Monetize This!: Resolving a Spiraling Public Debt Crisis

How Obama could take a Page from the Fed's Playbook

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> "Diseases desperate grown are by desperate appliances relieved, or not at all." – Shakespeare, "Hamlet"

Moody's credit rating agency is warning that the U.S. government's AAA credit rating is at risk, because it has taken on so much debt that there are few creditors left to underwrite it. Foreigners have bought as much as two-thirds of U.S. debt in recent years, but they could be doing much less purchasing of U.S. Treasury securities in the future, not so much out of a desire to chastise America as simply because they won't have the funds to do it. Oil prices have fallen off a cliff and the U.S. purchase of foreign exports has dried up, slashing the surpluses that those countries previously recycled back into U.S. Treasuries. And domestic buyers of securities, to the extent that they can be found, will no doubt demand substantially higher returns than the rock-bottom interest rates at which Treasuries are available now.1

Who, then, is left to buy the government's debt and fund President Obama's $900 billion stimulus package? The taxpayers are obviously tapped out, so the money will have to be borrowed; but borrowed from whom? The pool of available lenders is shrinking fast. Morever, servicing the federal debt through private lenders imposes a crippling interest burden on the U.S. Treasury. The interest tab was $412 billion in fiscal year 2008, or about one-third of the federal government's total income from personal income taxes ($1,220 billion in 2008). The taxpayers not only cannot afford the $900 billion; they cannot afford to increase their interest payments. But what is the alternative?

How about turning to the lender of last resort, the Federal Reserve itself? The advantage for the government of borrowing from its own central bank is that *this money is virtually free.* This is because *the Federal Reserve rebates any interest it receives to the Treasury after deducting its costs, and the federal debt is never actually paid off but is just rolled over from year to year*. Interest-free loans that are never paid off are basically free money. In 2008, 85% of the interest collected by the Federal Reserve (or "Fed") was returned to the Treasury. The average interest rate on Treasury securities today is only about 3%; 15% of 3% is less than ½% – such a negligible interest as to make the money nearly free.

The key is that the Fed does not actually have to acquire the money before lending it. The Fed originates the money it lends, either on a printing press or with accounting entries. It can purchase Treasury debt simply by writing credits into the "reserve account" of the seller's bank, which then credits the seller's account. The Fed's ability to write numbers into an account is obviously unlimited; but it has normally restricted its purchase of government securities to only so much as is necessary to provide the liquidity needed for banks to cash and clear checks. Funding the government's budget shortfall has usually been left to private lenders; but those loans are drying up, and servicing them is proving expensive. *Both this interest burden and the need to continually attract new lenders could be avoided by tapping into the government's credit line at its own central bank*.

But wouldn't that be dangerously inflationary? Not in today's economic climate, as will be shown. And if the notion of funding the government through its own central bank seems too radical and unprecedented to be entertained, consider the radical moves the Fed has already been taking in the last year. Without so much as a by-your-leave from Congress, the Fed just "monetized" $1.2 trillion in *private* debt, turning *commercial loans* into money. If private banks and private corporations now have multi-billion dollar credit lines with the Federal Reserve, then Congress should have one too. In fact Congress, which gave the Fed its charter to create the national money supply, should have been the first in line.

If the Fed Can "Monetize" Private Debt, It Can Monetize Public Debt.

The Fed has been a hotbed of radical, experimental activity in the past year. Ben Gisin is a former banker who has long been tracking the Fed's statistical releases. He says he has never seen anything like it. Assets have been magically appearing on the Fed's balance sheet, and they are not coming from any traditional source.2

In May 2007, the Fed reported assets of about $850 billion, and 92% of them were the usual federal securities (government I.O.U.s). A year later, the Fed's stash of federal securities had dropped to $500 billion, but its total assets remained substantially unchanged. The federal securities had just been swapped for other forms of debt. In January of 2009, however, the Fed reported assets of *$2.1 trillion*, an increase of *$1.2 trillion* from a year earlier.3 Where did this new money come from? The Fed's liabilities also went up by $1.2 trillion, indicating that it was creating "credit" simply by double-entry bookkeeping. Loans were being created by entering them as assets on one side of the Fed's books and as corresponding liabilities on the other.

