Another Way Around The Credit Crisis

Minnesota Bill Would Authorize State Banks To "Monetize" Productivity

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In August 2007, the nation was stunned by the collapse of a major Minneapolis bridge, killing nine people. The bridge had been rated structurally deficient by the U.S. government as far back as 1990, and it was only one of more than 70,000 bridges across the country with that rating. The American Society of Civil Engineers estimated that it would take nearly $190 billion to fix the country’s failing bridges over the next two decades. Minnesota and other states have the manpower and the materials to rebuild. What they lack is only the *money* to do it. Municipal governments have to borrow money by issuing bonds, and the interest they must pay on these bonds is going up.

On March 13, 2008, Erik Sirri, director of the SEC’s division of trading and markets, told Congress that the credit crisis has spread to municipal bond auctions. “There is no question that the recent dislocations in the municipal bond markets have created unanticipated hardships for municipal issuers and in some cases dramatically increased their borrowing costs,” Sirri said. The inability of cities and states to sell municipal bonds to investors at reasonable interest rates seriously threatens plans to build new roads, schools, airports and other public works projects.1

Although the cost of borrowing is going up for municipal governments, this is *not* because they are bad credit risks. In fact, they are extremely good credit risks. Creditors know where to find them, and local governments have the power to tax to pay their bills. The problem lies with the bond insurers called “monolines,” which have ventured into the very risky mortgage-backed securities market. This has put the insurers’ triple-A ratings in jeopardy, along with the ratings of the municipal bonds they insure.

While borrowing costs for municipal governments are skyrocketing, the interest rate the Federal Reserve charges to *banks* has been going *down*, even though banks are proving to be much riskier investments than local governments. The Federal Reserve is a private banking corporation that is owned by other banks. It was established in 1913 to prevent bank runs and otherwise keep the banks from getting into trouble for over-leveraging (lending out many times their assets), and that remains its principal function today. The Federal Reserve recently extended $200 billion in financing to 20 top investment banks at wholesale rates, but these low rates are not being passed on to municipal governments or home buyers. The Federal Reserve is evidently working for the banks more than for taxpayers or local governments.

Thinking Outside the Box: The Minnesota Transportation Act

Many people are getting tired of waiting for the Federal Reserve and the federal government to act, and one of them is a Minnesota resident named Byron Dale. Dale has drafted a bill called "the Minnesota Transportation Act" (MTA), which is scheduled for hearing before the Minnesota Senate Transportation Committee on March 25, 2008. If adopted, the bill could represent a major innovation in the way state and local projects are funded. It would mandate Minnesota's Transportation Department and State-chartered banks to enter into an agreement providing that the banks would advance funds for legislatively-approved transportation projects in the same way that banks make commercial loans – simply by "monetizing" the projects themselves. Banks routinely monetize the promissory notes of borrowers *just by making book entries to a checking account and saying "you have a new deposit with us."* (More on this below.)

Under the MTA, the state-chartered banks would create a pass-through account titled an Asset Monetization Account (AMA), monetizing the bid value of projects. This would be done in the same way banks that monetize collateral, except that the deposit would go on the bank's books as an asset rather than a liability, turning the bid value of the project into "money" without debt. This money would be debited electronically out of the AMA and credited to the State's Transportation Account (STA), from which it would then be debited out and credited in to the contractor's bank account in a state bank, according to the terms of the contract. The contractor would spend this money to complete the project. The money would flow into Minnesota's economy, where it would provide for better, safer, more durable roads and bridges. It would be used to purchase goods and services, benefiting business. It would go to pay taxes, helping the State balance its budget. And it would flow back into the state-chartered banks as interest on outstanding loans, reducing the number of loan defaults and improving the profits of the state-chartered banks. In this way, says Dale, the MTA would benefit every segment of society.

Too Radical? Maybe Not . . .

Dale says he has been proposing this sort of state funding alternative for years; but only now, with the looming liquidity crisis, have legislators begun to take him seriously. His plan may not be such a radical departure from existing practice as it sounds. Commercial banks are already in the business of creating money. Except for coins, our *entire* money supply is now created by banks in the form of loans.2 Indeed, banks create *all* the money they lend. This was confirmed by the Chicago Federal Reserve in a booklet called "Modern Money Mechanics," which states:

Of course, [banks] do not really pay out loans from the money they receive as deposits. If they did this, no additional money would be created. What they do when they make loans is to accept promissory notes in exchange for credits to the borrowers' transaction accounts. Loans (assets) and deposits (liabilities) both rise [by the same amount].3

Many other authorities have confirmed this money-creating mechanism of commercial banks.4 State-chartered banks get their authority to create money from the State, and the State has the authority to determine the purpose for which banks create money. State banks are now permitted to create money to monetize a mortgage or other promise to repay. They could as easily be authorized to "monetize" the promise of contractors to deliver labor and materials to the State in the form of road and bridge repair and construction.

