Credit as a Public Utility: the Key to Monetary Reform

Review Article

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We live in an era of deregulation, where economists and politicians speak of "the market," not government, as the appropriate vehicle for economic decisions. President Ronald Reagan said in his 1981 inaugural address, "Government is not a solution to our problem, government is the problem."

This attitude has defined the U.S. approach since then, including the Clinton years, when even a Democratic administration cut the size of the federal bureaucracy and tried to reduce its impact. The laissez-faire attitude has continued under President George W. Bush, though resistance is appearing from the Democratic majority elected to Congress in 2006 with respect to selected issues such as the high cost of student loans.

But if market-based economics is so wonderful, why do we have stagnating employee incomes, rapidly increasing control of wealth by the very rich, a middle class in decline, growing poverty, collapse of our manufacturing job base, a bursting housing bubble, resurgent commodity inflation, soaring but shaky stock prices, a trillion dollar war in the Middle East financed by runaway deficit spending, and capital markets dominated by predatory equity and hedge funds? Why and how has "the market" done so much damage to the many while enriching the few?

On top of everything else is the exponential growth of debt. American households today are deeper in debt than at any time in history. So is the federal government. So are state and local governments. So is business. The only ones not in debt are the financial institutions and their controllers to whom everyone else owes money. Maybe this is what is really meant by "the market."

Total U.S. societal debt has been reliably estimated at $48 trillion dollars and growing. If we assume, on the low side, that the cost of this debt is six percent interest per year, that's about $3 trillion per year in interest payments alone. This is equivalent to almost a quarter of the entire U.S. gross domestic product. It doesn't even count the repayment of the principle on the loans where repayment reduces the available purchasing power, thus making new loans constantly necessary.

Debt is an albatross around the neck of every citizen and resident, every man, woman, and child. Things have become worse since 2005 when Congress passed a much more onerous bankruptcy law at the urging of the financial industry. Some types of debt, such as student loans and taxes, can never be forgiven.

And as the debt ripples through the economy it makes everything else more expensive and turns individual financial problems into crises. It affects people's health, keeps them up at night with worry, and even drives many to alcohol, legal or illegal drugs, or even suicide. Worldwide, economic stresses and the need to constantly work harder and find new sources of income just to survive contribute to tension among nations and increase the chances of war or terrorism.

Is this really the legacy of the most highly developed and productive economy in the history of the world? Hasn't something gone terribly wrong?

CREDIT AS A PUBLIC UTILITY

In other recent reports the author has analyzed the structural causes whereby a developed economy like that of the U.S. fails to generate sufficient purchasing power through wages, salaries, and dividends to balance the cumulative prices of goods and services. In order to compensate, nations have historically attempted to generate trade surpluses to boost their income earnings, often resulting in international rivalries and war.

Over the last several decades, the U.S., with its chronic negative trade balance, has compensated for the gap between purchasing power and prices with debt of all types and in all sectors of the economy, both private and public. One effect of this general debt policy has been "dollar hegemony," whereby the dollars sent abroad to purchase products from countries like China come back in investment by the Chinese and other governments in the Treasury bonds that float the federal budget deficit.

In his reports, the author has proposed a series of monetary reform initiatives that are based on the idea that credit, properly conceived, should be viewed as a public utility like water or electricity, not the exclusive private domain of the financial industry. Given the high degree of interest by readers in these ideas, the author has concluded that a more in-depth explanation of credit is needed.

In particular, the author wishes to show that the concept of credit as a public utility is not a new idea. In fact it is inherent in the notion of a republic, a commonwealth of citizens, under which the U.S. was founded, as well as other forms of government throughout history. What is really anomalous is not the idea that credit should be viewed as a public, not a private heritage, but that the notion of the private ownership of credit to be allocated under "market" conditions ever should have gained so much credence in the first place.

OVERVIEW OF THE HISTORY OF CREDIT FROM ANCIENT TIMES THROUGH THE BANK OF ENGLAND

The free market ideology current in the U.S. and, increasingly, in other Western nations which today are losing touch with their former social democratic history, is the most extreme expression of private vs. public control of community life anywhere in the world in the last 6,000 years.

From the beginning, the societies which grew up in what we know as the cradles of civilization had communally regulated economies, especially those of a proto-urban nature in regions such as Mesopotamia, Egypt, India, and China. The same was true in the case of the Hebrew society of Palestine as well as other tribal cultures.

Among the most pressing concerns of all human societies has been to balance the rights of the individual with the needs of the community. The two have not always been seen in opposition as they tend to be today.

Individuals need the protection of a nurturing social environment, especially when they are young and when they are old. Communities, on the other hand, flourish through the contributions of strong, capable, and mature people.

The idea that is current today of the individual and community in conflict is a sign of an unbalanced paradigm. Thus we have in our own time two extreme views. One is that individuals should be able to do just about anything they want and that society is a hindrance. This is the mind-set that has fostered free-market capitalist economics. The other is that the individual should be totally subservient to the group as in state communism.

Curiously, though, neither ideology upholds the same ideals for all members of the culture. Free-market capitalists see nothing wrong if a handful of oligarchs hold everyone else in thrall to debt. The commissars of communism find it perfectly natural if their position in the party grants them privileges the rank-and-file will never attain. So both systems are rife with brutality, oppression, and hypocrisy.

Societies that wish to balance the needs of the individual with those of the community also foster a complex set of rules, laws, and customs to deal with the institution of property. Ancient religions usually saw land and other types of property as gifts of the Deity with men acting in a stewardship role.

