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Money and banking: a short primer

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Hiero  a/s/b/l

Alex Kampa

alex.kampa@riskengine.com

+352 691 46 85 81

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The Banking Law Journal, May 1913

WHAT IS MONEY?

BY A. MITCHELL INNES.

The fundamental theories on which the modern science of political economy is based are these:

That under primitive conditions men lived and live by barter;

That as life becomes more complex barter no longer suffices as a method of exchanging commodities, and by common consent one particular commodity is fixed on which is generally acceptable, and which therefore, everyone will take in exchange for the things he produces or the services he renders and which each in turn can equally pass on to others in exchange for whatever he may want;

That this commodity thus becomes a "medium of exchange and measure of value."

That a sale is the exchange of a commodity for this intermediate commodity which is called "money;"

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Alfred Mitchell Innes

Credit is the purchasing power so often mentioned in economic works as being one of the principal attributes of money, and, as I shall try to show, **credit and credit alone is money.** Credit and not gold or silver is the one property which all men seek, the acquisition of which is the aim and object of all commerce.



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Money

Money is a particular kind of debt instrument:

an anonymised, fungible, generally accepted debt instrument which can be used for repaying debts.

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Money or not ?



IOU



 **bitcoin**



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Money creation / destruction

Money gets created by simultaneously

- issuing debt
- and transforming it into money

(This transformation is done by banks)

Money gets destroyed by repaying the debt



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The widget maker

The widget-maker borrows #100 from the bank at 10% interest

The #100 allow him to buy some materials and live comfortably for a year.

At the end of the year, all the money is spent but he has produced 12 beautiful and useful widgets.

He sells 10 widgets in the market at #10 each, manages to sell another widget to the bank at #10, repays his loan from the proceeds and is left with one widget for himself.

Everyone is happy and the game can start anew....



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Of Radu, Gadu and Badu

Radu, Gadu and Badu live on a small planet with 3 mines : red, green and blue

Each owns one mine, from which he can extract as many units as necessary – it just takes a bit of work.

Each one needs at least 1 unit from each mine to live, but consuming more can be pleasurable

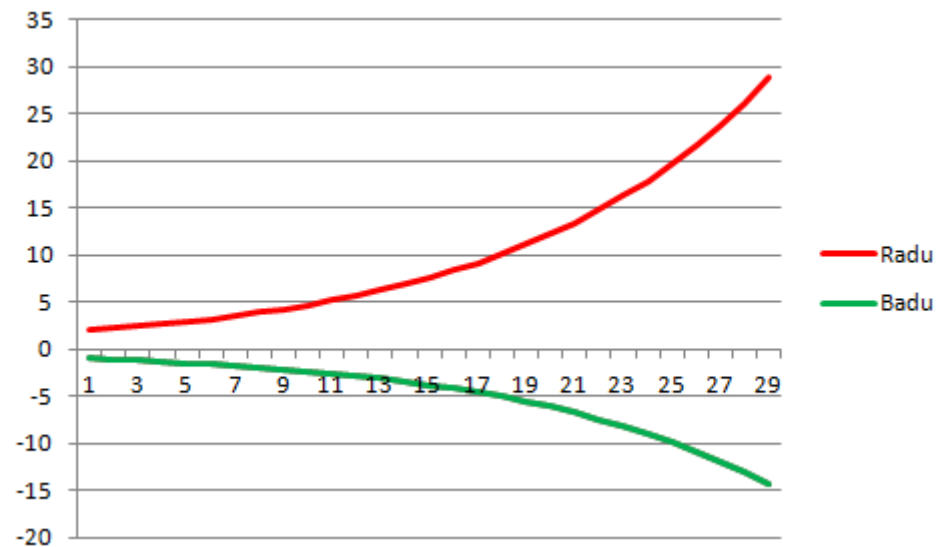
All 3 colours have to be consumed together

They set up an automated clearing system, with a 10% interest rate automatically credited / debited to each account. Each colour unit has the same value. Whoever gets more than 10 units in debt forfeits his mine.

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RGB: the party and the hangover

Gadu and Badu throw a party, during which they consume 2 units of each colour. Their accounts are thus -1 each, while Radu has 2 in his account. Even though Gadu and Badu plead with Radu to also consume a bit more so they can repay the debt, he refuses to take more than 1 unit of each colour a day. The result is:





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RGB (How it ended)

After a while Radu has so much credit that he does not need to work in his mine any more. He ends up owning all 3 mines, with Gadu and Badu doing all the mining.

Radu also finds that consuming 3 or even 4 units per day is really nice, and not having to work in the mine is even better.

Soon afterwards, Gadu and Badu gang together, beat up Radu and make him work all 3 mines.

Eventually , they take pity on him. Badu says: « Let's just go back to how it was before, but let's program the clearing system to deduct 10% from all credit and debit balances every day. » And they lived happily ever after.



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Tensions in the money system

- Everyone wants money, but for each credit there must be a debit
- The debtor wants to repay quickly, the creditor may prefer to wait
- normal debtors have to produce useful goods and services to repay, while governments do not have the same pressure; thus governments produce non-productive money
- governments have tried to repress the normal money destruction process via defaults



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Thanks!

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alex.kampa@riskengine.com

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