



# International Institute of Certified Public Accountants

Incorporated under the laws of the State of Delaware – iicpa.com

20 October 2013

OPEN LETTER

published on iicpa.com “articles and open letters”

TO

**The Ministers of Finance of the Euro Area:**

Austria, Belgium, Cyprus, Estonia, Finland,  
France, Germany, Greece, Ireland, Italy,  
Latvia (as of 1.1.2014), Luxembourg, Malta,  
The Netherlands, Portugal, Slovenia,  
Slovakia, Spain

AND TO

**The President of the European Central  
Bank**

AND TO

**The Governors of the Central Banks for  
the Euro Area**

Dear Sirs, dear Madams:

- **€2.8 trillion sovereign debt buyback with ECB funds from MFIs — inflation-neutral**
- **Thereby reducing sovereign debt to GDP ratios to bailout requirements, ending brutal austerity programs in Ireland, Greece, Cyprus, Portugal and Spain**
- **Increasing MFIs' liquidity €2.8 trillion**

Your **oath of office requires you, no doubt, to ACT in the public interest**, NOT to bailout, benefit and protect the interests of private commercial banks in monetizing sovereign debts but preventing the ECB from performing the task interest-free. Therefore, please end the needless austerity programs causing unemployment, and producing a lost generation.

The euro is still the **STRONGEST MAJOR CURRENCY** around; if only you cease to succumb to widely held but misconceived opinions. There is no such a thing as collective wisdom, and this letter intends to take away your deference of ‘not knowing.’

The Sovereign Debt Securities and Loans of the Euro Area held by the commercial banks (Monetary Financial Institutions – MFI) in the total amounts of € 2.8 trillion (as of August 2013) are to be redeemed with European Central Bank funds — entirely inflation neutral and sterile — thereby reducing total euro area debts and loans from € 8.8 trillion to € 5 trillion to end the misconceived austerity programs in Ireland, Greece, Cyprus, Portugal.

I am arguing my points in my latest book published 16 October 2013, reproduced for your ready reference and benefit on the following pages.

With all best wishes,

Michael Schemmann, PhD, CPA , CMA  
Associate Professor of Accounting and Finance  
Member, Advisory Board, Monetative e.V., Berlin  
Director of the IICPA

Excerpt from Michael Schemmann. 2013. "Money. Breakdown and Breakthrough. The History and Remedy of Financial Crises and Bank Failures. (1<sup>st</sup> Edition.). IICPA Publications iicpa.com ISBN 978-1492920595 Date of publication: 16 October 2013 available at Amazon.com, uk, de, fr, it, es.

## **A REMEDY FOR THE PRESENT BANKING AND EURO AREA SOVEREIGN DEBT CRISIS**

JK Galbraith (1975), "Money. Whence It Came. Where It Went," was right: "There is nothing about money that cannot be understood by a person of reasonable curiosity, diligence and intelligence. There is nothing on the following pages that cannot be so understood. And whatever errors of interpretation or of fact this history may contain, there are, the reader may be confident, none that proceed from simplifications. The study of money, above all other fields in economics, is one in which complexity is used to disguise truth or to evade truth, not to reveal it. Most things in life — automobiles, mistresses, cancer — are important principally to those who have them. Money, in contrast, is equally important to those who have it and those who don't. Both, accordingly, have a concern for understanding it. Both should proceed in the full confidence that they can."

And Thomas Jefferson (1813) was right in his warning: "Let banks continue if they please, but let them discount for cash alone or for [U.S. government] treasury notes."

Underlying complexity is simplicity, and the rest will fall into place — so here it is:

### **The Principal Remedy — Only Two Rules Are Needed for Sound Money, Banking and No Government Debt**

(1) Let there be banks operating on a 100% legal tender central bank money basis. With proper controls, deposit insurance would not be necessary to guarantee the solvency and safety of such deposit taking institutions. In the alternative, let the central banks allow each and every person, individual or business entity, to open and maintain an account strictly on a credit basis, without overdraft or any other accommodation similar to the postal chequing accounts, paying NO interest, but charging the necessary fees to maintain the service of deposit taking and cheque clearing or direct deposits. And let the government have accounts at the central bank only.