Creating money by double-entry bookkeeping is not actually unique to the central bank. It is how *all* commercial banks come up with the money they lend, as many authorities have attested. In a revealing booklet called Modern Money Mechanics, the Chicago Federal Reserve explained how banks expand the money supply (or create money) using double-entry bookkeeping. The booklet stated:

"Of course, [banks] do not really pay out loans from the money they receive as deposits. If they did this, no additional money would be created. *What they do when they make loans is to accept promissory notes in exchange for credits to the borrowers' transaction accounts. Loans (assets) and deposits (liabilities) both rise [by the same amount]*."4

Congressman Jerry Voorhis, writing in 1973, explained how monetary expansion is built on the 10% reserve requirement imposed by the Fed:

"[F]or every $1 or $1.50 which people – or the government – deposit in a bank, the banking system can create out of thin air and by the stroke of a pen some $10 of checkbook money or demand deposits. It can lend all that $10 into circulation at interest just so long as it has the $1 or a little more in reserve to back it up."5

That means that if the Federal Reserve were operating like a commercial bank, it could take its $500 billion in U.S. securities and fan them into $5 trillion in loans; and that appears to be exactly what it has been doing. What is extraordinary is that the money is being used to make *commercial* loans. If the Fed can come up with $1.2 trillion to "monetize" private promissory notes, argues Ben Gisin, there is no reason it could not come up with $900 billion to monetize Obama's stimulus package. In fact, Congress could *mandate* the central bank that it chartered to buy the bonds needed to fund the stimulus package.

The Advantage of Borrowing from the Federal Reserve

For the government, the difference between borrowing credit created with accounting entries by a private bank and the same sort of credit created by the Federal Reserve is that borrowing from the Fed is nearly interest-free. That is true today, but it has not always been true. Congressman Wright Patman, Chairman of the House Banking and Currency Committee, wrote in a 1964 treatise called A Primer on Money:

"The Federal Reserve Banks create money out of thin air to buy Government Bonds from the U.S. Treasury . . . [creating] out of nothing a . . . debt which the American people are obliged to pay *with interest*."

Patman was outraged at the inequity of this practice and boldly agitated for Congress to nationalize the privately-owned Federal Reserve, a move that would have allowed the government to issue the national money supply directly. Needless to say, however, this proposal met with strong opposition. Nationalization did not happen, but the Fed did have to compromise. According to Jerry Voorhis:

"As a direct result of logical and relentless agitation by members of Congress, led by Congressman Wright Patman as well as by other competent monetary experts, *the Federal Reserve began to pay to the U.S. Treasury a considerable part of its earnings from interest on government securities*. This was done without public notice and few people, even today, know that it is being done. It was done, quite obviously, as acknowledgment that *the Federal Reserve Banks were acting on the one hand as a national bank of issue, creating the nation's money, but on the other hand charging the nation interest on its own credit* – which no true national bank of issue could conceivably, or with any show of justice, dare to do."

Voorhis went on, "But this is only part of the story. And the less discouraging part, at that. For where the commercial banks are concerned, there is no such repayment of the people's money." Commercial banks, he explained, do *not* rebate the interest, although they also "'buy' the bonds with newly created demand deposit entries on their books – nothing more."6

Voorhis noted that the Constitution provides, "Congress shall have the power to coin money [and] regulate the value thereof." Whether "to coin money" means "to issue money" has been debated; but as President Andrew Jackson observed, if *anyone* was given the power to issue money, it was Congress, not a private banking elite. For a full century before the American Revolution, the colonists funded a period of unprecedented prosperity and productive enterprise with paper money issued directly by their own local governments or government-owned banks. According to Benjamin Franklin, it was chiefly to get that power back after King George halted the practice that the colonists fought the Revolution.7 They won the war but lost the money-creating power to a private banking cartel. We the people now have an opportunity to get that innovative funding system back, and we can do it *without* having to convince a faction-ridden Congress that they need to do anything so controversial as nationalizing the Federal Reserve or even passing new legislation. All that is required is a shift in emphasis, a shift the Federal Reserve has been making lately itself. The Fed routinely turns government bonds into dollars in order to expand the amount of currency in circulation; it has now begun doing that with corporate debt; and Fed officials are talking about doing it with long-term federal securities. According to a January 28, 2009 Associated Press report:

"With its key lending rate to banks already near zero, the Fed pledged anew to use 'all available tools' to revive the economy. Specifically, the Fed said it is 'prepared' to buy longer-term Treasury securities if the circumstances warrant such action."8

Traditionally, government debt has been "monetized" by the Fed only to provide the bank reserves necessary to cover check cashing and clearing. This tool is now being recommended "to revive the economy." Obama's stimulus package is also intended to revive the economy. Combine the two and you have a package that stimulates the economy without adding to the impossible burden of an exponentially-increasing debt.