Within the framework of this qualification, private ownership of property has been recognized as normal and natural by most cultures. The fact that no single individual can totally possess tangible goods is shown by the fact that property often outlives its owner. Thus laws of inheritance usually come into play.

Concepts of private property were also applied to money once it was invented and became current in commerce and trade. The rights of the community were recognized through the establishment of public institutions such as temples or royal palaces, supported in some measure through systems of taxation or revenues from the ownership of farmland or workshops. Both private and public parties thus took part in economic life and the exchange of money for goods and services.

A problem arose, however, when lending became involved, for all but the most rudimentary economic systems realized that a system of credit where money was borrowed and then repaid was needed to allow trade to function smoothly. According to economic historian Dr. Michael Hudson, lending was thus born from economic necessity. It also served to moderate the ups and downs of agriculture due to variations in weather by loans being extended to farmers in lean years with repayment being required when conditions improved.

Usually anyone who had money was allowed to lend, whether private individuals, kings and nobles, or priests. Interest rates were fixed by law and lasted unchanged for centuries. The recipients of lending were mainly the merchants and farmers. Failure to repay could have dire consequences, with the debtor or his family members being taken into bondage until the loan was repaid.

The harshness of such a system was ameliorated by periodic forgiveness of certain types of debts. In the case of commercial vs. agricultural lending, forfeiture of property was common.

The power of the creditor was greatest when interest was compounded, which was the norm, causing the debtor's burden to grow exponentially over time.

In the ancient Near East these practices passed from Mesopotamia to the Hebrews, the Greeks and Romans, and other cultures. But the problem of fair and equitable lending was never really solved. The Hebrew culture frowned on lending at usury, defined as charging interest. Still, lending often took place, though among the Hebrews debts were also periodically forgiven.

In Athens, Aristotle railed against compound interest, repelled by the idea that money, a sterile substance, should be allowed to multiply while its owner did nothing to enhance its productivity except to exact payment for its use from someone else.

Aristotle wrote: "The most hated sort [of wealth getting], and with the greatest reason, is usury, which makes a gain out of money itself and not from the natural object of it. For money was intended to be used in exchange but not to increase at interest. And this term interest [tokos], which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent. Whereof of all modes of getting wealth, this is the most unnatural."

Aristotle and the intellectuals of the classical age who agreed with him were the exception. Cato even likened usury to murder. But none of the ancient cultures really solved the problem that an effective source of financial credit was needed for economic progress and to moderate the natural fluctuations of economic conditions.

Over time, both the Greek and Roman cultures became thoroughly debt-ridden, leading to extreme stratification of social classes, endemic debt slavery, and eventual economic collapse. In fact, Hudson identifies the enormous "overhang" of debt as the principal cause of the fall of the Roman Empire and the start of the Dark Ages.

Next came the Christian era. It seemed that in prohibiting the practice of lending at interest, the Christians had learned a lesson which the Greeks and Romans had not. The Catholic Church outlawed money lending throughout the Middle Ages, though it was still a commercial necessity. So it was taken up by the Jews who had been excluded from most other professions. The Church prohibitions faded after the Reformation, though Martin Luther warned in dire terms against the unfairness of compound interest.

In the Islamic world, lending at interest was forbidden by the Koran. Yet a flourishing urban civilization developed in many regions through a complex commercial code whereby trade capital became available that allowed the provider to share in the profits but also in the risks of the enterprise.

It was in Italy that both modern banking and paper money were born. The Italian bankers of the Renaissance were the foremost financiers of Europe, providing liquidity for commerce but also lending large sums to kings and princes to pay for their wars. This experience showed both the good and bad sides of credit. The Medici bankers of Florence gained a reputation for enlightened stewardship where lending supported the growth both of trade and the arts of civilization. The bankers of Genoa, by contrast, were seen as greedy and cruel speculators.

The period also saw the half-legendary birth of what came to be known as fractional reserve banking, one of the most dubious innovations in history. Money at the time was viewed as a commodity—gold, silver, collectively called specie, or other substances of value. Notes redeemable in specie were printed and circulated to meet commercial needs. But a new era opened when the bankers began to issue notes in excess of their specie reserve.

The bankers were required by the laws of the municipalities to redeem their notes with gold or silver on demand. If they could not, the punishment could be execution. The value of the notes depended on the reputation of the banker along with prevailing economic conditions. But with the use of notes spread across geographical regions, through the intermediation of money brokers, trade could expand virtually without limit. This led to rapid expansion of industry and agriculture which produced the goods offered in trade.

The fractional reserve system was institutionalized on a national scale with the founding of the Bank of England in 1694. While the notes issued by the bank were ostensibly redeemable in gold, much of the collateral was in debt instruments issued by the king's treasury. England had become Great Britain and used vast sums of credit issued on a fractional reserve basis to finance its colonial wars, but only by creating a debt so monstrous that only the interest could be paid, never the principal. This was what was meant by calling it a "funded" debt.

The system was extremely ambiguous, with no clear answer as to whose money it really was—the government's whose debt instruments collateralized the system, or the private financiers who owned the bank's stock, held its gold reserve, lent the bank notes as currency, and lived off the interest payments received from the national treasury and bank customers.

Naturally it was in the government's interest to do anything it could to inflate the currency, so as to pay the interest due in installments of lesser value, even though such inflation worked against the population which had to accept the paper money when offered in trade. This made the fractional reserve system inherently corrupt and caused the government—and the financiers who propped it up—to become the monetary enemy of its own people.