### **Complete Separation or "Ring-Fencing" of Deposit Taking from Lending and Investment Banking:**

(2) Let there be deposit-taking institutions or banks that are completely separate from lending institutions or finance companies which consist of the former credit departments of commercial banks, savings banks and institutions, whose funding comes from investments in legal tender central bank money by anyone desirous of earning interest or a profit on his/her investment at such a finance company for the full risk of such investment..

### **The Benefits of the "Two Rule" Remedy Are:**

- The money supply of the nation(s) can be held constant by the issuing authority, eg. the jurisdiction's note issuing central or national bank.
- Such a stable money supply meet the European Central Bank's first and foremost objective of stable prices.
- Such stable money and prices likewise stabilize the external value of the currency.
- Booms and depressions resulting from fluctuations in the money supply do not occur.
- Asset bubbles resulting from bank-created money of account cannot form.

- Private commercial banks in their present form as creators of 95% of the euro area's money supply are a phenomenon of the past.
- The lending and investing departments of present commercial banks will in essence become finance companies, whose failure is of no concern to the economy as a whole let alone the State, because the money issued at one time is simply in the pockets of other people; the finance companies suffering losses at the sole and complete expense of their investors. The economy as a whole would not suffer.
- Deposit insurance is not needed because deposit-taking banks are liquid at all times; eventually 100%.
- Bailouts and bails-ins are a matter of the past.
- The financial institutions' earnings would be fees/commission and the margin between the interest charged to borrowers, and the interest paid to the investors. If the finance companies engage in derivative trading, their investors benefit or lose according to the results.
- Banking rules and regulation need not be complex to protect depositors as they are today because deposit-taking banks are "ring fenced". See UK's Financial Services (Banking Reform) Bill 2012-13 separating deposit taking activities from investment activities, and the German "Trennbankengesetz" of 2013 which, unfortunately, has no bite being effective only for large banks with at least 100 billion euros assets.<sup>1</sup>
- Banking supervision could effectively be limited to internal and external audits by professionally licensed accountants, submitting their reports to the ECB and making them public.
- There is no compulsion for constant economic growth with an increase in the money supply to enable borrowers to pay the interest on banks' loans created as money of account.
- When debts owed to finance companies are repaid, the money supply is NOT destroyed as by present commercial banks.
- Increases in the money supply come from central bank-issued money spent into circulation by general government to cover budget deficits instead of borrowing; or to redeem old debts.
- Deposit insurance, if any, will be a thing of the past.
- The Basel Capital Accords will be redundant.

Under the Two Rule Remedy, banks can no longer create "money of account". In the long-run, all bank deposits will be 100% backed by legal tender, ie, money created by the independent note issuing central bank.

Commercial banks would be subject to a strict, not a watered down, ring-fencing, ie, a complete separation of deposit-taking and payment activities from those of lending and investing.

The deposit-taking banks would effectively be operating as agencies of the central bank where customers' deposits are ultimately held, taking customers' deposits, executing payments, and maintaining automated teller machines (ATMs); all on a credit basis, and for fees to cover the banks' operating expenses.

The lending and investing operations would be funded by investors, not depositors. The lending and investing operations would effectively be at the finance companies, the investors bearing all of the risks.

---

<sup>1</sup> Prof. em. Joseph Huber's submission to the finance committee of the Bundestag, 22.04.2013. (Huber's conclusion is published in Michael Schemmann. 2013, "Deutschlands Geld-Illusion. Monetative Reform oder Bankpleiten." IICPA Publications, ISBN978-1484920572, pp. 66, 68 et seq.)

