More Thoughts on Trump's $1 Trillion Infrastructure Plan

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To stimulate the economy, create new jobs and generate new GDP requires an injection of new money. Borrowing from the bond markets or off-balance-sheet in public/private partnerships won't do it. If Congress won't issue money directly, it should borrow from banks, which create money on their books when they make loans.

The Trump agenda, it seems, is not set in stone. The president-elect has a range of advisors with as many ideas. Steven Mnuchin, his nominee for Treasury Secretary, said in November that "we'll take a look at everything,"even the possibility of extending the maturity of the federal debt with 50-year or 100-year bonds to take advantage of unusually low interest rates.

Steve Bannon, appointed chief White House strategist, seems to be envisioning Roosevelt-style experimentation with whatever works. "We're just going to throw it up against the wall and see if it sticks," he said in an interview posted by Michael Wolff on November 18th:

> Like [Andrew] Jackson's populism, we're going to build an entirely new political movement. It's everything related to jobs. The conservatives are going to go crazy. I'm the guy pushing a trillion-dollar infrastructure plan. With negative interest rates throughout the world, it's the greatest opportunity to rebuild everything. Shipyards, ironworks, get them all jacked up. . . . It will be as exciting as the 1930s, greater than the Reagan revolution — conservatives, plus populists, in an economic nationalist movement.

That sounds promising. Obsolete systems will go and will be replaced. But how to ensure that the replacements are an improvement?

Another Look at the Trillion Dollar Infrastructure Plan

Current proposals for funding Trump's $1 trillion infrastructure project have been heavily criticized. In October, his economic advisors Wilbur Ross and Peter Navarro proposedfunding the plan with tax credits to private investors, who would then borrow from the bond markets. An infrastructure bank tapping into private investment has also been suggested. Both rely on public/private partnerships. Michelle Chen, writing in The Nation on December 2, calls the plan "a full on privatization assault."

A February 2015 report by Public Services International titled "Why Public-Private Partnerships Don't Work" maintains that public/private partnerships are just another form of government borrowing, moved off-balance-sheet to evade debt ceilings and deficit fears.

The report concludes:

> [E]xperience over the last 15 years shows that PPPs are an expensive and inefficient way of financing infrastructure and diverting government spending away from other public services. They conceal public borrowing, while providing long-term state guarantees for profits to private companies.

PPPs also won't work to fund the sorts of unprofitable but necessary infrastructure projects that Trump's plan is supposed to include. As observed on Bloomberg View on November 18th:

> The problem is that pension funds, hedge funds and other private parties will only back projects that produce a lucrative and steady stream of revenue to cover operating costs, interest and principal on the debt, and dividends to repay their investment. . . .
>
> Most of the physical structures that undergird the economy — for example, non-tolled roads, sewage-treatment plants, train stations and schools — produce little or no revenue. The same is true for spending on routine maintenance. . . .
>
> Unglamorous projects, like mass transit and removing lead contamination from drinking water, would fail to attract investor interest and therefore wouldn't get funding. . . .
>
> There's also the matter of capital shift, in which companies behind already-planned construction seek infrastructure-bank financing, resulting in no net new spending or hiring.

Net New Spending Requires Net New Money

There would be no net new spending or new hiring for another reason. Funding through the bond markets merely recirculates existing money, transferring it from one pocket to another, without creating the new money needed to fund new GDP. Government investment "crowds out" private investment. So argues investment advisor Paul Krasiel in a November 21st article titled "Do Larger Budget Deficits Stimulate Spending? Depends on Where the Funding Comes From." He writes:

> President-elect Trump's economic advisers have suggested that an increase in infrastructure spending could be funded largely by private entities through some kind of public-private plan. This . . . would not result in net increase in U.S. spending on domestically-produced goods and services and net increase in employment unless there were a net increase in thin-air credit. The private entities providing the bulk of financing of the increased infrastructure spending would have to get the funds either from some entities increasing their saving, that is, by cutting back on their current spending, or by selling other existing assets from their portfolios. . . . [U]nder these circumstances, there would be no net increase in spending on domestically-produced goods and services.

Krasiel concludes that "tax-rate cuts and increased government spending do not have a significant positive cyclical effect on economic growth and employment unless the government receives the funding for such out of 'thin air'." So who creates money out of thin air? One obvious possibility is the government itself, following the revolutionary lead of the American colonists and Abraham Lincoln during the Civil War. (See my earlier article here.)