THE AMERICAN EXPERIENCE

Monetary matters were clearer in England's American colonies. From the founding of Jamestown in 1607 to late in the American Revolution in 1779 there was not a single bank in North America. Goods were bartered, coinage entered the colonies through trade, and even Indian wampum was utilized. But all this was insufficient, so the colonial governments began to issue their own paper money. Notes were issued to landowners who use their land as collateral, or, in Virginia, to owners of tobacco in government warehouses.

In several of the colonies, including Massachusetts and Pennsylvania, the legislatures simply spent paper money—called "bills of credit"—into circulation then accepted it back in payment of taxes. The system worked extremely well and was explained by Benjamin Franklin in a famous 1729 pamphlet entitled, "A Modest Inquiry into the Nature and Necessity of a Paper Currency."

Franklin wrote, "The riches of a country are to be valued by the quantity of labor its inhabitants are able to purchase, and not by the quantity of gold and silver they possess." The colonial paper currencies thus allowed society to monetize the value of the goods and services its inhabitants were able to produce.

Credit was thus treated as a public utility that governments issued according to the needs of the producing economy. They followed the pattern of the medieval English kings who had issued currency in the form of specially notched sticks. Once in circulation, such credit, as money free from any liens of bank debt, could be transformed into the private ownership of the people who worked for a living. Credit issued publicly thus became private property and was protected from unlawful seizure by legal traditions going back to the Magna Carta.

Because the colonial notes were spent directly into circulation, not issued by a central bank through lending at interest, they did not inflate. They remained in circulation once spent, unlike bank loans which would have had to be repaid. Again, there were no banks in British North America, so the problem of lending never arose, though merchants financed the carrying trade and other forms of commerce on a fee basis.

It was the colonial paper currencies that by 1760 allowed the thirteen American colonies to build one of the most flourishing economies on earth with prosperity reaching to all social classes. The bankers who by now ran the British government through the Bank of England were appalled.

So in 1764 the British Parliament, at the urging of the financiers who controlled the Bank of England, outlawed the issuance of paper currency by the colonial legislatures. This act of tyranny is rarely mentioned in textbooks, but it was the ensuing contraction of the currency resulting in economic depression that was viewed by Benjamin Franklin and others as the main cause of the American Revolution.

Despite the Parliamentary prohibition on new currency issues, $22 million in colonial paper money remained in circulation. Franklin, now serving as the agent of the Pennsylvania Assembly in London, proposed a plan whereby colonial American legislatures would loan paper money into circulation using interest-bearing notes, with earned interest being shared with Great Britain in lieu of Parliament-imposed taxes.

Again, the Americans were treating money as a public utility, not the private property of a financier-owned bank. As would be expected, the plan was turned down by the British government. This was Franklin's last-ditch attempt to avoid an irreparable breach by proposing a monetary solution to a monetary problem.

The Continental Congress which began meeting in Philadelphia in 1775 pursued the same monetary policy as the colonial legislatures by authorizing the printing of Continental Currency. As documented by Stephen Zarlenga in "The Lost Science of Money," the currency inflated due largely to British counterfeiting in New York City, which was being occupied by the British army. The currency still served to keep Washington's army in the field for several years, so played an essential role in struggle for independence.

In 1778 The Articles of Confederation were adopted which authorized the Continental Congress to continue to "emit bills of credit"; i.e., to print and spend paper money into circulation without the intermediary of a bank. But over the next several years the pressures of wartime finance prevailed, and American businessmen in Philadelphia founded the Bank of North America which floated loans to Congress using the first system of fractional reserve banking in the United States.

After the war came economic depression, causing farmers, laborers, and debtors to demand new issues of state-authorized paper money. Lack of a circulating currency was the main cause of Shays's Rebellion in Massachusetts.

In 1787 the Constitutional Convention convened in Philadelphia, where more than half of the delegates were investors or speculators in public securities. The new Constitution gave Congress the right to levy taxes, borrow on the credit of the United States, and to "coin money and regulate the value thereof."

Reference to bills of credit as mentioned in the Articles of Confederation was omitted, except that states were banned from using them. This lack of any mention of paper currency soon led to confusion in determining the role of the federal government in creating money, indicating that maneuvering was going on behind the scenes by financiers who were planning to institute a system like that of the Bank of England.

In 1789 George Washington was inaugurated as the first President of the United States and named Alexander Hamilton of New York as secretary of the treasury and Thomas Jefferson of Virginia, secretary of state. Hamilton now proposed a funded national debt like the British and a national bank like the Bank of England. Hamilton was strenuously opposed by Jefferson and James Madison, who argued that a national bank was explicitly rejected by the Constitutional Convention and would be unconstitutional, as power to create one was not given to Congress by the Constitution.

Hamilton argued an "implied powers" doctrine, which President Washington accepted. This stated that Congress may take any measure necessary to implement a designated constitutional power, such as taxation, borrowing, or monetary regulation, even if the measure itself was not cited in the Constitution.

A funded debt and the First Bank of the United States were approved by Congress, but were viewed by Jefferson and his party as a virtual coup d'etat by Hamilton in imposing British monarchical institutions on the U.S.

Hamilton was candid in his attempts to bind the financiers who controlled the monetary power in the U.S. and Great Britain to the new American government, even if it involved what he acknowledged as "corruption." Hamilton also gained Congressional approval of federal assumption of state Revolutionary War debts, which led to huge windfalls for speculators who bought the securities from their original owners for pennies on the dollar.

