Chapter 12
Eurozone Banking Reform 2015:
An accounting solution with the added benefit of paying off the Governments' Debts

Previously published by Michael Schemmann. 2010. "European Monetary Reform: A Plan for the Redemption of Central Government Debt and the Financial Rehabilitation of the Eurozone." Chapter 12 (updated February 2015)

The European Central Bank reports the combined statements of financial positions (also known as "balance sheets") as the "Aggregate balance sheet of euo area monetary financial institutions, excluding the Eurosystem: December 2014", meaning in plain words: "Combined balance sheet of all deposit-taking financial institutions, eg, banks", but not including the national central banks (NCBs) and the European Central Bank (ECB). The following numbers are used as they are given; a breakdown of the numbers is not available on the ECB's website.

The combined balance sheet shows that the banks' total deposits of about € 17 trillion about equal the banks' total loans receivable of € 17 trillion (unchanged since 2010), giving credence to the fact that banks create deposits, say fiat money, through double-entry bookkeeping based solely on the promise of the borrower to repay (plus collateral, if any) by debiting loans receivable and crediting deposits.

All Euro Area Monetary Financial Institutions
Combined Balance Sheet
As of December 2014
(in billion euros)

Money market funds and investments	1,230	Currency in circulation - memo	[1.044]
Loans to EUR res. (thereof Gen. govt. 1,115)	16,857	Deposits of EUR res (thereof Central govt. 182)	16,792
Inv. in debt sec. of EUR res. (thereof Gen.govt. 1,846)	4,537	Money market fund shares	454
External assets	4,282	Debt sec. issued	4,060
Bank buildings	202	External liabilities	3.353
Unspecified remaining assets	4,067	Unspecified remaining liabilities	4,105
	_______	Capital & reserves	2,411
	31,175		**31,175**

If government had used its constitutional money power, it would have had NO need to borrow, but could have created and spent money into circulation the same way that cash is printed and spent into circulation. Cash, also known as 'currency in circulation,' is that part of the government-debt on which no interest is paid. Cash is issued by the a nation's central bank – the ECB for the Eurozone – by debiting "notes receivable from central government" (an asset account), and crediting "notes in circulation" (a liability account). But this currency in circulation is a relatively miniscule amount of 1 trillion euros, about 6%, of the deposits created out of nothing by the banks.

A similar process is required by issuing bookmoney by the central bank: eg, debit "notes receivable from central government", and credit "central government's general account". The government would spend the money by making direct deposits (or writing cheques) for old age pensions and social security, the military, education, public works, and interest payable on its government debt.

What the central bank should have done at no interest expense to the taxpayer, is currently done by the private commercial banks, the so called "MFI" (Monetary Financial Institutions"), but at interest to the taxpayer. Interest rates are at a historical low, but if increasing again, then the governments' budgets are increasingly forked over to the government bond holders until the government debt can no longer be served and the world suffers a global financial crisis. This has been the way of the world for centuries.[1]

Bank created bookmoney is not an asset because its creation out of nothing violates all basic accounting concepts, and therefore the public has a right to see this money-creation-process-out-of-nothing-abuse ended.

A first step is to pay off the central government debt by instructing the central banks to pay it back, debiting "notes receivable from central government" (an asset) and crediting, for example, "central government redemption receipts" (a liability account) in the form of restricted ECB checks.

The ECB under its former President, Jean-Claube Trichet, was already buying Greek debt. The debt can be anulled and cancelled internally by the ECB's in the form of a bookkeeping entry, debiting the "Greek Central Government Notes Receivable", and crediting the ECB's asset account that holds the Greek government bonds.

It would be understood that the Greek government would borrow no more by issuing bonds in the market place, but only to the ECB via its central bank which is a part of the Eurosystem, and the Greek government that owns its central bank, would pay no interest on the notes issued to its central bank, or to the ECB, the same way that no interest is paid on the cash, so called currency in circulation.

Classical economic theory holds that monetizing the current Eurozone's government debt outstanding of 2013: €9,007 billion or €9 trillion[2] (2010: €7,064,000,000,000 or €7 trillion) would add to the money supply, and the excess money supply over the present money supply would cause price inflation because more

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[1] Michael Schemmann. 2014. “The Ten Day Banker. Professional Guide.” Chapter 2, “Financial Crises and Bank Failures.” IICPA Publicaitons ISBN 978-14944806

2 Eurostat General government gross debt - annual data money is seeking the same amount of goods and services produced in the economy.

There is a simple solution to control the money supply:

The excess money supply resulting from the redemption of the national debts can be mopped up [or rather sterilized] by disallowing banks to accept the redemptions receipts issued in redemption of the national debts for deposit in any money deposit account (eg, current or savings account, certificates of deposit or term deposits), but to accept the redemption receipts ONLY in payment for the issue of new bank capital equity.