## **The First Step to End the Euro Area's Sovereign Debt Crisis and Make the Commercial Banks Liquid**

As a first **sterile non-inflationary** act would be for the central banks to finance with new money

- governments' repayment of their commercial banks loans at the Monetary Financial Institutions (MFIs), the commercial banks, and
- governments' buy-back of general government debt securities presently held by the MFIs

both of which is merely a switch in assets for the MFIs and does not increase the money supply one *iota*, thereby relieving the general governments' budgets of the burdens to service that part of the debt and relieve the banks' of the risks of sovereign debt default.

As a result of these two kinds of repayments/buybacks, the most brutal and idiotically-misconceived austerity programs that are crippling Greece, Cyprus, Spain and Portugal (and soon Italy and perhaps also France) can be rolled back and cancelled.

As a further result of these two kinds of repayments/buybacks, the MFIs, the commercial banks, currently financing general government debt will be relatively liquid with 2.8 trillion euros of high-powered central bank money.

There is significant mental hemorrhage in the minds of the present German central banker and the present German minister of finance based on the traditional national fear of inflation, namely that money supply created by the central bank(s) signals the beginning of a repeat of the 1923 Reichsmark debacle, which was an exponential increase of Germany's post-World War One's money supply, eventually reducing the value of the Reichsmark to nothing (or precisely one US dollar to 4.2 billion Reichsmarks) (see "History of Economic Crises and Bank Failures, Hyperinflation and the *Reichsmark* Crisis of 1923" above).

The misconception is not limited to the German central bankers, but to German economists as well, who may be correct on the law governing the operation of the European Union and the ECB, but patently wrong on the facts being the "money-side":<sup>2</sup>.

*The Wall Street Journal* of 11 September 2013 reports:

"More than one hundred German economics professors, led by influential economists *Manfred Neumann* and *Roland Vaubel* are now responding to a public defense of the ECB's Outright Monetary Transactions program, or OMT, launched by a large group of European and American economists a few weeks ago. The attack comes as Germany's constitutional court is due to rule on the legality of the controversial program under German law later this year. Mr. Neumann is emeritus professor at the University of Bonn. Mr. Vaubel is a professor of economics at the University of Mannheim."

*We — 136 German professors of economics — consider the **European Central Bank's program to buy government bonds unlawful and economically amiss.** [Emphasis added.]*

---

<sup>2</sup> "Economists Call ECB's Bond Buying Plan Unlawful," article in *The Wall Street Journal*, 11 September 2013.

*Article 123 Treaty of Lisbon forbids the ECB the direct “purchase of debt instruments” from governments of Member States. The article clarifies that monetary finance of governments is inadmissible. While a purchase of bonds in secondary markets is permitted, it must serve monetary policy goals (e.g. short-run money market balance) not government finance. If monetary policy were its focus, the ECB would buy the representative bond portfolio, including sovereign or private debt from all member states. But this is not the policy. Instead the ECB concentrates on buying the bonds of over-indebted member states. This is money finance of governments.*

*Money finance of governments is rightly prohibited because it endangers the central bank’s independence from governments. The central bank’s duty is maintaining price stability; it is not reducing the sovereign risk premia member states have to pay in bond markets.*

*The authors of the above-mentioned defense of the ECB’s bond purchase program disapprove of any interference by the Bundesverfassungsgericht, the German constitutional court. They assert this to be incompatible with central bank independence. We counter: As anyone the ECB is bound to observe the law! The Treaty requires independence from politics. But the ECB is not independent if it is ready to finance member states’ budget deficits.*

The Wall Street Journal printed all of the 100+ professors’ names as if there was such a thing as collective wisdom.

Traditionally, universities on the whole do not teach, let alone research, the creation of money. And they teach that savings are needed to fund investments, as does Fed Chairman Ben Bernanke, an economist professor from Princeton University, in his address at Morehouse College, 14 April 2009.

Professor Mario Draghi of the ECB is also a professor but one who is now a practitioner of the highest ranking of monetary policy instead of in the ivory tower.