The controversies within Washington's first administration were the origin of the American two-party system, with the Federalists being controlled by what President Martin Van Buren later called the Money Power and the Democrats being more concerned with the rights, interests, and financial solvency of ordinary Americans. Van Buren described how it happened in his book "Inquiry into the Origin and Course of Political Parties of the United States," published posthumously in 1867.

From 1789-1800 the government was dominated by the Federalists, with Hamilton at its head. Jefferson was the leader of the Republicans, later called Democrats. The First Bank of the United States operated through investors, including foreigners, who purchased Treasury bonds, then used them as capital to fund bank shares. The bank then used fractional reserve lending to issue paper currency which Hamilton candidly called "a substitute for money."

Hamilton viewed his financial policies as necessary to create what he called an American "empire." While he favored the use of public credit for government investments in public and private infrastructure, including manufactures, borrowing by the government was largely confined during his tenure as secretary of the treasury to paying war debts and starting to build a permanent army and navy.

Meanwhile, the U.S. Mint was established to mint gold or silver coins for individuals presenting bullion, which offered an alternative national currency to bank notes. Metallic coinage continued as a substantial component of the U.S. currency system until the 1930s. Eventually the value of coinage, except for purchases of convenience, was destroyed by inflation under the Federal Reserve System.

In 1800 what was called the "Civic Revolution of 1800" took place, with Jefferson being elected over President John Adams, followed by the dissolution of the Federalist Party. The triumph of what would be called the Democratic Party now took place in the executive and legislative branches of the government, though the Federalists retained control of the judicial branch by Adams' last-minute appointment of John Marshall as chief justice.

The Democrats dominated American politics until 1860 except for two four-year interludes under the Whigs. The electoral power of the Democrats was based on the numerical superiority of farmers and town laborers whom Jefferson and his successors were able to organize effectively. Sharp cutbacks took place in federal expenditures, including those for the standing army and navy, allowing Jefferson and his secretary of the treasury Albert Gallatin to balance the federal budget each of the eight years of his presidency.

Through the Louisiana Purchase of 1804, Jefferson ensured that much of America's energies over the next century would be devoted to westward expansion rather than foreign wars against European rivals. Both the federal and state governments benefited by selling public land to settlers. Later much of the land was given away for free under the Homestead Acts.

In 1811 the charter of the First Bank of the United States expired, and there was no national bank for the next five years. By now, state-chartered banks, including some banks owned outright by the states, had begun to issue paper money through fractional reserve lending. But it was a regulated system with restrictions on usury and lending confined mainly to commercial transactions.

But due to having had to borrow during the War of 1812, President Madison signed legislation in 1816 for the Second Bank of the United States, which acted as had the First Bank as the fiscal agent for the Treasury, holding government funds as part of its reserve collateral. The Second Bank gained notoriety for corruption, favoritism, and bribery of politicians.

By 1830 gold and silver specie in circulation amounted to only one-thirtieth to one-fiftieth of the U.S. gross national product, showing the continuing need for paper currency. In 1832 President Andrew Jackson vetoed a bill to renew the charter of the Second Bank of the United States, though it continued to operate under its original twenty-year charter.

In 1834 Jackson removed all federal funds from the Second Bank of the United States and deposited them in state-chartered banks. He later pulled federal funds from the banking system altogether and created a system of “sub-treasuries,” which continued until 1913. The elimination of federal deposits as a banking reserve contracted the currency and caused an economic depression.

In 1836 the charter of the Second Bank expired. Until 1861 the federal government largely had balanced budgets from import, tariff, and excise revenues, with some sale of Treasury bonds to fund the Mexican War of 1845-8. State bank currencies expanded and provided the paper money that fueled national commerce.

Still there was a currency shortage which restricted economic growth, but the discovery of gold in California increased the coinage in circulation and fueled the expansion of trade and manufacturing. The railroad industry was one of the main beneficiaries of economic growth during this period. Public works such as turnpikes and canals were funded by state and corporate bonds.

In 1861 the Civil War began, resulting in a monetary as well as a political crisis. Congress imposed the first U.S. income tax and sharply increased excise taxes. New York bankers, also acting as agents for British and European financiers, demanded extortionist rates of interest from President Abraham Lincoln to purchase government bonds, but he refused these terms.

Congress, in emergency legislation, authorized $450 million in Greenbacks, not immediately redeemable in specie, which were spent into circulation in payment of government war obligations. Greenbacks constituted eleven percent of the circulating currency at this time and were no more inflationary than would be expected from the usual wartime price increases.

Again, Congress had decided to treat credit as a public utility, not the property of private bankers. Ordinary citizens recognized at the time that it was the Greenbacks, a true democratic currency, which saved the Union. Also at this time the federal government began to market war bonds directly to citizens, again bypassing the banks.

But the bankers were active in lobbying Congress. In 1863-4 Congress passed national banking legislation which set the stage for long-term growth in the power and influence of the U.S. banking establishment. Under the legislation the banks could issue paper debt-based currency through lending as well as deal in government bonds. The legislation also taxed state bank currency out of existence.

The post-Civil War era again saw insufficient currency to fuel the growing economy, leading to political movements such as the Greenback Party, the Populist Party, and a strong monetary expansion sentiment within the Democratic Party. But the government was largely under control of the Republicans who became increasingly pro-bank.

