"Running Out of Money". The US Government On the Brink of Default. How Obama Could Beat the Debt Ceiling

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Until the control of the issue of currency and credit is restored to government and recognized as its most conspicuous and sacred responsibility, all talk of the sovereignty of Parliament and of democracy is idle and futile — Canadian Prime Minister William Lyon Mackenzie King, 1935

On November 3rd, the US government will again run out of money due to a debt ceiling artificially imposed by Congress. This is the third time in four years that a radical faction has taken the country to the brink of default to extort concessions that are at best only marginally related to the budget.

The debt ceiling is an unconstitutional gimmick that violates the 14th amendment, which says the validity of the government's debt shall not be questioned. The debt was incurred by Congress when it passed the budget, and the money has been borrowed and spent. Congress cannot now refuse to pay.

One good gimmick deserves another. The debt ceiling could be eliminated for good, by restoring to the government its constitutional authority to create money. Article 1, Section 8, provides: "The Congress shall have the power to coin money [and] regulate the value thereof . . . ." The president could pay the government's bills by issuing some large denomination coins by executive order.

When the Constitution was ratified, coins were the only officially recognized legal tender. By 1850, coins made up only about half the currency. Today, they make up less than one-half of one percent of the money supply – about 50 billion out of a $12 trillion circulating money supply (M2). These coins, along with about $25 billion in US Notes or Greenbacks originally issued during the Civil War, are all that is left of the Treasury's money-creating power.

As the Bank of England recently acknowledged, the vast majority of the money supply is now created privately by banks as deposits when they make loans. The power to issue the national money supply needs to be returned to the people from whom it has been deceptively usurped. As Thomas Edison observed in the 1920s:

> It is absurd to say our Country can issue bonds and cannot issue currency. Both are promises to pay, but one fattens the usurer and the other helps the People.

In Lincoln’s Footsteps

In the early days of his presidency, Barack Obama claimed Abraham Lincoln as his role model. One of Lincoln’s less well known achievements was to avoid a massive debt to private banks at usurious interest rates by restoring an earlier form of government-issued money, the paper scrip of the American colonists. In the 1860s, these US Notes or Greenbacks constituted 40% of the national currency. Today, 40% of the circulating money supply would be $5 trillion.

This massive money-printing during the Civil War did not lead to hyperinflation. US Notes suffered a drop in value as against gold, but according to Milton Friedman and Anna Schwarz in *A Monetary History of the United States, 1867-1960*, this was not due to “just printing money” but was caused by trade imbalances with foreign trading partners on the gold standard.

The Greenbacks aided the Union not only in winning the war but in funding a period of unprecedented economic expansion. Lincoln’s government created the greatest industrial giant the world had yet seen. The steel industry was launched, a continental railroad system was created, a new era of farm machinery and cheap tools was promoted, free higher education was established, government support was provided to all branches of science, the Bureau of Mines was organized, and labor productivity was increased by 50 to 75 percent.

President Obama could follow the lead of his mentor and beat the debt ceiling by calling for a new issue of debt-free US Notes. The problem with that alternative is that it would require legislation, an impossibility before the looming November 3rd debt ceiling deadline.

Another way to solve the crisis with government-issued money was proposed by Republican presidential candidate Ron Paul and endorsed by Democratic Representative Alan Grayson during the last debt ceiling crisis: the Federal Reserve could be ordered to transfer to the Treasury the federal securities it has purchased with accounting entries through “quantitative easing.” The Treasury could then just void out this part of the debt, which currently tallies in at $2.7 trillion. That alternative too would be legal, but it would require persuading the Federal Reserve to act.

A third alternative, which could be done very quickly by executive order, would be for the federal government to exercise its constitutional power to “coin money and regulate the value thereof” by minting one or more trillion dollar platinum coins.

A Treasury Issue of Special Coins

The idea of minting large denomination coins to solve economic problems was first suggested in the early 1980s by a chairman of the Coinage Subcommittee of the House of Representatives. He observed that the Constitution gives Congress the power to coin money and regulate its value, and that no limit is put on the value of the coins it creates. He said the government could pay off its entire debt with some billion dollar coins. I wrote about this in *Web of Debt* in 2007 and said it would have to be a trillion dollar coin today.

In 1982, however, Congress chose to choke off this remaining vestige of its money-creating power by imposing limits on the amounts and denominations of most coins. The one exception was the platinum coin, which a special provision allows to be minted in any amount for commemorative purposes. (31 U.S. Code § 5112.)

In 2013, Carlos Mucha, an attorney blogging under the pseudonym Beowulf, proposed issuing a platinum coin to capitalize on this loophole. With the endless gridlock in Congress over the debt ceiling, the proposal got picked up by Paul Krugman and some other economists as a way to move forward.

Philip Diehl, former head of the US Mint and co-author of the platinum coin law, confirmed that the coin would be legal tender. He said:

> In minting the $1 trillion platinum coin, the Treasury Secretary would be exercising authority which Congress has granted routinely for more than 220 years . . . under power expressly granted to Congress in the Constitution (Article 1, Section 8).

Prof. Randall Wray explained that the coin would not circulate but would be deposited in the government's account at the Fed, so it would not inflate the circulating money supply. The budget would still need Congressional approval. To keep a lid on spending, Congress would just need to abide by some basic rules of economics. It could spend on goods and services up to full employment without creating price inflation (since supply and demand would rise together). After that, it would need to tax — not to fund the budget, but to shrink the circulating money supply and avoid driving up prices with excess demand.

Why Not Pay Off the Whole Federal Debt?

As the chairman of the Coinage Subcommittee observed in the 1980s, the entire federal debt could actually be paid in this way. The Federal Reserve has already established that it can issue $4.5 trillion in accounting-entry QE without triggering hyperinflation. In fact, it has not succeeded in triggering the modest inflation the exercise was designed for. As with QE, paying the federal debt in this way would just be an asset swap, replacing an interest-bearing obligation with a non-interest-bearing one. The market for goods and services would not be flooded with "new" money that would inflate the prices of consumer goods, because the bond holders would not consider themselves any richer than before. They presumably had their money in bonds in the first place because they wanted to save it rather than spend it. They would no doubt continue to save it, either as cash or by investing it in some other interest-generating securities.

The ease with which the government's debt could be paid in this way was demonstrated in January 2004, when the US Treasury called a 30-year bond issue before its due date. The bonds were redeemed "at par" to avoid a 9-1/8% interest rate, which was then well above market rates. The Treasury's January 15, 2004 announcement said that payment would be made "in book entry form," meaning numbers were simply entered into the Treasury's online money market fund (Treasury Direct). In effect, the money just moved from an online savings account to an online depository account, converting interest-bearing bonds into non-interest-bearing cash.

Where did the Treasury get the money to refinance this $3 billion bond issue at a lower interest rate? Whether it came from the private banking system or from the Federal Reserve, it was no doubt created out of thin air. As Federal Reserve Board Chairman Marriner Eccles testified before the House Banking and Currency Committee in 1935:

> When the banks buy a billion dollars of Government bonds as they are offered .

. . they actually create, by a bookkeeping entry, a billion dollars.

The US government can just as easily create this money by a bookkeeping entry itself. It can and it should, to avoid the interest charges that compound the national debt and make it unrepayable. Quoting Thomas Edison again:

> If the Nation can issue a dollar bond it can issue a dollar bill. The element that makes the bond good makes the bill good also. The difference between the bond and the bill is that the bond lets the money broker collect twice the amount of the bond and an additional 20%. Whereas the currency, the honest sort provided by the Constitution pays nobody but those who contribute in some useful way.

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