The ECB being an independent institution under European law, German courts may lack jurisdiction to rein it in; wherefore the professors’ urgings for Mario Draghi to observe the law but not to have it enforced against him, come across as a somewhat empty gesture.

I would support Prof. Draghi’s Euro Area general government debt buyback from the MFIs (in the so called secondary market), and have advocated the approach since 1991, after three years of researching money-creation, bank failures and the alarming rises of national debts, focusing on the United States and, in part, on Canada and Germany; the European Union and the ECB did not yet exist.<sup>3</sup>

My submissions are entirely my own and unsolicited.

---

<sup>3</sup> Michael Schemmann. 1991. “Money in Crisis.” 3<sup>rd</sup> ed. ISBN 2013, ISBN 978-1449583057.



Mario Draghi, President, European Central Bank, Frankfurt is captured during the special address session at the Annual Meeting 2013 of the World Economic Forum in Davos, Switzerland, January 25, 2013.

Copyright by World Economic Forum.  
. swiss-image.ch/Photo Remy  
Steinegger.<sup>4</sup>

**Mario "The Dragon" Draghi** (born 1947 in Rome) is an Italian banker and professor of economics who succeeded Jean-Claude Trichet as the President of the ECB on 1 November 2011. He was full professor at the Cesare Alfieri Faculty of Political Science of the University of Florence from 1981 until 1994 and fellow of the Institute of Politics at the John F. Kennedy School of Government at Harvard University (2001), and previously the governor of the Bank of Italy from January 2006 until October 2011. . In 2012 *Forbes* nominated Draghi 8<sup>th</sup> most powerful person in the world after Barack Obama, Angela Merkel, Vladimir Putin, Bill Gates, Pope Benedict XVI, Ben Bernanke, Saudi Arabia's Monarch Abdullah, before China's leader Xi Jinping and Britain's PM David Cameron.

The present total euro area government debt securities of €8.8 trillion has already been bought — first of all monetized — by the MFIs' with their own self-created credit or "money of account" out of nothing, before passing it on 80% to their (or other MFIs') depositors.

In terms of money supply, the depositors' purchase of government debt does not increase the money supply and is therefore inflation-sterile or neutral; but that amount which is not resold to depositors but is still held by the banks for investment did increase the money supply with the government being a new depositor for 20% of the debt.

Price inflation sets in when the money supply increases to buy the same number of goods or services available for sale. The repurchasing or buyback of government debt by the government through its own agency, the central bank, from the banks' investment holdings does NOT increase bank deposits and the money supply, but is merely a switch in assets on the balance sheets of the banks (see T-account below) with the added advantage of receipt by the banks of high-power central bank money — liquidity of the highest order — as backing for their customers' deposits.

---

<sup>4</sup> Wikipedia, "Mario Draghi; license under the Creative Commons Attribution-Share Alike 2.0 Generic license.

**Demonstrative Bank**  
Balance Sheet

<b>Assets</b>		<b>Liabilities</b>	
Cash	x	Customer deposits	xxxx
Central bank balance	xx		
(+)			
Govt. securities	(-) xxx		

**Increasing the liquidity of euro area commercial banks**

In the matter of the banks' liquidity, as of August 2013, the euro area's commercial banks' (Monetary Financial Institutions or MFIs) had total deposits amount to €16.9 trillion<sup>5</sup> for which the MFIs held about €500 billion in cash in order to payout deposits on demand (total cash, say banknotes, in circulation was only €894 billion), representing a liquidity-to-deposit ratio of only 3% which is next to nothing. The general governments' repurchase of the debt securities which are still on the MFIs' balance sheets, namely €1.8 trillion by the ECB, and paying off the MFIs' loans to the euro area's general governments of €1 trillion by the ECB, together €2.8 trillion would increase the MFIs cash from currently €500 billion to €3.4 trillion and improve the cash-to-deposits ratio from 3% to 20%.