Farmers were particularly hard-hit by monetary scarcity, with price deflation steadily driving down market prices of their commodities and leading to frequent default on mortgages and erosion of rural economic power. Silver was demonetized by the Coinage Act of 1873, also known as “The Crime of 1873.” This was in line with a worldwide banker-sponsored shift toward a gold standard. The bankers favored this policy because it made money more scarce and secure from inflation. From 1875 to 1896 consumer prices declined about 1.7 percent a year.

By the end of the century, relief took place from discoveries of gold in South Africa and Alaska and through improved methods of extracting gold from ore. But banks using the national banking legislation were concentrating and centralizing in the financial centers of New York, Chicago, and San Francisco.

Frequent money shortages resulted in banking panics, though U.S. industrial expansion was largely fueled by the reinvestment of profits rather than through bank loans. By 1900, the U.S. currency consisted of $346 million in Greenbacks (by now redeemable in gold), $484 million in Treasury-issued silver certificates, $76 million in coined or bullion silver, and $331 million in national bank notes. Thus of a money supply of $1.237 billion, only twenty-seven percent was bank-issued debt currency.

By the early years of the twentieth century, through a period of tremendous economic expansion, the U.S. had witnessed a century of relative monetary and fiscal stability through a combination of fiat, metallic, and bank-issued currencies. This was about to change drastically, as financial and industrial capitalism had begun to merge, culminating in the appearance of business trusts. The most powerful was the Money Trust under the Morgan and Rockefeller banking interests allied with financiers from Great Britain and continental Europe.

In 1913 the Federal Reserve System was created by an act of Congress signed by President Woodrow Wilson. He later regretted doing so, saying “I have unwittingly ruined my country.”

The Federal Reserve was a privately-owned and controlled central banking system like the Bank of England. But in creating it, Congress had ceded its constitutional authority over the nation’s monetary system to the private financiers. Congressman Charles A. Lindberg, Sr., Republican of Minnesota and father of the future aviator, called the Federal Reserve Act, “the worst legislative crime of the ages.”

The process was now established whereby the Federal Reserve issued debt-based currency through purchase of Treasury securities in the open market using ledger debit entries as a substitute for real value. The collateral was the promise of the federal government to pay its debts. This was done to increase the reserves of the member banks which could then use them for lending under the fractional reserve method. The more the government borrowed, the more credit the banks could issue and the more profits they would make.

An explosion in the U.S. national debt now took place through Federal Reserve-backed financing of World War I. The government could collateralize and pay interest on the debt only through soaring income tax rates made possible by the Sixteenth Amendment to the Constitution, ratified in 1913.

Through the Federal Reserve, U.S. banks made massive loans to France, Britain, Italy, and other allied nations for their war expenditures. Looking deeper, it was through the Federal Reserve that international banking took over the U.S. economy and used its industrial wealth as a base to finance the century of total worldwide warfare that continues through today. The current “War on Terror,” also financed by public debt generated through the banking system, is the latest phase.

Massive post-World War I inflation now resulted as the Federal Reserve-generated debt doubled the consumer price index. The inflation destroyed most of the remaining value of the Greenbacks and Treasury silver certificates. U.S. government insistence that the allies repay their World War I debts contributed to European economic collapse and eventually to World War II. This policy also assured that the focal point of Western economic power now shifted from Europe to America.

The “Roaring 20s” saw massive financing of stock and real estate speculation financed by the banking system, combined with an ongoing decline of farm income due to price deflation and foreclosures. The stock market boom was a typical bubble economy made possible by the triumph of finance capitalism in harnessing and dominating the productive forces of manufacturing and agriculture.

Both in 1929 and 1932 the stock market crashed, the latter due to sudden deflation of the currency by the Federal Reserve which shipped a major portion of U.S. gold reserves to the Bank of England. The Great Depression resulted in unprecedented unemployment and economic distress. Creditors purchased huge amounts of U.S. assets at bankruptcy prices, forming the basis for many modern fortunes.

In 1932 President Herbert Hoover created the Reconstruction Finance Corporation (RFC), which moved to recapitalize failing non-Federal Reserve state banks in rural areas and small towns. RFC loan programs had a major impact over the next twenty years, providing low interest loans to the railroad industry, farmers, exporters, state and local governments, and wartime industries.

$50 billion was lent by 1953, often at interest rates of only two percent, as the RFC transformed the federal deficit into employment and saved the U.S. economy. It was another example of the effective use of credit as a public utility, similar to the Greenbacks, Continental Currency, and issuance of paper notes by the colonial legislatures.

In 1933 Franklin Delano Roosevelt was inaugurated as president and called for a national banking holiday. Roosevelt ended gold redemption for the U.S. currency and called in citizen-held gold coins and bullion which the government purchased at below-market prices.

From 1933-40 Roosevelt used the RFC, Public Works Administration, Civilian Conservation Corps, and other agencies to attack the depression and provide employment through infrastructure investment. The modern U.S. physical economy came into existence, including public schools and hospitals, dams, municipal water and sewage systems, rural electrification, etc. The RFC continued lending until 1953.

The economic expansion was financed through high income taxes, large federal deficits, and low interest rates. Later this method of producing economic growth was known as Keynesianism, named after British economist John Maynard Keynes. Congress also passed the Thomas Amendment which authorized new issues of Greenbacks, though Roosevelt did not do so.

In the depths of the Depression, while unemployment remained high, U.S. banks made more loans to European nations, including Nazi Germany. The U.S. contributed to the Depression in Europe by insisting on continued repayment of World War I debt which bankrupted and fragmented the European trade-based economies. It was financial control through bank lending that shifted the balance of power in the Western world from Europe to the United States.

