The Bankers' "Power Revolution": How the Government Got Shackled by Debt

By Ellen Brown
Global Research, May 31, 2019

Region: USA
Theme: Global Economy

This article is excerpted from my new book Banking on the People: Democratizing Money in the Digital Age, available in paperback June 1.

The U.S. federal debt has more than doubled since the 2008 financial crisis, shooting up from $9.4 trillion in mid-2008 to over $22 trillion in April 2019. The debt is never paid off. The government just keeps paying the interest on it, and interest rates are rising.

In 2018, the Fed announced plans to raise rates by 2020 to "normal" levels — a fed funds target of 3.375 percent — and to *sell* about $1.5 trillion in federal securities at the rate of $50 billion monthly, further growing the mountain of federal debt on the market. When the Fed holds government securities, it returns the interest to the government after deducting its costs; but the private buyers of these securities will be pocketing the interest, adding to the taxpayers' bill.

In fact it is the interest, not the debt itself, that is the problem with a burgeoning federal debt. The principal just gets rolled over from year to year. But the interest must be paid to private bondholders annually by the taxpayers and constitutes one of the biggest items in the federal budget. Currently the Fed's plans for "quantitative tightening" are on hold; but assuming it follows through with them, projections are that by 2027 U.S. taxpayers will owe $1 trillion annually just in interest on the federal debt. That is enough to fund President Donald Trump's trillion-dollar infrastructure plan *every year*, and it is a direct transfer of wealth from the middle class to the wealthy investors holding most of the bonds.

Where will this money come from? Crippling taxes, wholesale privatization of public assets, and elimination of social services will not be sufficient to cover the bill.

Bondholder Debt Is Unnecessary

The irony is that the United States does not need to carry a debt to bondholders at all. It has been financially sovereign ever since President Franklin D. Roosevelt took the dollar off the gold standard domestically in 1933. This was recognized by Beardsley Ruml, Chairman of the Federal Reserve Bank of New York, in a 1945 presentation before the American Bar Association titled "Taxes for Revenue Are Obsolete."

> "The necessity for government to tax in order to maintain both its independence and its solvency is true for state and local governments," he said, "but it is not true for a national government."

The government was now at liberty to spend as needed to meet its budget, drawing on credit issued by its own central bank. It could do this until price inflation indicated a weakened purchasing power of the currency.

Then, and only then, would the government need to levy taxes — not to fund the budget but to counteract inflation by contracting the money supply. The principal purpose of taxes, said Ruml, was "the maintenance of a dollar which has stable purchasing power over the years. Sometimes this purpose is stated as 'the avoidance of inflation.'"

The government could be funded without taxes by drawing on credit from its own central bank; and since there was no longer a need for gold to cover the loan, the central bank would not have to borrow. It could just create the money on its books. This insight is a basic tenet of Modern Monetary Theory: the government does not need to borrow or tax, at least until prices are driven up. It can just create the money it needs. The government could create money by issuing it directly; or by borrowing it directly from the central bank, which would create the money on its books; or by taking a perpetual overdraft on the Treasury's account at the central bank, which would have the same effect.

The "Power Revolution" — Transferring the "Money Power" to the Banks

The Treasury could do that in theory, but some laws would need to be changed. Currently the federal government is not allowed to borrow directly from the Fed and is required to have the money in its account before spending it. After the dollar went off the gold standard in 1933, Congress could have had the Fed just print money and lend it to the government, cutting the banks out. But Wall Street lobbied for an amendment to the Federal Reserve Act, forbidding the Fed to buy bonds directly from the Treasury as it had done in the past.

The Treasury can borrow from itself by transferring money from "intragovernmental accounts" — Social Security and other trust funds that are under the auspices of the Treasury and have a surplus – but these funds do not include the Federal Reserve, which can lend to the government only by buying federal securities from bond dealers. The Fed is considered independent of the government. Its website states,

> "The Federal Reserve's holdings of Treasury securities are categorized as 'held by the public,' because they are not in government accounts."

According to Marriner Eccles, chairman of the Federal Reserve from 1934 to 1948, the prohibition against allowing the government to borrow directly from its own central bank was written into the Banking Act of 1935 at the behest of those bond dealers that have an exclusive right to purchase directly from the Fed. A historical review on the website of the New York Federal Reserve quotes Eccles as stating,

> "I think the real reasons for writing the prohibition into the [Banking Act] … can be traced to certain Government bond dealers who quite naturally had their eyes on business that might be lost to them if direct purchasing were permitted."

