Ground Zero on Wall Street

Fed Funds and T-Bills Hit 0% Interest

By Ellen Brown

Global Research, December 20, 2008
webofdebt.com 20 December 2008

Region: USA
Theme: Global Economy

> "I am more concerned with the return of my money than the return on my money."– Mark Twain

In the last two weeks, two federal interest rates hit all-time record lows. On December 16, the market was taken by surprise when Fed Chairman Ben Bernanke lowered the federal funds rate (the interest banks pay to borrow the reserves they need to meet their reserve requirement) to zero. The explanation given was that the Federal Reserve was just setting the rate closer to where banks had already been trading with each other for weeks.1

In an even more stunning development, the week before that the federal government itself began borrowing money for free. "We were all watching it agog," said a Treasury spokesman of the December 9 auction of three-month Treasury bills. Investors were so hungry for Treasury debt that they were snatching up the T-bills at zero percent interest. In the secondary market (investors buying from each other), Treasuries were actually trading at a negative interest rate. That meant buyers were paying more than they would get back when the Treasuries came due. Even at these unprecedented rates of non-return, the Treasury was having trouble keeping up with the demand. Four times as much money wanted in as was sought by the government, indicating much more demand than availability.2

What is going on? The credit market remains so tight that state and local governments are being forced to pay interest rates as high as 20 percent. Why is the debt of our insolvent federal government so much more desirable that investors are clamoring to buy it when the return is zero or even negative? The U.S. government is the most indebted nation in the world, with an official federal debt topping $10 trillion. Everyone knows that this debt never can or will be paid off with taxpayer dollars, now or in the future. Commentators have been warning for years that the federal debt would soon be so crippling that foreign investors would flee and the interest alone would be more than the taxpayers could pay. Why are investors now rushing in to buy the U.S. government's exploding debt, even at a 0% return? Wouldn't their money be safer and more liquid tucked under the mattress or left in cash in the bank?

Why Lend Money for Free?

The explanation proffered by commentators is that mattresses are vulnerable to thieves; and the U.S. government, though insolvent, is less likely to file for bankruptcy than either your local bank or your local government. If your bank goes bankrupt, your money will become part of an FDIC receivership. You may get it back eventually, but you could be doing without it for longer than you would like. Another problem with cash, for investors who have a lot of it, is that it can't be moved from place to place without reporting it; and huge amounts of money are difficult to convert to currency, making it more convenient to just park the funds in Treasuries.

What makes the debt of the insolvent U.S. government less risky than that of state and local governments is that the federal government has the power to print its way out of any dollar deficiency. Not that the Treasury actually prints Federal Reserve Notes (dollar bills) – the Federal Reserve does that – but the Treasury can always print more bonds, which the Federal Reserve can then be counted on to buy with new dollar bills (or, more often, with new computer entries in bank accounts).

Something More Interesting than Interest?

While that may all be true, it still doesn't seem to explain a sudden surge of interest in a potentially risky investment that generates zero profit. Or could it be that the profit is coming in other ways than interest? For banks, U.S. Treasuries are highly sought after regardless of interest rate, because the securities are considered "risk-free" for purposes of meeting the "risk-weighted" capital requirement of the Bank for International Settlements. Under the Troubled Asset Relief Program (TARP), banks can bolster their balance sheets by swapping T-bills for riskier "toxic" collateral, including those pesky derivatives that are messing up their books. Banks are allowed to buy Treasuries with their "excess reserves" (the amount by which the bank's deposits have not been leveraged by a factor of ten or so into new loans).3 By putting these lendable funds into T-bills, the TARP recipients can remove them from the reach of riskier borrowers. The fact that the Fed is now paying interest on the reserves that banks hold at the central bank could also factor into the equation.4

Adding to the heavy demand for federal securities may be competition from the Federal Reserve itself. On December 1, 2008, Chairman Bernanke announced that the Fed could soon be providing "liquidity" to the frozen credit market by buying "longer-term Treasury and agency securities on the open market in substantial quantities."5 For the Fed to buy U.S. Treasuries with money created on a printing press is actually nothing new. The process is called "open market operations" and is how the Fed has always expanded the money supply. But the Fed is now talking about "substantial quantities," and today that could mean trillions. The Los Angeles Times reported on November 30 that the loans, commitments and guarantees of the Treasury and the Fed together now come to $8.5 trillion.6 That's roughly half the gross domestic product of the whole country; yet Congress approved only $700 billion in its latest bailout excursion in October. Where is the other $7-plus trillion coming from? The Fed is obviously just creating it with accounting entries on computer screens.7 A trillion here, a trillion there, as the saying goes, and pretty soon you're talking real money.

What the Fed is doing with all this money-conjured-out-of-nothing, however, remains a state secret. When Bloomberg News sued recently under the Freedom of Information Act to find out who had received $2 trillion in loans and what the collateral was, the Fed refused to disclose the documents, claiming it was protecting "trade secrets."8 Whose trade and what sort of secrets? We're not supposed to know which banks are lined up at the trough and how dodgy their collateral is, because that would erode investor confidence. But why should we have confidence in banks engaging in "confidence tricks"?

The biggest "trade secret" of the banking business is that banks create the money they lend out of thin air. "The process by which banks create money is so simple," wrote economist John Kenneth Galbraith, "that the mind is repelled." Banks simply write "credit" into an account in exchange for the borrower's promise to repay. In the case of the federal government, the bank that "monetizes" its promise to repay is the privately-owned Federal Reserve; and today the Fed is taking that monetizing power to such dangerous lengths that the currency could be hyperinflated into oblivion.

