banking — a process in which only a certain fraction of the newly created credit-money (usually between 10 and 20 percent) really exists in the bank’s reserve account at the central bank. The rest of the “loan” is created out of thin air, simply by the bank’s crediting the account of the customer for the amount “borrowed” (Rothbard 1983; Greider 1987).

This process is analogous to an ordinary person’s writing a bad check for more than exists in his or her checking account. As Rothbard puts it, “*a bank is always inherently bankrupt*, and would actually become so if its depositors all woke up to the fact that the money they believe to be available on demand is actually not there.” (Rothbard is right about this, though he’s wrong about much else, as discussed below.)

We should not be surprised to learn, then, that the fractional reserve banking system actually originated as a form of fraud. Here’s the story. In the days before banks of deposit existed, people often placed large amounts of gold in the vaults of goldsmiths for safekeeping. The goldsmiths would then issue warehouse receipts for the gold, which were used by their holders

1984 for a bibliography). Hence mutualism is an essential ingredient in the type of “steady-state” economy advocated by eco-economists.

To quote Greene (1919) again, once a mutual credit system gets started in any part of the country, it will inevitably spread to all parts, until eventually it overwhelms the old system. This is because money and credit will periodically become scarce (or more accurately, scarcer) in the mainstream economy during recessions and depressions; hence at such times many people will start using mutual money simply in order to survive. But once they perceive the many advantages of the new system — e.g. low inflation, high employment, no recessions, high incomes for workers, and an automatic, equitable redistribution of wealth — word will spread and others will join the system by a ripple effect.

Mutual clearinghouses do not lend money, they create it. Money lenders often claim that interest is their compensation for postponing the use of the money they lend. This is often raised as an objection to the claim that interest rates would fall to zero in a mutual-credit system. “People would still want compensation for postponing the use of their money, even if there were mutual banks, so interest rates could not fall to zero,” it is alleged.

Such an objection reveals a misunderstanding of what a mutual bank or clearinghouse does. The “compensation-for-postponing-use” justification for charging interest is not available to such an institution, because it does not actually lend anybody’s money. Instead it creates new money, as credit, by monetizing the credit recipient’s collateral. This new money does not belong to any of the clearinghouse’s depositors, nor is it “based on” or “backed by” a portion of the money of any of those depositors. In this respect a mutual-credit system is unlike the current fractional reserve system, where a certain portion of depositors’ money is held in “reserve accounts” at the central bank.

State to print money to cover deficit spending. Therefore mutual banking will eliminate the current system's contribution to both inflation and the business cycle.

Nevertheless, critics may object that the easier availability of credit in the mutualist system would still produce a tendency toward inflation. In reply, we must consider the complete economic context of the proposal under discussion. This context is a network of worker-controlled productive enterprises. As mentioned earlier, mutualism will empower workers, who will gradually establish an economy based on firms practicing workplace democracy, self-management, and collective ownership.

Hence we can assume that productivity will be much higher among the highly motivated worker-owners and self-managers in the new economy than it will be among the bored, apathetic, and resentful wage-slaves of the capitalist economy — who will continue to engage in featherbedding, high absenteeism, slowdowns, sabotage, strikes, and so on, just as they now do.

Therefore, in the alternate system there will be more goods and services available in relation to the amount of credit-money that has been “borrowed” into circulation to finance start-up and production costs. This will have a deflationary effect on prices, offsetting inflationary tendencies that might emerge from the easier availability of credit.

Moreover since the clearinghouse charges no interest on the credit it extends to members, worker-owners who have borrowed to finance start-up or production costs will be under far less pressure to raise their prices than capitalist owners who have borrowed from commercial banks at high rates of interest. As noted already, reduction of this pressure will also lessen the incentive to expand, with obvious environmental benefits. Worker cooperatives, which the new system will promote, have the further advantage of typically growing at a slower rates than capitalist firms, as several studies have shown (see Levin

as a form of paper money that could be exchanged for real gold by anyone presenting them to the issuing goldsmith. However, many goldsmiths soon began issuing *fake* warehouse receipts for more gold than they actually had in storage, and “loaning” them at interest to “borrowers.” This scheme worked quite well unless there was a run on the vault — that is, too many holders of arehouse receipts presenting them at one time for redemption — which clearly revealed the fraud, whereupon the goldsmith was usually taken out and hanged.