The government was required to sell bonds through Wall Street middlemen, which the Fed could buy only through "open market operations" – purchases on the private bond market. Open market operations are conducted by the Federal Open Market Committee (FOMC), which meets behind closed doors and is dominated by private banker interests. The FOMC has no obligation to buy the government's debt and generally does so only when it serves the purposes of the Fed and the banks.

Rep. Wright Patman, Chairman of the House Committee on Banking and Currency from 1963 to 1975, called the official sanctioning of the Federal Open Market Committee in the banking laws of 1933 and 1935 "the power revolution" — the transfer of the "money power" to the banks. Patman said,

> "The 'open market' is in reality a tightly closed market."

Only a selected few bond dealers were entitled to bid on the bonds the Treasury made available for auction each week. The practical effect, he said, was to take money from the taxpayer and give it to these dealers.

Feeding Off the Real Economy

That massive Wall Street subsidy was the subject of testimony by Eccles to the House Committee on Banking and Currency on March 3-5, 1947. Patman asked Eccles,

> "Now, since 1935, in order for the Federal Reserve banks to buy Government bonds, they had to go through a middleman, is that correct?"

Eccles replied in the affirmative. Patman then launched into a prophetic warning, stating,

> "I am opposed to the United States Government, which possesses the sovereign and exclusive privilege of creating money, paying private bankers for the use of its own money. … I insist it is absolutely wrong for this committee to permit this condition to continue and saddle the taxpayers of this Nation with a burden of debt that they will not be able to liquidate in a hundred years or two hundred years."

The truth of that statement is painfully evident today, when we have a $22 trillion debt that cannot possibly be repaid. The government just keeps rolling it over and paying the interest to banks and bondholders, feeding the "financialized" economy in which money makes money without producing new goods and services. The financialized economy has become a parasite feeding off the real economy, driving producers and workers further and further into debt.

In the 1960s, Patman attempted to have the Fed nationalized. The effort failed, but his committee did succeed in forcing the central bank to return its profits to the Treasury after deducting its costs. The prohibition against direct lending by the central bank to the government, however, remains in force. The money power is still with the FOMC and the banks.

A Model We Can No Longer Afford

Today, the debt-growth model has reached its limits, as even the Bank for International Settlements, the "central bankers' bank" in Switzerland, acknowledges. In its June 2016 annual report, the BIS said that debt levels were too high, productivity growth was too low, and the room for policy maneuver was too narrow.

> "The global economy cannot afford to rely any longer on the debt-fueled growth model that has brought it to the current juncture," the BIS warned.

But the solutions it proposed would continue the austerity policies long imposed on countries that cannot pay their debts. It prescribed "prudential, fiscal and, above all, structural policies" — "structural readjustment." That means privatizing public assets, slashing services, and raising taxes, choking off the very productivity needed to pay the nations' debts. That approach has repeatedly been tried and has failed, as witnessed for example in the devastated economy of Greece.

Meanwhile, according to Minneapolis Fed president Neel Kashkari, financial regulation since 2008 has reduced the chances of another government bailout only modestly, from 84 percent to 67 percent. That means there is still a 67 percent chance of another major systemwide crisis, and this one could be worse than the last. The biggest banks are bigger, local banks are fewer, and global debt levels are higher. The economy has farther to fall. The regulators' models are obsolete, aimed at a form of "old-fashioned banking" that has long since been abandoned.

We need a new model, one designed to serve the needs of the public and the economy rather than to maximize shareholder profits at public expense.

*

Note to readers: please click the share buttons above or below. Forward this article to your email lists. Crosspost on your blog site, internet forums. etc.

An earlier version of this article was published in Truthout.org.

Ellen Brown is an attorney, founder of the Public Banking Institute, and author of thirteen books including Web of Debtand The Public Bank Solution. Her latest book is Banking on the People: Democratizing Money in the Digital Age, published by the Democracy Collaborative. She also co-hosts a radio program on PRN.FM called "It's Our Money." Her 300+ blog articles are posted at EllenBrown.com. She is a frequent contributor to Global Research.