World War II Lend-Lease policies and military spending finally gave the U.S. a full-employment economy while the national debt grew 418 percent to a twentieth century high of 120 percent of GNP. The post-war Bretton Woods agreements stabilized international currency exchange rates until they were abolished in 1971-2.

Post-war demobilization channeled economic activity into the civilian economy, leading to continued industrial innovation and expansion which began to stall by the time John F. Kennedy was elected president in 1960. The Bretton Woods agreements resulted in the creation of World Bank, International Monetary Fund, and General Agreement on Tariffs and Trade. These institutions became instruments of worldwide economic domination of developing countries by U.S. trade policies.

In 1961 outgoing President Dwight D. Eisenhower warned the nation against the growing power and dominance of the military-industrial complex. After President Kennedy was assassinated in 1963, mobilization for the Vietnam War and spending for President Lyndon Johnson's Great Society dominated the economy. The Department of Defense under Secretary of Defense Robert McNamara, expanded the influence of the military-industrial complex throughout the American economy and culture. The era ended in 1975 with the fall of Saigon and failure of the Vietnam War.

THE PRESENT CRISIS

In 1971 the U.S. abrogated the Bretton Woods fixed-exchange rate monetary agreements, destabilizing international currencies and leading to an era of continuous currency speculation and conflict. The main purpose was to allow the dollar to expand as an international reserve and petroleum trading currency.

This also involved President Richard Nixon in taking the final steps to remove the U.S. from any vestiges of the gold standard. It left the Federal Reserve without any monetary supply tools other than attempts to influence the economy through raising and lowering of interest rates, a policy of targeting known as "monetarism." An adjunct of monetarism was the notion of deliberately allowing the dollar to inflate as a debt-paydown mechanism.

The floating dollar allowed the U.S. to finance its budget deficits arising from military expenditures on the Vietnam War, its trade deficits resulting from the economic recovery of other nations from World War II, and the growth in domestic entitlement spending by sale of Treasury debt securities to foreign countries. This policy later became known as "dollar hegemony."

Then from 1979-83 the Federal Reserve reversed its earlier pro-inflation policies by deciding to combat inflation by contracting the money supply through steeply higher interest rates. Rates topped out at over twenty percent, which plunged the nation into the worst recession since the Great Depression.

U.S. industrial and infrastructure capacity were devastated, including the destruction of the steel industry and the creation of the "rust belt." Billions of dollars in assets were acquired by financial institutions and investors at bankruptcy prices as happened during the Depression. There was also a major decline in government infrastructure investment at all levels and the privatization of many public utilities, services, and facilities. This was the start of the "service" vs. the industrial economy as manufacturing jobs disappeared.

With deregulation of the banking industry during the Reagan administration came the era of "junk bonds" used for leveraged buyouts and mergers, along with the collapse of the savings and loan industry. Deregulation led to a sell-off of U.S. business assets with further erosion of the industrial base and sharply increased foreign acquisition of businesses.

The Reagan tax cuts for the upper brackets, combined with tax base erosion, the trillion-dollar military build-up, and proxy military action in third-world countries around the globe under the "Reagan doctrine" (Afghanistan, Nicaragua, Angola, etc.) resulted in unprecedented growth of the national debt. Overall, the Reagan years saw the greatest leap in bank prominence and power since the passage of the Federal Reserve Act in 1913.

Another recession now led to the election as president of Democrat Bill Clinton over incumbent George H.W. Bush in 1992. From 1992-9 the Clinton administration created a "strong" dollar to attract foreign capital which led to jobs and investment through the dot.com bubble. In 1992 international financiers and speculators commenced purchase of the assets of former Soviet Bloc nations in a manner similar to the U.S. sell-offs of the 1980s.

Despite the economic upturn of the 1990s, U.S. industrial jobs never came back. NAFTA, the World Trade Organization, and bilateral trade agreements resulted in the export of even more manufacturing jobs and a worsening trade deficit. Meanwhile, U.S. infrastructure was crumbling. In 1998 the American Society of Civil Engineers estimated a $1.8 trillion U.S. infrastructure maintenance deficit, including roads, bridges, water systems, school buildings, hazardous waste disposal, etc.

From 1998-2000 President Clinton achieved federal budget surpluses through fiscal discipline combined with capital gains tax revenues from the stock bubble. But in 2000 the dot.com bubble burst, leading to stockholder losses of $2 trillion, wiping out retirement funds, and eroding the tax base at all levels of government.

Federal Reserve Chairman Alan Greenspan stopped the crash after the damage had been done by creating a "wall of money" with sharply reduced interest rates. In December 2000 George W. Bush was designated president over Al Gore by the U. S. Supreme Court after the Florida vote-counting debacle.

By 2001 the U.S. economy was in recession again. Total U.S. debt of all types was running triple the GDP, with annual principle and interest payments amounting to forty percent of GDP. But the ability of the Federal Reserve System to produce hundreds of billions of dollars in lending virtually overnight was enhanced by computerized processing and modern methods of "cash management" by businesses and the banking system.

With endless possibilities of leveraged investment, equity funds, hedge funds, and derivatives trading began to dwarf the legitimate business transactions of the physical producing economy. The financial industry had become the largest line of business in America with annual profits of over $500 billion. This was more than the annual GDP of ninety-two percent of the world's nations.

Attacks on the World Trade Center and Pentagon on September 11, 2001, by alleged terrorists provided an occasion for the U.S. invasion of Afghanistan using pre-existing war plans. During 2001-2, nations designated by President Bush as an "axis of evil"—Iraq, Iran, and North Korea—had been moving toward a shift to the Euro for denomination of oil and foreign trade, threatening a stampede of oil-producing nations.