But the current conservative Congress is likely to balk at that solution. A more acceptable alternative in that case could be to borrow from *banks*. Ideally, this would be the central bank, since the loan would be interest-free and could be rolled over indefinitely. But borrowing from private banks would also work, since they too simply create the money they lend on their books. (See the Bank of England's 2014 quarterly report.) Krasiel writes:

> [L]et's assume that the new government bonds issued to fund new government infrastructure spending are purchased by the depository institution system (commercial banks, S&Ls and credit unions) and the Federal Reserve. In this case, the funds to purchase the new government bonds are created, figuratively, out of "thin air". This implies that no other entity need cut back on its current spending on goods and services while the government increases its spending in the infrastructure sector.

Most New Money Is Created by Banks

Richard Werner, Professor of Economics at the University of Southampton in the UK, agrees. Werner invented the term "quantitative easing," but the central banks that adopted the term did not follow his policy advice. They tried to expand credit creation by padding the reserve accounts of banks; but the banks did not follow through with new lending into the market. Werner's suggestion was for the banks to lend directly to governments.

In a July 2012 research paper titled "How to End the European Crisis – At No Further Cost and Without the Need for Political Changes," he noted that a full 97% of the UK money supply is created by ordinary commercial banks. That makes banks far superior to the bond market in their ability to create the credit necessary to stimulate the economy. To the objection that banks don't have sufficient money to fund governments, he wrote:

> That may be true in one sense. But this is true for any loan granted by a bank. Which is why banks do not lend money, they create it: banks are allowed to invent a deposit in the borrower's account (although no new deposit was made by anyone from outside the bank) and since they function as the settlement system of the economy, nobody can tell the difference between these invented deposits and "real" ones.

Werner lists other advantages of governments funding themselves by tapping bank credit lines rather than issuing bonds. One is that the borrowing rate is substantially lower. Basel banking regulations give governments the lowest risk-weighting (zero), so they can borrow from banks at the favored-client rate; and the banks will be happy to lend, because with zero risk-weighting they will need no new capital to back the loans.

Another advantage: "Instead of primary market bond underwriters, such as Goldman Sachs, earning large fees in cosy relationships with semi-privatised public debt management agencies, banks will be the beneficiaries of this business."

Most important, however, is that with the government as borrower, banks can create the new credit necessary to underwrite new productivity.

For historical precedent, Werner cites the system of short-term bills of trade known as “Mefo Wechsel” issued by semi-public entities in Germany from 1933 onwards. These bills were bought by German banks, increasing bank credit creation:

> [T]he sharp German economic recovery from over 20% unemployment in early 1933 to virtually full employment by the end of 1936 was the result of the ensuing expansion in bank credit creation – in other words, it was the funding of fiscal policy through credit creation that caused the recovery, not fiscal stimulus per se. Japan’s experience of the 1990s has proven how even far larger fiscal expansions will not boost the economy at all if they are not funded by credit creation. [Citing sources.]

Unlike borrowing money created by the Federal Reserve, borrowing money created by banks would involve an interest cost. But as Steve Bannon observes, interest rates today are at record lows; and borrowing from banks would have the consummate advantage over borrowing from the bond market that it would expand the pool of bank deposits that are now officially counted as “money” in M2. This is what the Fed tried but failed to do with its quantitative easing policies: stimulate the economy by expanding the bank lending that expands the money supply.

For a compelling video presentation of these ideas, see Prof. Werner’s Power Point given in Dublin in April 2016, linked here.

A revolutionary movement needs a revolutionary financial system. If everything is on the table, as Steven Mnuchin says, the Trump team could consider funding its trillion dollar infrastructure plan with newly-issued credit, whether created by the Treasury or the central bank or through government credit lines with commercial banks. An Andrew Jackson-style president could avoid adding to the national debt altogether, by simply issuing an executive order to the Treasury to mint a trillion dollar coin. As shown in earlier articles here and here, this could be done without the need for congressional approval and without trrggering hyperinflation.

Ellen Brown is an attorney and author of twelve books, including the best-selling Web of Debt. Her latest book, The Public Bank Solution, explores successful public banking models historically and globally. Her 300+ blog articles are at EllenBrown.com. She can be heard biweekly on “It’s Our Money with Ellen Brown” on PRN.FM.

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