An increase of minimum reserve requirements to also 20% will prevent euro area MFIs from making fresh loans that would increase the money supply with the liquidity risk from another asset bubble causing inflation, and all the rest of the crises we have witnesses before. Bank management considers vault cash a necessary evil — a dead non-income producing asset — which they try to minimize to the absolutely required level, instead relying on holding marketable securities which cannot be marketed in stressed markets during times of crisis as we have seen in 2008 and after.

I have proven that redemption of general government debt by the central bank taken from the balance sheets of MFIs is sterile in that it does not increase the money supply; therefore, there is NO logic in the Maastricht Agreement, and no logic in the laws governing the European Union's operations and the European Central Bank (ECB) which allow private MFIs to monetize the governments' sovereign debt by creating and issuing their money of account out of nothing, but prohibit the ECB to do likewise with its high-powered universally accepted money, saving the governments the interest expense on their sovereign debt because any interest earned by the ECB flows back to the governments.

**Reduction of euro area general government debt**

MFIs are currently financing (say, monetizing) the euro area's General governments in the following amounts:

---

<sup>5</sup> ECB Aggregate balance sheet of euro area monetary financial institutions, excluding the Eurosystem: August 2013.

Euro area MFIs' financing of euro area  
**General governments:**

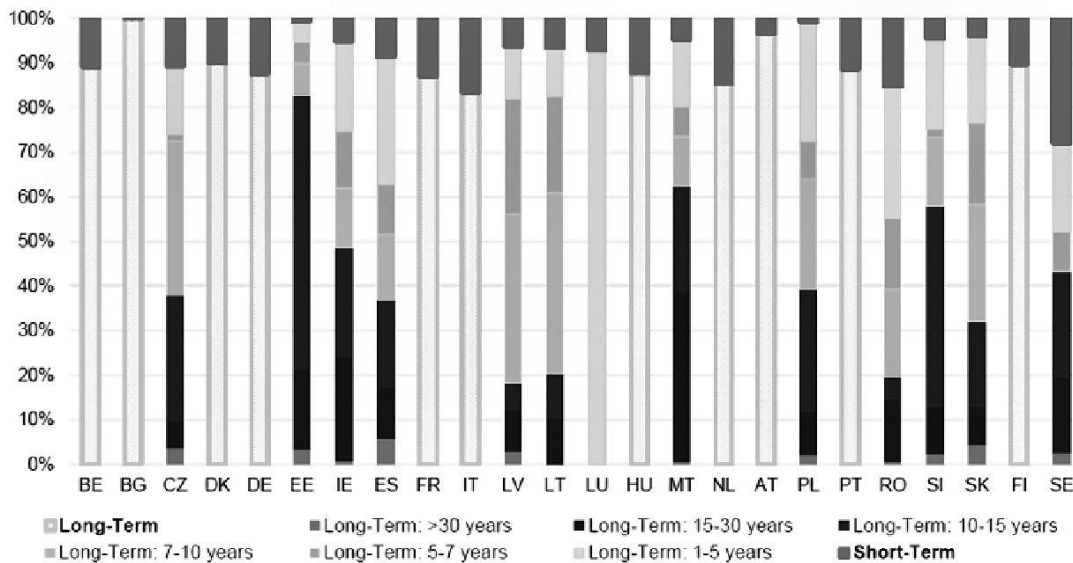
As of August 2013  
 (in billions of euros)

Loans to General government	€1,079
Holding of General government securities	<u>1,755</u>
	<b>€2,834</b>

The euro area MFIs' loans to general government plus holdings of government securities in the total amount of **€2.8 trillion euros** as of August 2013, represent about one third of the **€8.8 trillion** euro area general government's total debt.

The numbers are illustrative only, and may be accurate, or may not be accurate, which does not take away from the solution proposed herein.

Under special recall legislation, this €2.8 trillion euro area general government debt can be subject to instant redemption, financed by the ECB without price inflation, or when due at maturity — 10-15% of debt matures within 1 year, 80-90% within 1 to 5 years.