The cash held by the banks at the central banks, say ECB, could be released for free disposition after raising minimum reserve requirements (which are currently negligible); to what percentage is a matter of fine-tuning by the ECB in the fulfillment of its mandate as guardian of the internal and external value of the currency, stable prices, full employment, and "growth" of the economy.

The private banks would competete for the redemption receipts, being in high-powered central bank money, in order to meet their minimum reserve requirements on deposits which they have created.

The bondholders of the of the national debts if residing in the Eurozone can be compelled by law to comply and accept new bank equity capital in payment of central government debt, which is in their best interest and would be preferable to losing their investments entirely as a result of government debt defaults.

Foreign bondholders, especially souvereigns including China, cannot be legislated to do anything and may have to be repaid with new ECB money, which would result in an increase in the Eurozone's money supply, an increase that is already underway by the ECB's purchases of government instruments in the money markets.

The government might have to exempt the banks from taxation on a *pro rata* basis for awhile to enable the banks to pay dividends sufficient to maintain the attractiveness of their new capital shares to the former government bond holders. This, too, is a matter of fine tuning.

Deposit insurance would become unnecessary, and the bank's would save the cost of premiums that are prospectively levied against them.

The combined balance sheet of the Eurozone's depositary institutions after the redemption of the €9.007 trillion government debts would take the following form:

All Euro Area Monetary Financial Institutions
Combined Balance Sheet
After Euro Area Governnment Debt Redemption
Based on December 2014 Amounts
(in billion euros)

Cash at the ECB	9,007	Currency in circulation - memo	[1.044]
Money marekt funds and investments	1,230	Deposits of EUR res (thereof Central govt. 182)	16,792
Loans to EUR res. (thereof Gen. govt. 1,115)	16,857	Money market fund shares	454
Inv. in debt sec. of EUR res. (thereof Gen.govt. 1,846)	4,537	Debt sec. issued	4,060
External assets	4,282	External liabilities	3.353
Bank buildings	202	Unspecified remaining liabilities	4,105
Unspecified remaining assets	4,067	Capital and reserves	11,416
	40,182		**40,182**

Total bank deposits of €17 trillion (the same amount as before the redemption of government debts by the central banks and the ECB) would now be covered by €9 trillion of legel tender “cash” at the ECB.

Minimum reserve requirements should be put in place to reflect that percentage of up to 53.6%, as an inducement to the banks to compete for the redemption receipts, and as a limit on expansion of the money supply by creating deposit money.

The banks' liquidity in high-powered central bank money will make the Euro the strongest and most sought-after currency in the world.

Ideally, banks ought to be separated into pure deposit-taking institutions that pay no interest on deposits, and into lending institutions that reward the depositors-investors for their risk-taking.

The separation of deposit-taking departments from lending departments is suggested by Irving Fisher (1935) in his *100% Money* book.

> "The Government should take away from the banks all control over *money*, but should leave the *lending* of money to bankers. We could leave the banks free, or at any rate far freer than they are now, to lend money as they please, provided we no longer allowed them to manufacture the money which they lend.
>
> This means that in practice each commercial bank would be split into two departments, one a warehouse for money, the checking department, and the other the money lending department, virtually a savings bank or investment bank. It seems that Sir Robert Peel and Lord Overstone had such a picture in mind when they devised the plan used by the Bank of England since 1844." (See page 17 above.)

In the UK, an independent commission was being established to look at breaking up banks into their retail [deposit taking] and investment banking [lending] arms to reduce risk, as reported in the media.[3]

The following comments and figures are taken from the prior publication in 2010:

The Eurozone's central government debt redemption would save the governments the interest payments (a total of € 263 billion based on the average interest rate of 3.72%; Greece pays 7.83% – see Table 1), which would balance the budgets, and make future spending programs independent of the public debt by requiring the central banks to finance the programs in line with an authorized increase of the money supply as required by economic

[3] "Europe seeks new levy on Banks to create crisis fund..". BBC News 26 May 2010

expansion. The 'pork barrelling' would shift from the parliaments to the board room at ECB in Frankfurt am Main.

The plan herein, when implemented, would signal the end of the Global Financial Crisis and mass unemployment; and public pensions earned by the "baby boomers" would no longer be in jeopardy.