U.S. intervention failed in an abortive coup in Venezuela, the only western hemisphere OPEC nation. Meanwhile, the state and local government borrowing deficit (funds borrowed vs. paid back) reached $127 billion, up from $38 billion in 1993. A threatened loan default by Argentina was shored up by massive emergency loans by the International Monetary Fund.

By 2003 the U.S. export of jobs continued as the recession produced rising unemployment despite productivity increases from automation. The domestic economy was now largely fueled by home mortgages and refinancing due to lower interest rates that were offset by inflation of home prices, jeopardizing home ownership for future generations.

Following false claims about Iraqi possession of weapons of mass destruction, President Bush ordered the invasion that started the second Iraq war in March 2003. The wars in Afghanistan and Iraq were financed by huge quantities of government debt made necessary by the tax cuts favorable to the upper income brackets enacted by the Bush administration in 2001 and 2003.

Foreign holdings of Treasury securities now reached forty-five percent as the dollar declined against the Euro and other foreign currencies, threatening a recall of foreign investment. The banks continued to pump money into the securities markets, and the U.S. national debt reached $8.6 trillion by 2006. Forty-three percent of the debt was held by Social Security and other trust funds, endangered by the growing insolvency of the federal government.

By 2005 fifty percent of U.S. economic growth derived from the housing bubble, which began to collapse over the next year owing to the resetting of adjustable rate mortgages and the growth in foreclosures from subprime mortgages. Meanwhile, Congress passed a much more stringent bankruptcy law. In 2006, deeply concerned about the Iraq War and the shaky economy, U.S. voters gave the Democrats majorities in both houses of Congress.

Behind all the disturbing political and social events of the era was the steadily climbing burden of societal debt threatening a system-wide crash. In early 2007, the head of the Carlyle Company, an equity firm that handles investments for many former high-ranking government officials, wrote in a memo that was leaked to the press that after the expected collapse, “the buying opportunity [for distressed businesses] will be once in a lifetime.”

ANALYSIS AND CONCLUSIONS

Perhaps the most consequential event of U.S. history during the twentieth century took place when the private banking system was given control of the U.S. economy in 1913 through the passage of the Federal Reserve Act. Those who accomplished this were not only Americans but also financiers from Great Britain and continental Europe. The Federal Reserve today continues as a branch of international finance.

Since then this system has produced nearly a century of almost constant warfare, the ascent to power of the military-industrial complex/national security state, periodic creation and destruction of gigantic financial bubbles, and the erosion of ninety-five percent of the value of the U.S. dollar. The vast productive resources of the U.S. and the talents and hard work of its people have been used by the financiers for these purposes.

Side-by-side have been tremendous advances in science, technology, and medicine, and a longer human life span. But much of the investment that has produced these benefits has come through public expenditures from tax revenues, supporting, for instance, the large state research universities, or from private corporations which draw on funding from retained earnings and the capital markets.

Bank credit, by contrast, has historically been oriented toward asset purchases and speculation, especially real estate and business acquisitions, toward purchase of consumer goods by people who lack ready money to meet their needs, toward the profits drawn from capital gains fed by inflation, and toward purchase of federal government securities and lending to foreign governments. In the case of lending to governments, naturally the greatest profits are made at times of financial distress and war.

It is extremely important to understand that most of these transactions are essentially non-productive in an economic sense, involve gigantic sums of money created from “nothing” through the bankers’ fractional reserve privileges, and have little in common with the type of investment in the producing economy that takes place through the capital markets.

A typical case involves the purchase of a business by investors who borrow large sums of money to close the deal, then sell off assets, fire many of the employees, and slash the benefits of those who remain. They then use the profits from the business to repay their loans or sell the stripped-down company to other parties. This strategy is especially appealing to equity funds and is called “restructuring.”

This type of financial corruption in which the banks and investment funds are complicit has become common over the last twenty-five years. It’s another area where “market” forces are said to be at work.

The history of credit shows its power to draw forth work on the part of men and women who need to exchange goods and services among themselves in order to live. But as this report dramatizes, credit can be used for divergent purposes. Like electricity, it is neither good nor evil. It can be used or misused. Electricity can electrocute prisoners or bring light to cities. Credit in the wrong hands can start wars but used properly can accomplish miracles of science.

Today the U.S. is in great peril. Through the failed war in Iraq and the barbaric manner in which it has been carried out, our standing in the world has never been lower. As stated in the beginning of this report, our economy is wracked with debt. This debt is growing exponentially through compound interest.

In fact our producing economy has been wrecked by monetary madness. Our working population is poorer every day even as the Federal Reserve pours out trillions of dollars in new debt and the incomes of the financial magnates soar. According to a recent report from the Bank for International Settlements, money is even being lent to hedge funds which are betting on our economic decline. We are looking at a potential system-wide collapse on a scale never before seen in history.

Further, the dollar hegemony we have used so cleverly to float our national debt has come back to haunt us as we see China using the dollars they have acquired, through exploitation of their own domestic workforce in producing the goods that fill the shelves of our Walmarts, to buy up assets around the world—in Asia, Africa, Latin America, and now in the U.S. Economists who work for the Federal Reserve have advocated in print the sale of U.S. properties to China as a way of dealing with the “functional bankruptcy” of the U.S. government.