The fractional reserve system of modern commercial banks, in which enormous amounts of interest-bearing credit-money are pyramided on a small base of “reserves,” is a direct descendent of this fraud. In essence, commercial banking is a giant Ponzi scheme, differing from the old goldsmiths’ racket only in the fact that it has been legalized by a series of unjust court decisions which gave bankers the exclusive privilege of issuing fake warehouse receipts for something they don’t actually possess. The injustice of these decisions is apparent from the fact that the writing of fake warehouse receipts for other types of goods — for example wheat (receipts for which have also been used as money) — is still subject to criminal penalties.

Fractional reserve banking is highly inflationary because the vast majority of the money in circulation exists in the form of interest-bearing credit, created when banks make fractional-reserves “loans,” particularly to their large corporate customers. (In fact, every dollar in circulation is interest-bearing at its point of origin, since even currency must be backed by government securities.) Since all money thus represents an interest-bearing debt, every business that has “borrowed” to finance its operations must scramble madly to pay back the interest it owes by gathering profits from a pool of total dollars that is necessarily insufficient to repay the total principal and interest outstanding at any particular time. This fact obviously constitutes a strong incentive for such businesses to raise their prices and also to expand. For unless there is sufficient growth,

indebted companies won't generate enough profits to continue financing their debt. Indeed, many investors seek out highly indebted companies as likely high-growth investments.

Moreover, corporations must also satisfy stockholders, who demand high growth in order to raise the value of their stock. Like the capital-goods and landlordist monopolies, the stock market depends on the State's creation of an artificial scarcity of credit, which makes it necessary for corporations to sell stock in order to raise funds to finance their operations (thus incidentally placing companies under the control of absentee owners). Under mutual banking, however, the easier availability of credit will make this practice unnecessary, or at least greatly reduce its importance.

A further inflationary pressure — perhaps the main one — occurs because central government finance their deficit spending by, in effect, printing the money they need to pay their debts, a practice that increases the money supply. This is done by issuing new interest-bearing securities, which of course puts such governments even further in debt, leading to the printing of even more debt-money, and so on in a vicious circle.

Fractional reserve banking is also a major contributor to the business cycle, simply because Ponzi schemes have an inherent tendency to collapse when public confidence in them is weakened for one reason or another. This is why recessions and depressions in the past were often triggered by bank runs — which is to say, when the “inherent bankruptcy” of certain banks was discovered by the public — whereupon all banks would begin calling in their old loans and refusing to make new ones in order to increase their reserve base, fearful that their own insolvency would also be discovered.

Today, deposit insurance has largely eliminated the problem of bank runs; but other reasons still exist for banks to contract credit from time to time. The result is a “credit crunch,” which shrinks the total pool of available money from which

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Mutual dollars have no *intrinsic* value, that is, they cannot be bought and sold as commodities, since they are not redeemable at the clearinghouse in Federal Reserve notes, gold, or anything else. Thus, as Greene (1919) points out in his classic work on mutual banking, mutual dollars are “a mere medium for the facilitation of barter.” In this respect they are closely akin to the so-called “barter dollars” now being circulated by barter associations through the use of checks and barter cards. To be precise, then, we should refer to the units of mutual money as “mutual barter dollars.”

But whereas ordinary barter dollars are created at the same time that a barter transaction occurs and are used to record the values exchanged in that transaction, mutual barter dollars are created *before* any actual barter transaction occurs, being intended to facilitate future barter transactions. This fact is important because it can be used as the basis for a legal argument that clearinghouses are essentially barter associations rather than banks, thrifts, or credit unions, and therefore should not be subject to the laws governing the latter institutions.

Low inflation and the end of the business cycle

Unlike fractional-reserve banking, a mutual credit system will not create money by pyramiding fake interest-bearing “warehouse receipts” (i.e. Federal Reserve dollars) on top of a small base of “reserves.” Moreover, it will not be used by the

certain amount of property as “collateral” (referred to by some other term — perhaps “pledge” is good enough). On the basis of this pledge, an account is opened for the new member and credited with a sum of mutual dollars equivalent to some fraction of the assessed value of the property pledged. [2] The new member agrees to repay this amount plus the cost-covering service fee by a certain date. The mutual dollars in the new account may then be transferred through the clearinghouse by using a barter card, by writing a personal check, or by sending e-money via modem to the accounts of other members, who have agreed to receive mutual money in payment for all debts.