Implications and Possibilities

When you understand this sleight of hand, the way out of the government's debt trap appears equally simple: Congress could just nationalize the Federal Reserve and print Federal Reserve Notes itself. This government-issued money could then be either spent or lent into the economy to get the wheels of production rolling again.

But isn't the Federal Reserve already a federal agency? That commonly held misconception was dispelled when the Fed refused to comply with the Bloomberg demand under the FOIA. Most of the documents, said the Fed, are held by the New York Federal Reserve; and the New York Fed is not subject to the FOIA because it is not a federal agency.9

It is not a federal agency but it should be, because we the people are picking up the tab. The Fed and the banks are creating $8 trillion out of thin air, nearly doubling the money supply; and that means the value of our dollars is being diluted by nearly 50%. If it is our money, we should get the interest, have the right to full accountability, and have control over where the money goes. Instead of pouring money into a massive black hole on the derivatives books of bankrupt banks, Congress could and should be using the national credit card to bolster manufacturing, housing and infrastructure development, either by making low-interest credit readily available to qualified borrowers or by a direct infusion of government-issued dollars into the economy.

The objection to the government printing dollars and simply spending them on public projects has always been that it would be inflationary, but that alternative would actually be less inflationary than letting the privately-owned Federal Reserve print dollars and swap them for U.S. debt, as is being done now. This is because Treasury debt, once created, is never paid off. The U.S. federal debt hasn't been paid off since the days of Andrew Jackson. Instead, U.S. government securities wind up circulating in the economy along with the dollars that were printed to buy them. These securities represent a claim against U.S. goods and services just as dollars do. Indeed, that is why the government's securities are so highly valued: they are just as good as dollars. They can be cashed in at any time for their dollar equivalent or deposited and borrowed against for an equivalent sum in loans, and they can be swapped for the risker toxic collateral that is tying up the banks' capital, preventing the banks from making new loans. Federal securities are particularly valuable to banks, because they can become the "reserves" for generating many times their face value in new loans. If the government were to print dollars directly, the bonds would be taken out of the picture. There would be debt-free, permanent money in circulation, money not subject to perpetual servicing with interest by the taxpayers.

Banking with the U.S. Government

The superior safety and security that investors feel when they stash their savings with the U.S. government could be achieved by nationalizing bankrupt banks. This is not a radical idea. Rather than being bailed out with taxpayer money, insolvent banks are actually supposed to be put into receivership under the FDIC (a government agency). It then has the option of taking the bank's stock (effectively nationalizing it) in return for getting the bank back on its feet. This was done, for example, with Continental Illinois, the nation's fourth largest bank, when it went bankrupt in the 1990s.

In a number of capitalist countries, including Switzerland and India, publicly-owned banks operate right alongside privately-owned banks. Studies in India comparing public and private banks have found that Indian public banks not only are more secure but give superior customer service.10 In European countries, working for the government is considered more prestigious than working for the private sector, and government employees have better training. Interestingly, the first banks owned publicly in democratic communities were established in the American colonies. It may be time to return to our roots and restore the U.S. banking system to public ownership again.

Ellen Brown *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 earlier books focused on the pharmaceutical cartel that gets its power from "the money trust." Her eleven books include Forbidden Medicine, Nature's Pharmacy (co-authored with Dr. Lynne Walker), and The Key to Ultimate Health (co-authored with Dr. Richard Hansen). Her websites are www.webofdebt.com and www.ellenbrown.com.*

Notes

"US Rate Futures Spike as Fed Sets Low Funds Target Range," Reuters (December 16, 2008).

Tom Petruno, "Safety Outweighs Negative Yield for Some T-bill Investors," Los Angeles Times (December 10, 2008); "Treasurys Higher as Bad News Creeps in," MarketWatch (December 9, 2008).

See Chicago Federal Reserve, Modern Money Mechanics (1961, last revised 1992), originally produced and distributed free by the Public Information Center of the Federal Reserve Bank of Chicago, Chicago, Illinois, now available on the Internet at http://landru.i-link-2.net/monques/MMM.pdf.

Mark Felsenthal, "Bailout Bill Gives Fed New Tool to Boost Liquidity," Reuters (October 3, 2008).

Scott Lanman, Vivien Lou Chen, "Bernanke Says Fed May Buy Treasuries to Aid Economy," Bloomberg News (December 1, 2008).

Jim Puzzanghera, "Bailout: Pay Now, Worry Later," Los Angeles Times (November 30, 2008).

See Ellen Brown, "Oops, We Meant $7 Trillion!", www.webofdebt.com/articles (November 30, 2008).

Mark Pittam, "Fed Refused to Disclose Recipients of $2 Trillion," Bloomberg News (December 12, 2008).

"Bloomberg Picks a Fight With the Federal Reserve," The Prudent Investor (November 9, 2008).

"State Bank of India Ranks Highest in Consumer Satisfaction," J.D. Power Asia Pacific Reports (2001); Nirmal Chandra, "Is Inclusive Growth Feasible in Neoliberal India?", www.networkideas.org (September 2008).

The original source of this article is webofdebt.com

Comment on Global Research Articles on our Facebook page

Become a Member of Global Research

Articles by: Ellen Brown