Table 1

Euro area - IV-2009 up to May 2010 current	Pop mio (1)	Govt debt € billion (Note 2)	Interest rate (Note 11)	Debt per capita €	GDP € billion	Govt rev % GDP (Note 2)	Govt rev. € billion	Govt Debt to Govt. Rev.
Austria	8.4	184	3.48%	21,905	277	48	134	138%
Belgium	10.7	327	3.54%	30,561	338	48	163	201%
Cyprus	0.8	10	4.60%	12,500	17	40	7	146%
Finland	5.0	75	3.36%	15,000	171	53	91	82%
France	64.1	1,489	3.40%	23,229	1,919	48	923	161%
Germany	82.0	1,762	3.06%	21,488	2,407	44	1,066	165%
Greece	11.3	273	7.83%	24,159	237	37	87	312%
Ireland	4.5	105	4.76%	23,333	164	34	56	188%
Italy	60.0	1,761	4.00%	29,350	1,521	47	709	248%
Luxembourg	0.5	5	3.60%	10,000	38	42	16	32%
Malta	0.4	4	4.18%	10,000	8	41	3	123%
Netherlands	16.5	347	3.32%	21,030	570	46	264	131%
Portugal	10.6	126	4.78%	11,887	164	42	68	185%
Slovakia	6.0	23	3.93%	3,833	63	34	21	107%
Slovenia	3.0	13	3.94%	4,333	35	44	16	84%
Spain	45.8	560	3.90%	12,227	1,051	35	365	154%
	329.6	**7,064**	**3.72%**	**21,432**	**8,980**	**683**	**3,989**	**177%**
By comparison								
USA (3, 10) current	*307.0*	*10,500*		*34,202*	*11,800*	*14.4*	*1,700*	*618%*
Canada (4) - 2009 YE	*33.3*	*360*		*10,811*	*1,070*	*41.3*	*442*	*81%*
UK (5) - current	*61.4*	*1,120*		*18,241*	*1,640*	*40.3*	*661*	*169%*

Notes:

(1) Wikipedia http://en.wikipedia.org/wiki/Eurozone
(2) Eurostat News Release (per 2009) http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-22042010-BP/EN/2-22042010-BP-EN.PDF

(3) FRB H.4.1, H.8 (& US Treas direct) http://www.federalreserve.gov/releases/h8/current/

(4) Stats Canada, Bk of Can Annual Rep http://www40.statcan.ca/l01/cst01/finn17a-eng.htm
(5) Eurostat (2) (and BOE Bankstats) http://www.bankofengland.co.uk/statistics/ms/current/index.htm#b
(6) ECB aggregate bal sheet - APR 2010 http://www.ecb.int/stats/money/aggregates/bsheets html/outstanding_amounts_2010-04.en.html
(7) Deutsche Bundesbank 'Minimum Reserves' negibile http://www.bundesbank.de/gm/gm_mindestreserven.en.php

(8) ECB "Minimum Reserves' (1 Percent) http://www.ecb.int/mopo/implement/mr/

html/index.en.html

(9) ECB aggregate balance sheet 'Holdings of securities other than shares of EUR residents' (which include 71 percent Monetary Financial Institutions -
eg from 'pumping money' into system, see, for example, WStJ article 25 June 2009 " ECB Lends Record $622 Billion [€ 442] in Bid to Ease Crisis" at http://online.wsj.com/article/SB124583774423646701.html

Table 1 (cont'd)

Euro area - IV-2009 up to May 2010 current	Deposits EUR res. € billion (Note 6)	Central Bk Money Creat'n € billion (Notes 7, 8, 9)	Excess Bk Book Money Created € billion (I minus J)	Issue Govt Debt Redmptn Recpts € billion (Colum C)	Plan Min. Resvs at NCB (L/I)
Austria	539	133	406	184	34%
Belgium	624	218	406	327	52%
Cyprus	99	25	74	10	10%
Finland	138	23	115	75	54%
France	3,549	1,156	2,393	1,489	42%
Germany	4,536	1,273	3,263	1,762	39%
Greece	373	69	304	273	73%
Ireland	655	315	340	105	16%
Italy	2,011	562	1,449	1,761	88%
Luxembourg	471	275	196	5	1%
Malta	18	5	13	4	22%
Netherlands	1,020	412	608	347	34%
Portugal	296	93	203	126	43%
Slovakia	41	15	26	23	56%
Slovenia	39	7	32	13	33%
Spain	2,183	559	1,624	560	26%
	16,592	**5,140**	**11,452**	**7,064**	**43%**
By comparison					(USA Note 10)
USA (3, 10) current	*6,202*	*885*	*5,317*	*6,202*	*100%*
Canada (4) - 2009 YE	*980*	*9*	*971*	*360*	*37%*
UK (5) - current	*4,934*	*130*	*4,804*	*1,120*	*23%*

Notes (cont.)

(10) Current Gross US Federal Debt exceeds banks deposits by 69%. Minimum Reserves at the Fed are, therefore, limited to 100% of bank deposits. The US Federal Debt's gross amount is $12,988 billion, less intragovernment debt held by US agencies of $4,493 billion, is a net of $8,495 [€ 6,906 billion) held by the public, of
which 89.8% would be redeemed under the proposal herein, putting a stop to its 'exponential explosion'.

(11) ECB Long-term interest rate statistics for EU Member States online http://www.ecb.int/stats/money/long/html/index.en.html April 2010