Liquidity

Quite simply, liquidity is the ability to pay.

We are all accustomed to paying for purchases with legal tender money. We do that in one of several ways, either by handing over paper notes or coins, by using a debit card that debits our bank or credit union account, or by using a credit card by which a bank temporarily advances the amount we need to make the purchase. In every case, it is bank-created money that is being rendered.

Banks are supposed to provide liquidity by monetizing the value-added by local enterprises. They do this by making loans to finance working capital and business expansions and development. But banking has become increasingly centralized as local banks have been taken over by large bank holding companies that have less concern for local economies and favor lower risk loans made to large corporations and government entities that are remote from the local community. Thus, money is lavished on central governments that use much of it to make war and build weapons far in excess of what is needed to provide security, and to enable the continual expansion of mega-corporations that reduce market competition and concentrate wealth in ever fewer hands.

But there are still some locally owned and managed banks. You can find some by going to http://moveyourmoneyproject.org/. Still, that is only an easy first step. Even those banks must invest much of their resources in government bills and bonds and large corporate securities in order to survive in a milieu of manipulated markets and a regulatory environment that tilts in that direction. Further, since banks create money by making loans at interest, the entire system forces continual growth of debt, artificial scarcity of money, and environmental destruction.

What must ultimately happen is described in my book, The End of Money and the Future of Civilization. A proven approach is the organization of local credit clearing exchanges that enable businesses themselves to cooperate in collectively monetizing their own value-added, without the burden of interest and without the growth imperative. This is already happening at both the grassroots and commercial levels, but more optimal exchange designs need to be implemented and the entire process needs to be scaled up by networking trade exchanges together.

Monetization

Quite simply, monetization is the process by which value claims are converted into liquid or spendable form, i.e., to a device we commonly call “money.”

Def. 1. Monetization is the process of converting the value of an illiquid asset to a liquid form, i.e., a form that can be used as a payment medium (money).
Def. 2. Monetization is the process of creating money on the basis of some foundation value.

Example: A bank or other entity can create credit instruments, like notes, “deposits,” or account balances on the basis of an asset upon which it has a claim. For example, when a bank makes a loan against a business’ inventories it creates money which can then be spent into circulation by the borrower. That money then circulates through the economy and presumably becomes available to consumers to purchase the inventory upon which that money was created. In a sense, that money is a virtual representation of the value of goods (or services) that are available for purchase in the market.

However, banks also often monetize the value of real estate or other assets that are not on the market. A bank’s mortgage claim against a property allows the bank to create an amount of money that is some portion of the presumed market value of that property. Monetization of such assets can cause general price inflation.

A peculiar and destructive aspect of the present money system is the monetization of debts, particularly the debts of the central government. The monetization of existing debts puts more money into the economy without putting more goods and services into the economy. This is a major cause of price inflation. When economists speak of debt monetization, they are referring to the process by which central banks add to the money supply by purchasing government bonds. In the United States, for example, when the Federal Reserve Banks wish to expand the amount of money in circulation, the Federal Open Market Committee (FOMC) will buy U.S. government bonds on the open market.

In brief, the process is as follows:
The FOMC purchases government bonds on the open market. It pays for them by issuing a check to the seller. This check is drawn against no funds. In other words, the Fed creates the money needed to pay for the bonds simply by making an entry on its books. But this is not the end of the monetization process. This new, so-called, high powered money enters the banking system when the bond seller deposits the funds in a bank. This provides the commercial banks with new reserves upon which the banks can expand their own lending, thus creating even more money. If the bank then buys a government bond, then still more government debt is monetized. This is a primary cause of price inflation.

Commercial banks also create money when they make loans to individuals or businesses, but these loans are usually secured by the pledge of some collateral assets—a car, a house, or some other valuable asset owned by the borrower. Thus, the banks monetize the value of that collateral, i.e., they transform the value of collateral assets into spendable form, i.e., money. As borrowers repay their bank loans, the portion of the money payment that is applied to the loan principal is extinguished. Thus money is created when banks make “loans,” and money is extinguished when loan principal is repaid.

Monetization of value outside of banks

In non-bank exchange mechanisms, such as local currencies and mutual credit systems, the
participants, apart from any bank involvement, empower themselves to monetize their own labor, skills, and inventories. They can also monetize the value of their physical assets. Established enterprises have plenty of assets that can be monetized. These include working capital (inventories of merchandise or raw materials and accounts receivable), as well as fixed capital (plant and equipment like buildings and machinery). Working capital turns over in the market in the short term, while fixed capital produces marketable goods and services over a longer time period.

A fundamental question that arises is, “which assets are appropriate for monetization and which are not?” Or, perhaps a better question is, how can each type of asset be monetized so as to provide the necessary liquidity for consumption while not adversely affecting the value of the currency or the general level of market prices?

It is better to issue a community currency by monetizing the value of existing inventories and service capabilities than it is to monetize the value of fixed assets because a loan on the former is self-liquidating. A self-liquidating loan is “a type of short- or intermediate-term credit that is repaid with money generated by the assets it is used to purchase. The repayment schedule and maturity of a self-liquidating loan are designed to coincide with the timing of the assets' income generation. These loans are intended to finance purchases that will quickly and reliably generate cash,”¹ or in the case of a credit clearing exchange, the credit that was advanced will generate sales sufficient to offset it.

Credit Money vs. Commodity Money

If only commodities are used as money, then there will always be a limited supply of money and it must circulate ever faster to mediate a growing number of desired transactions. But credit money is unlimited in supply. It can safely expand in relation to the amount of goods and services that are available to be exchanged. When lines of credit are based on historical and prospective sales, then there need never be any shortage of exchange media (credit).

We need to stop thinking of money as a THING. In a credit clearing exchange, the quantity theory of money does not hold. I show this in Chapter 12 of The End of Money and the Future of Civilization, pp. 132-133. As the example illustrates, the amount of outstanding credit (the "money" supply) can even go to zero at times. It matters not, since lines of credit are prearranged and can be drawn upon as needed to make new purchases, thus new credit money is created in the process.

¹ A self-liquidating loan is a form of short- or intermediate-term credit that is repaid with money generated by the assets it is used to purchase. The repayment schedule and maturity of a self-liquidating loan are timed to coincide with when the assets are expected to produce income. These loans are intended to finance purchases that will quickly and reliably generate cash. http://www.investopedia.com/terms/s/self-liquidating-loan.asp.