2012 General government gross debt (Maastricht debt) by maturity (Eurostat).



TABLE — showing:  
**EU and Euro Area general government debt**

Euro area loans and securities monetized and held by euro area commercial banks (MFI)  
 Remaining amount of euro area general government debt subsequent to buyback with ECB funds

In billions of euros	EU 27 (2012) general govt. debt	EA 17 (2012) general govt. debt	Loans to general govt Aug 2013 (1.1.2)	Securit. hold'g of gen. govt Aug 2013 (1.2.2)	Total loans + securit. buyback	Approx. 2012 General govt debt remaining
Belgium	375	<b>375</b>	25	88	113	<b>262</b>
Bulgaria	7					
Czech Rep	70					
Denmark	112					
Germany	2,166	<b>2,166</b>	371	344	715	<b>1,451</b>
Estonia	2	<b>2</b>	1	0	1	<b>1</b>
Ireland	192	<b>192</b>	5	57	62	<b>130</b>
Greece	304	<b>304</b>	7	13	20	<b>284</b>
Spain	884	<b>884</b>	97	313	410	<b>474</b>
France	1,834	<b>1,834</b>	216	260	476	<b>1,358</b>
Croatia						
Italy	1,989	<b>1,989</b>	260	423	683	<b>1,306</b>
Cyprus	15	<b>15</b>	1	6	7	<b>8</b>
Latvia	9					
Lithuania	13					
Luxemb'g *)	9	<b>9</b>	4	53	57	
Hungary	77					<b>0</b>
Malta	5	<b>5</b>	0	3	3	<b>2</b>
Netherlands	428	<b>428</b>	54	91	145	<b>283</b>
Austria	227	<b>227</b>	28	38	66	<b>161</b>
Poland	218				0	<b>0</b>
Portugal	204	<b>204</b>	7	39	46	<b>158</b>
Romania	50					<b>0</b>
Slovenia	19	<b>19</b>	2	5	7	<b>12</b>
Slovakia	37	<b>37</b>	1	12	13	<b>24</b>
Finland	103	<b>103</b>		10	10	<b>93</b>
Sweden	158					
UK	1,700					
<b>Total</b>	<b>11,207</b>	<b>8,793</b>	<b>1,079</b>	<b>1,755</b>	<b>2,834</b>	<b>6,007</b>

Sources: Eurostat, ECB Aggregated balance sheet EA MFIs Aug 2013

\*) Luxembourg ECB's stats disagree with Eurostat's.

### **Money supply — increased reserve requirements — zero inflation**

The euro area's total bank deposits as of August 2013 come to €17 trillion. Following the proposed buyback of euro area general government debt of €3 trillion, the composition of these deposits is as follows:

Deposits constituting “money of account”	€14 trillion
Deposits backed by central bank money	<u>3 trillion</u>
Total euro area bank deposits	€17 trillion

At the time of the euro-area-general-government-debt-buyback from MFIs, the minimum reserve requirement on demand deposits should be increased to nearly 20% with a view of an eventual increase to 100% and an organizational ring-fencing, completely separating deposit-taking from lending and investing operations.

As already mentioned, the above €3 trillion buyback of euro area's central government debt from monetary financial institutions (MFIs) does NOT increase the euro area's money supply, and is therefore inflation-neutral or sterile.

### **Proposal for the remaining €6 trillion general government debt redemption following the proposed €2.8 trillion buyback of the debt held by MFIs**

The euro area's total general government debt as of 2012 amounts to €8.8 trillion. If €2.8 trillion are redeemed by way of the proposed buyback, then €6 trillion of euro area general government debt remain outstanding.

To be realistic, in spite of all good intentions during elections, these remaining €6 trillion of debts will NOT be redeemed, and especially NOT be redeemed from taxes. Other more urgent programs than debt reduction are always on the horizon if and when budgets go into surplus, such as tax reductions, education, healthcare, welfare, social housing, old age security, and so on.