The opening of this sort of account is, of course, the same as taking out of a “loan” in the sense that a commercial bank “lends” by extending credit to a borrower in return for a signed note pledging a certain amount of property as security. It’s like fractional-reserve banking in this respect. The crucial difference, however, is that the clearinghouse does not purport to be “lending” a sum of money that it *already has*, as is fraudulently claimed, with much hand-waving and doubletalk, by commercial banks. (Hence the creation of mutual credit does not have to be officially described as “making a loan.”) Instead it honestly admits that it is creating new money in the form of credit, but charging no interest for doing so. New accounts can also be opened simply telling the clearinghouse that one wants an account and then arranging with other people who already have balances to transfer mutual money into one’s new account.

funds for loan repayments can be gathered by businesses, thus producing a wave of business bankruptcies. Such a wave causes many weak banks to fail as their bankrupt business customers default on loans, which in turn causes the remaining “solvent” banks to tighten their credit even further, producing more business bankruptcies, further bank failures, and so on, until eventually there’s a full-blown recession.

The failure of Libertarianism

Some Libertarians (e.g. Rothbard) have proposed as a solution to such problems that currency be returned to the gold standard; that banks be required to maintain a 100 percent reserve of gold or paper currency redeemable in gold as backing for all extensions of credit; and that the central bank be eliminated in order to increase competition among banks (which, among other things, would lower interest rates.) Unfortunately, however, although this proposal would probably do *some* good, it still fails miserably as a solution to the major problems of exploitation which arise from the State’s creation and protection of a financial monopoly.

For consider: Since gold is a naturally scarce commodity, and since the State would require that this scarce commodity be used as the basis of all money, the power to issue credit and currency based on gold would still be monopolized by a financial elite — namely those who monopolized gold. As Greene (1919) points out, the history of gold-standard banking in this country demonstrates that gold is one of the easiest commodities to monopolize, especially with the State’s help. But any financial monopoly, whether based on gold or not, will give rise to further monopolies of capital goods, land, and buildings. Moreover, although interest rates might fall under the system Rothbard proposes, they would certainly not fall to zero. Hence the three forms of usury previously discussed — interest, prof-

its, and rents — would continue, though perhaps at a somewhat lower rate.

In fact, right-wing Libertarians such as Rothbard never suggest that the fundamental mechanisms of economic exploitation, i.e. the goon-squad functions of the State, should be dismantled. Rather, they wish merely to “limit” the State to its “classical” role of performing only goon-squad functions — a role in which it would not get into the further businesses of providing social welfare, building roads and bridges, educating people, protecting the rights of workers, etc. In other words, Libertarians propose that the activities of the State should be confined entirely to protecting those key monopolies which allow the racketeering elite (i.e. bankers, capitalists, and landlords) to continue robbing and enslaving the rest of the population.

Thus, in order to find proposals that strike at the heart of capitalist exploitation, we must turn instead to the ideas of libertarian socialists, and especially to the idea of a zero-interest credit system of the type first set forth by Proudhon.

An updated version of mutual banking

2. In an article in the Nov. 26th issue of *The Economist* it is stated: “The transformation of the Internet from a huge virtual community into a huge virtual economy may herald the age of electronic money — and with it, headaches for traditional banks and regulators.” What the article does not state is that “e-money” is potentially a means of destroying the monopoly-capitalist system as we know it. For the lynch-pin of that system is finance-capital’s monopoly of the power to create money as credit.

Along these lines, I want to sketch an updated version of mutual banking, complete with e-money transfer capability via the Internet. As I see it, a mutual bank should grow from a col-

lectively owned and operated barter association that is responsive to the participatory-democratic assembly of a radical urban community. Here’s a possible scenario: The new economic system — not yet self-sufficient but increasingly so — is born when the community barter association begins issuing an alternative currency accepted as money by all businesses within the system. For reasons discussed below, this “currency” does not at first take the form of tangible monetary tokens (i.e. coins or bills), but is circulated entirely through transactions involving the use of barter-cards, personal checks, and “e-money” transfers via modem/Internet. [1]

Since it doesn’t charge interest — the source of regular banks’ profits — and since its purpose is to provide economic assistance to the community, it may be possible to charter this new financial institution as a nonprofit charitable organization. In order to get non-profit status, however, it is essential that mutual-credit organizations not be officially described as “banks” “thrifts,” “savings and loans,” “credit unions,” etc., which would make them subject to the charter laws governing such institutions. For convenience I’ll refer to an anarchist zero-interest credit-issuer as a “mutual barter clearinghouse” (or just “clearinghouse” for short). Other semantic expedients regarding the official description of its operations may also be necessary in dealing with the State.

The clearinghouse has a twofold mandate: first, to extend interest-free credit to members; second, to manage the circulation of credit-money within the system, charging only a small service fee (probably one percent or less) which covers its costs of operation. Such costs would include the making of plastic barter cards, printing personal checks, keeping track of transactions, paying its workers, insuring itself against losses from uncollectible debts, and so forth.

The clearinghouse is organized and functions as follows. Members of the original barter association are invited to become subscriber-members of the mutual bank by pledging a