But Wouldn't That Be Inflationary?

The usual objection to funding the government with credits drawn on its own central bank is that the result would be inflationary. However, the scenario most feared today is actually *deflation* – a *lack* of available dollars to fuel the economy. Asset values have collapsed, and savings have collapsed along with them. People with only half as much money in their brokerage accounts have less to spend; people whose houses have plummeted in value cannot take out consumer loans against equity as was done in the boom years. Funding a "stimulus" package with existing money that is merely recycled through the banking system as loans will not stimulate the economy but will only add to the problem, by adding to the collective burden to service debt. Money that should have gone into more productive endeavors will wind up going into interest payments. To bolster demand and stimulate production, recovery requires an infusion of *new* dollars – dollars that can be used to pay wages and salaries, which can then be used to buy goods and services.

In any case, adding new money to the money supply will not inflate prices if the money is used in the production of new goods and services. Price inflation results only when "demand" (dollars) exceeds "supply" (goods and services). If the new dollars are used to create new goods and services, demand and supply will rise together and prices will remain stable. If the goods being produced are income-generating assets – railroads, bridges, alternative energy sources, low-cost housing, medical services – so much the better. The projects can be "monetized" in the same way that banks monetize mortgages – by entering them as assets on one side of their books and as liabilities on the other. The funds received from the central bank can then be repaid to the central bank from the income the assets produce, extinguishing the debt and avoiding inflation. Ideally, the projects would actually turn a profit, generating income for the government and reducing the tax burden on the public.

The bottom line is that we *cannot* borrow our way out of debt. Only *new* money will stimulate a debt-ridden economy – money that is interest-free and does not have to be paid back. The direct road to that result would have been to nationalize the Federal Reserve and return the power to create money to Congress; but as Wright Patman found, that solution is controversial and could be a difficult piece of legislation to get passed. In the meantime, the same result can be achieved by tapping into the government's nearly-interest-free credit line at the Federal Reserve. Nearly-interest-free loans of accounting-entry money that never has to be paid back are a source of debt-free liquidity that can be used to fund projects that put people back to work, without increasing the interest burden on the government or the tax burden on the public.

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*](http://www.webofdebt.com) *and* [*www.ellenbrown.com*](http://www.ellenbrown.com)*.*

Notes

1. Aaron Task, "Another $3T of U.S. Debt: Don't Count on Foreigners to Pay for Our Bailouts" (citing John Ryding, chief economist of RDQ Economics), Finance.Yahoo.com (February 13, 2009).

2. Benjamin Gisin, Michael Krajovic, "Rescuing the Physical Economy," Conscious Economics (January 2009).

3. Federal Reserve Board, "Annual Report 2007," "Statistical Tables, "No. 9: Statement of Condition of Federal Reserve Banks," & "No. 10: Income and Expenses of the Federal Reserve Banks," www.federalreserve.gov/boarddocs/rptcongress/default.htm; "Current Release," www.federalreserve.gov/releases/h41.

4. Modern Money Mechanics: A Workbook on Bank Reserves and Deposit Expansion (Federal Reserve Bank of Chicago, Public Information Service, 1992, available at http://www.rayservers.com/images/ModernMoneyMechanics.pdf), page 6.

5. J. Voorhis, The Strange Case of Richard Milhous Nixon (1973), excerpted at http://www.sonic.net/~doretk/ArchiveARCHIVE/ECONOMICSPOLITICS/FEDERAL%20RESERVE/Jerry%20VoorhisFedReserve.html.

6. Jerry Voorhis, op. cit.

7. Quoted by Congressman Charles Binderup in a 1941 speech, "How America Created Its Own Money in 1750: How Benjamin Franklin Made New England Prosperous," reprinted in Unrobing the Ghosts of Wall Street, http://reactor-core.org/america-created-money.html.

8. Jeannine Aversa, "Fed Ready to Provide Fresh Aid to Revive Economy," Associated Press (January 28, 2009).

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