There is an opportunity, however, arising from the need to supply the ring-fencing deposit institutions with €14 trillion of legal tender which only the government's agency, the independent central bank, can provide in the form of central bank money (or balances at the central bank), and nothing seems more attractive than to have the central bank monetize the government's remaining debt, giving the proceeds to the ring-fenced banks, if the procedure could be sterile-inflation-neutral, but it would not be so because the €6 trillion of the remaining debt are held by the public, by people who are also depositors, by increasing their deposits and thereby the money supply accordingly.

The increase by buying back the privately held general government debt of €6 trillion would be from currently €16.9 trillion<sup>6</sup> to €22.9 trillion, or 35.5%.

---

<sup>6</sup> ECB , Aggregated balance sheet of euro area monetary financial institutions, excluding the Eurosystem: August 2013, line item 2.2 Deposits of euro area residents.

### **Alternatives — “once and for all” with inflation — bank capital equity or slow liabilities**

If the possibly and likely price of inflation up to 35% were the price of the “once and for all” monetary reform to pay off the troublesome sovereign debt, to establish a truly ring-fenced deposit system, and above all to end the brutal and damaging austerity programs in Ireland, Greece, Cyprus, Portugal and Spain with their lost generation of unemployed youth, the monetary expansion and inflation of up to 35% will be a tax which no one can avoid or escape, but it will also be a 21<sup>st</sup> century’s type of Marshall Plan that works

If the euro area general government debt redemptions would be in the form certificates other than money, but certificates that commercial banks would turn into equity capital or such other slow liability while receiving full money’s worth from the ECB, then the general government debt redemption would be inflation-neutral or sterile. What could be the form of customers’ general government debt redemption credits, must be debated.

### **Transition to 100% legal tender money system**

How to accomplish the **transition** of redeeming the remainder of the outstanding general government debt is also discussed in my book *European Monetary Reform: A Plan for the Redemption of Central Government Debt and the Financial Rehabilitation of the Eurozone*, 2010. See the list of my various publications at the end of this book.

---

List of previous publications by Michael Schemmann on money, banking and sovereign debts

(all available at Amazon.com, uk, de, fr, it, es)

- *Money in Crisis*, 1991, 2009, 2013
  - *Why Banks Keep on Failing: Money, Banking and the Basel II Accord*. Central Asia Business, Vol. 1, No. 1, 2008
  - *MBA Handbook 2008*
  - *The Complete Glossary of Accounting Terms*, 2010.
  - *American GAAP Codification*. 2010
  - *Corporate Finance, Banking Issues and Commercial Law. Professional Study Guide*, 2010
  - *Financial Accounting and Reporting — IFRS and US-GAAP - Codification Professional Study Guide*, 2010
  - *Irving Fisher's 100% Money Model to Fix the Current Banking Crisis. A Practical Solution to Resolve America's Financial System and Redeem the National Debt*, 2010
  - *European Monetary Reform: A Plan for the Redemption of Central Government Debt and the Financial Rehabilitation of the Eurozone*, 2010
  - *Money and Banking Without Public Debt*, 2011
  - *The ABC of Sovereign Debt Redemption. A Layman's Guide To Completely Avoid Governmental Austerity Programmes*, 2011
  - *European Banking Authority's 'Stress Teasing'. The fallacy of capital adequacy requirements for commercial banks*. 2011
  - *Accounting Perversion in Bank Financial Statements. Root Cause of the Ongoing Global Financial Crisis*, 2012
  - *Liquid Money – The Final Thing. Federal Reserve and Central Bank Accounts for Everyone*, 2012.
  - *Reflections on American Money, Private Wealth, the National Debt and Alternatives for Redemption*. 2012
  - *The Euro is Still the Strongest Currency Around. Analyses and Solutions for the Money and Sovereign Debt Crises of the 2010s*. 2013.
-