The collapse of the banking system was spectacular, but the Royal Bank of Sustainability report makes it clear that it has been failing us insidiously for years – directing money towards environmentally and socially destructive projects rather than investment in a safe future for mankind. As owners of large volumes of banking stock we have a right to reorient this investment, but we also need to think more broadly about the role that banks would play in a green society.

As a green economist and basket-maker I feel considerably more comfortable with Butterworth's Banks of Green Willow than Citibank or Royal Bank of Scotland, but the transition to a sustainable economy requires that we lock horns with the beasts that stalk the corporate jungle if only to replace their world of testosterone and risk with one of stability and mutuality. So what can we, as people who care about the planet and each other, propose as a vision for a banking system we would like to sign up to?

At the most basic level what we want a bank to do is to hold money when we have too much of it and lend it to us when we are temporarily short. Over the course of a human life these times should tend, on average, to balance up. If, for the purposes of argument, we take a life as 80 years long, we will spend the first quarter in education and the last quarter in retirement—both periods are 'in the red' in money terms. The middle period is when we are economically active and accumulating money. Beyond our individual horizon we share the value of our work that this money represents supporting our parents' generation and the children who will support us when we are no longer active.

So on a weekly, yearly and even a generational basis, this is the sort of service a bank can provide, evening up money across time and between the members of a community. This we might think of as the key function of a retail bank. Since its aim is to support the welfare of the community it makes sense that it is owned and controlled by the community, much as existing credit unions are. Like a credit union, a bank could require that we share a 'common bond'—perhaps the locality where we live or membership of a profession. The decisions about how the bank invested our money could be made by a board elected democratically from the membership. If the bank decided to invest money at interest, that interest would be shared between the members of the community; if it decided to invest money in a wind-turbine without charging interest, the community would also see the benefit.

So far I have assumed that the bank would deal primarily in the national currency, but it might also choose to handle, or even to issue, a local currency. This could then be designed to meet its own community's economic objectives. In Stroud our local currency has a form of negative interest (known as 'demurrage') which means that it loses 3% of its value every six months. This is intended to speed up its circulation to counteract the recession.

The image I am painting here is so fluffy that I am reminded of the cracker joke about the riverbank being the place where otters put their money. But let's move on to the more ferocious aspects of banking: the encounter with the big beasts. The Glass-Steagall Act that became so popular with commentators during the rollercoaster of the banking crisis was designed to separate this sort of domestic banking from the higher-risk investment banking. The confusion was what led to so many of the American poor being bankrupted during the 1929 Crash, after they had been tempted into high-interest, high-risk investments, much as punters in the UK were in the run-up to the 2008 crash.

This takes us to the very origin of banking, back in Medieval Italy, where financial traders would do their business from benches known as *banco* in Italian. These were the heady days of expanding trade—remember Shakespeare's *Merchant of Venice*?—where those with cash to spare invested it in risky sea-borne ventures. This merchant banking was always a minority sport, since it is only within the past century or so that the majority of people have had enough money to consider the need to open a bank account.

Merchant banking has always been at high risk with the possibility of correspondingly high returns—or losses. It is totally amoral and apolitical: money follows the route towards the highest profit, regardless of the social consequences. This is why there is always plenty of money to invest in derivatives and foreign exchange transactions and never enough to build hospitals or insulate school buildings. In the frenzy that preceded the crash, more and more money was being sucked into these ‘upper circuits’ and it is so concentrated there now that it is causing the asphyxiation of the real economy.

The only answer to this is a political one: we must reverse the abnegation of political control over commercial banking that has been eroded over the past 40 years, first gradually and then spectacularly with Big Bang in 1986.

Like all aspects of economic life, banking is a social activity, as proved by the immediate political response to the failure of the banking system. We all need banks, and so they should be constrained within social institutions. The free market was always a myth, but in the case of banking it has proved itself a costly and damaging one. Governments need to create socially benign frameworks for the operation of merchant banking – along the lines suggested by the Royal Bank of Sustainability proposal - and they should have the courage to reintroduce credit controls. I am not arguing for Communist-style central control and micro-direction of bank lending policies, but I would argue that the total amount that can be loaned, and the sectors it should be directed towards, should be subject to political direction. Once these socially benign structures are in place, then banks can operate freely within them.

What drives the commercial banks is the pursuit of interest, and this presents a problem for the green economist because, within a steady-state economy, it seems fairly certain that interest rates will be fixed at 0%. Interest represents the accrual of extra value and that value has to come from somewhere. Where it comes from at present is the body of our poor old mother earth. Perhaps we could squeeze some marginal extra value out of the economy via greater human ingenuity or higher energy efficiency, but once the economy is in equilibrium with the planet, interest will be only a memory.

So can we imagine a bank that functioned without interest? In fact we don’t have to because that bank already exists and is found, unsurprisingly, in Sweden. Rather than paying interest on their loans, borrowers pay after-savings (to keep the bank well capitalised) and when they have repaid the principal this is returned to them as a lump sum. The fact that it is more or less equivalent to the amount they originally borrowed indicates the iniquity of the interest-banking model.

Finally we reach the third and most abstruse role of banking: that of the banking system, working with the central bank to determine monetary policy at the macro level. How banks create money through debt is something we teach our economics students in the first year, but somehow the political implications of it do not filter into the public consciousness. We teach about the money multiplier—a means by which the banking system as a whole inflates any deposit to ten times its original size, assuming a traditional reserve ratio of 10%. Since the reserve ratio has been effectively abolished in recent years (banks having taken on a self-denying prudence they then blatantly ignored) the only effective constraint on the bank’s ability to create money was our willingness to borrow it.

The exhaustion of willing borrowers led to the collapse of this particular pyramid-selling scheme and a consequent seizing up of the money mechanism, commonly known as the credit crunch. This allowed governments to reclaim their power to make money—through the policy known as quantitative easing. The move from private money creation to public money creation was a positive one, except for the fact that the money was queased into the stock-market (via the purchase of government and other debt) rather than into the real economy.

A green chancellor would reclaim this most valuable source of common wealth, spending money into circulation as and where it was required. This would actually prove less inflationary than the current system, since the government could balance the level of money in the economy by taxing money out if price levels suggested a surfeit. The central aim of monetary policy would become to match the level of money circulation to the rate of economic activity in the economy. This would empower a green government to enable the transition to a steady state economy, and during that transition it could quease the money towards investment in the infrastructure that this economy will need. There would still be private banks, but their role would be only that of taking deposits and lending money—effectively ensuring the optimal sharing of the money stock. Their lending would only be permitted within strict reserve-ratio criteria.

The first step towards greening our banking system is to challenge and put to rest the lie that gains strength through its constant repetition: that bankers create wealth. As I hope I have explained, and by a corrupt mechanism that all progressive thinkers should learn with alacrity, banks create money, but that is by no means the same thing. As John Ruskin so eloquently put it, ‘There is no wealth but life’.