China is already dictating trade policies to us. Soon they will be dictating political policies as well. Companies like IBM, GE, and General Motors are boosting their stock prices by building factories in China to sell Chinese workers consumer goods. It's great for the stockholders of those corporations. It's death for the U.S. workers who have no jobs and no money to buy the necessities of life except through more credit card charges.

This brings us full circle to where this report began, for "market" economics is nothing more than the abuse of what should be a public good for just such selfish purposes. That is why a powerful economy such as we have built over the last several generations can do so much harm along with the obvious benefits. It's the result of monetary policies where what we were told were "market" forces were in reality the expression of unbridled greed by a financial sector that is totally out of control.

We now need to return to the recognition that money and credit truly are public utilities as recognized during colonial days and at the times of great crises such as the Revolutionary War, the Civil War, and the New Deal.

Today we are in a similar crisis, when the solution is the same as it has been in the past. It is for the commonwealth of Americans, acting through their elected representatives, to exert their constitutional prerogatives in controlling the nation's supply of money and credit.

In other reports published over the last several weeks, the author has made a number of suggestions of the steps that now should be taken. These steps follow the guidelines of numerous monetary reformers of the past but can generally be summarized in two major provisions:

1. We should spend sufficient credit into existence to supply the basic operating expenses of government at all levels without recourse to either taxes or borrowing. At least ninety percent of all taxes could be eliminated. The only taxes that should be retained would be those in the form of user fees for infrastructure operations and maintenance and those levied only for dire emergencies. Capital expenses for infrastructure construction at the federal, state, and local levels should be financed through a self-capitalized national infrastructure bank lending at zero-interest. Operating on a national scale, such a bank could begin to rebuild our job base starting at the state and local levels. A public program of direct government expenditures as described herein would be as effective, as timely, far less inflationary, and much cheaper than creating new public debt by borrowing credit created "out of thin air" by the banking system.

2. The endemic gap between prices and purchasing power in an advanced economic system in reality is the "leisure dividend" that we never received from our amazing producing economy. That gap should now be filled by a non-taxable National Dividend of two types. One would be a cash stipend paid to all citizens which would also serve the purpose of eliminating poverty by providing everyone with a basic income guarantee. The remainder of the National Dividend would consist of an overall pricing subsidy, whereby a designated proportion of all purchases, including home building expenses, would be rebated to consumers. The average National Dividend per person would probably exceed $12,000 per year under today's economic conditions. It would be a calculated value charged against a government ledger but would be off-budget, with no need to finance it with taxation or borrowing. The calculation of this dividend was outlined by the

author in his recent report, “An Emergency Program of Monetary Reform for the United States.”

The theory of this program of monetary reform derives from two principal sources. One is the worldwide National Dividend movement founded almost a century ago by Scottish engineer Major C.H. Douglas. The other is the program of monetary reform based on direct government spending set forth by groups like the American Monetary Institute in its model legislation, the American Monetary Act, to which the author of this report has contributed.

In Great Britain, similar work is being done by the Bromsborg Group and other reformers. The monetary reform movement is worldwide. Through his previous reports the author has received positive support and feedback from many countries, including Poland, Italy, India, Australia, Canada, Germany, New Zealand, and others.

The top priority of the reform program would be to use public credit to rebuild the producing economy which has been wrecked by the phony ideology of “market” economics and the inept and self-serving manipulation of the money supply by the Federal Reserve and the banks.

Direct funding of government expenditures would remove the banking system from the business of financing a massive government debt. Implementation of a National Dividend would establish the balance between production and consumption which the banks failed to do through creation of huge quantities of consumer debt to compensate for shipping our manufacturing capabilities to China and other foreign countries. Both measures would go a long away toward shifting the basis of our economy from one that uses debt for making war and transferring wealth to the upper income brackets to one that uses public control of credit to facilitate peace, domestic harmony, and economic democracy.

Once these major steps were taken, other measures could be instituted that would also reflect the status of credit as a public utility. These include the ready availability of low cost credit for consumers, small businesses, and students; the ability of capital markets to function without the destructive overhang of predatory financial methods; the elimination of all bank lending for speculation, including purchase of securities on margin, leveraged buyouts, and leveraged hedge funds and derivatives trading; restoration of a liberal bankruptcy law and the writing off much of the debt currently in place that can never be repaid, including student debt and debt held by developing nations; the elimination of fractional reserve banking by requiring that bank lending in excess of deposits be done only with credit purchased from a central government authority; the creation of a fair and structured system of international finance and investment to replace the tragically failed system of dollar hegemony; and a plan to restructure the national debt that would pay off private and foreign creditors but eliminate Treasury securities as bank collateral.

Such a program of reform would be far-reaching, but it would be based on the best traditions of America, and it would work. Above all, it would allow us as citizens of the American constitutional commonwealth to take back our country from the control of national and international finance. The same could be done by other countries. The technical know-how for accomplishing this program exists. A scaled-down banking system would still exist, but the tail would no longer wag the dog.

What we need now is for the public to wake up to the urgent need for change and for the political leadership at all levels of government to step up and make it happen. Standing in the way is the near-total control of the mass media and the major political parties by the monetary elite. Given such control, only a grass-roots movement among millions of concerned people can have an impact.

Of course it is much easier to suffer in silence, especially if people are uncertain about where their economic interests lie. But the hour is late. The U.S. is in great danger, particularly if our leaders continue to project our internal economic problems onto external enemies. What we need is a monetary system based on our best constitutional traditions that will allow us to resume our place as a great industrial democracy and live in peace with the rest of the world. The time for action is now.

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