The argument against this creative approach is that it would be inflationary, but would it? Inflation results when “demand” (money) increases faster than “supply” (goods and services); and in this case goods and services would be increasing along with the money available to spend, keeping the money supply in balance and prices stable. In fact, it is the *lending* of money created out of thin air that is inflationary, because banks create the principal but not the interest necessary to pay back their loans. Additional loans must therefore continually be taken out just to service the “money” (or debt) that is already in the money supply; and this newly-created money goes into the pockets of middlemen rather than contributing to the productivity of the community. “Demand” (money) thus goes up without a corresponding increase in “supply,” creating price inflation.

The solution to this conundrum is to authorize banks to monetize the production of *real* goods and services, creating supply and demand at the same time. There is substantial precedent for this approach, stretching as far back as the early American colonies:

* In the early eighteenth century, the colony of Pennsylvania issued money that was both lent and spent by the local government into the economy, producing an unprecedented period of prosperity. This was done not only without producing price inflation but without taxing the people.

* When Abraham Lincoln needed money to fund the American Civil War, rather than paying 25 to 36 percent interest charges, he avoided going into debt by printing Greenback dollars that were “legal tender” in themselves. Again, historians of the period attest that this issue of Greenbacks was not responsible for price inflation.

* A successful infrastructure program funded with interest-free “national credit” was instituted in New Zealand after it elected its first Labor government in the 1930s. Credit issued by its nationalized central bank allowed New Zealand to thrive at a time when the rest of the world was struggling with poverty and lack of productivity.

* The island state of Guernsey, located in the British Channel Islands, has been funding infrastructure with government-issued money for over 200 years, without creating price inflation and without government debt.5

But Is It Constitutional?

These governments could create the money they needed because they were sovereign entities, but what about individual States governed by a federal Constitution? In the United States, the U.S. Constitution controls. But that august document says very little about the creation of money – so little that banks have stepped in and taken over the business by default. Here are the sole Constitutional provisions directly addressing the creation of money:

Article I, Section 8, Clause 5: The Congress shall have Power…To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures.

Article I, Section 10, Clause 1: No State shall…coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debt.

Congress has been given the power to *coin* money, but minting coins is not the same thing as issuing paper money, checkbook money, accounting-entry money, or electronic money – the forms of money used most often today. Arguably, "to coin" money was an archaic way of saying "to create" money, but then what is to be made of the clause stating, *"No state shall . . . make any Thing but gold and silver Coin a Tender in Payment of Debt"*? "Coin" here clearly means precious metal coins, period.

That clause is interesting for another reason: when was the last time you heard of a State paying its debts in gold or silver coin? States routinely pay their debts with the bank-created accounting-entry money that now composes over 97 percent of the U.S. money supply (M3), and that form of money is omitted from the Constitution altogether. The States therefore violate the Constitution every day, something they *must* do if they are to pay their debts at all, since gold and silver coins are no longer in general circulation. The Constitution obviously needs to be amended to suit the times. Meanwhile, the Tenth Amendment to the Constitution (part of the Bill of Rights) provides:

X – Rights of the States under Constitution: The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Creating checkbook money is not specifically delegated to the United States, so it must be delegated to the States, unless it is specifically prohibited to them. What about the provision that "No State shall . . . emit Bills of Credit"? According to "the 'Lectric Law Library," "bills of credit are declared to mean *promissory notes* . . . . Bills of credit may be defined to be paper issued and intended to circulate through the community for its ordinary purposes as *money redeemable at a future day*." Bills of credit are *promises to pay later* rather than what is being discussed here: checkbook money issued as "legal tender" – the sort of dollars banks issue every day when they make commercial loans. The Constitution does not say who is authorized to issue this sort of money – whether in paper, electronic or accounting-entry form – so under the Tenth Amendment, this right is reserved to the States and to the People.

As the credit crisis deepens and exposes the inability of the existing banking structure to meet the public's needs, creative funding plans similar to the proposed MTA could be popping up in communities around the country. If the U.S. Congress and the privately-owned Federal Reserve will not issue the funds necessary for bridge and road repair and other urgent public projects, we can encourage our State legislators to fill the breach; and if they won't do it, we the people can get together, apply for a bank charter, and create the funding ourselves. (See E. Brown, "How to Start Your Own Bank," webofdebt.wordpress.com, February 23, 2008.)

Ellen Brown, J.D., developed her research skills as an attorney practicing civil litigation in Los Angeles. In Web of Debt, her latest book, she turns those skills to an analysis of the Federal Reserve and "the money trust." She shows how this private cartel has usurped the power to create money from the people themselves, and how we the people can get it back. Her eleven books include the bestselling Nature's Pharmacy, co-authored with Dr. Lynne Walker, which has sold 285,000 copies.

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