Solving the Debt Crisis the American Way

Our forefathers turned their debts into currency. That Constitutional approach could work today.

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On Friday, Jan. 13, ***Treasury Secretary Janet Yellen*** *wrote to Congress that the U.S. government will hit its borrowing limit on Jan. 19, forcing the new Congress into negotiations over the debt limit much sooner than expected. She said she will use accounting maneuvers she called "extraordinary measures" to keep U.S. finances running for a few months, pushing the potential date for default to sometime in the summer. But she urged Congress to get to work on raising the debt ceiling.*

Lifting it above its current $31.385 trillion limit won't be easy with a highly divided and gridlocked Congress. As former Republican politician David Stockman crowed in a Jan. 11 article:

> 15 [House] votes and the slings and arrows of MSM opprobrium were well worth it. That's because the GOP's anti-McCarthy insurrection obtained concessions which just might slow America's headlong rush to fiscal armageddon. And just in the nick of time!
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> We are referring, of course, to the Speaker elect's promise that there will be no more debt ceiling increases without off-setting spending cuts; and that in the event of a double-cross a single Member of the House may table a motion to vacate the Speaker's chair.

Even if Congress succeeds in raising the debt ceiling, the Federal Reserve's aggressive interest rate hikes are likely to push interest on the federal debt to unsustainable levels. The problem was detailed by the House Republican Policy Committee like this:

> As of December 8, 2022, the U.S. gross national debt stood at nearly $31.5 trillion, $8.5 trillion higher than it was just three years before and the highest level in our nation's history. Last year [in March 2021], the Congressional Budget Office (CBO) projected the federal government would spend $282 billion servicing our debt in 2022, but that projection ballooned to nearly $400 billion as the Federal Reserve tightens monetary

> policy and the debt continues to grow.
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> … While interest rates have been low by historical standards, if interest rates rose to 5 percent, where they were as recently as 2007, net interest payments on the current debt level held by the public would be over $1 trillion, more than the federal government spends annually on everything but Social Security [emphasis added; endnotes omitted].

San Francisco Fed President **Mary Daly** said during a live-streamed interview with The Wall Street Journal that she expects policymakers to raise interest rates to somewhere above 5%, and JPMorgan CEO **Jamie Dimon** said it "may very well" raise rates to 6%.

The global debt cycle has reached the stage where, historically, a major "monetary reset" has been required. In 1913, it was done by instituting the Federal Reserve to backstop a banking system unable to meet withdrawals in gold. In 1933, it was done by taking the dollar off the gold standard domestically; in 1969, by taking the dollar off the gold standard internationally; and in 2008-09, by bailing out the banks with quantitative easing.

Resetting the Game Board in Line with the Constitution

What about today? In a Jan. 11 article in Forbes, after discussing the limitations of the "extraordinary measures" to which the Treasury can resort, investment advisor Simon Moore wrote:

> Some have also argued that the government could go further, perhaps invoking the 14th Amendment, or minting an enormously high-value coin as further strategies to sidestep debt ceiling issues. However, these ideas are untested …

The 14th Amendment says the validity of the government's debt shall not be questioned. Fixing the budget deficit by minting some trillion dollar coins would be a radical monetary "reset," but the approach is not actually untested. Abraham Lincoln did something similar to avoid a usurious national debt at 24 to 36% interest during the Civil War, and he was drawing from the playbook of the American colonists a century earlier.

Article 1, Section 8, of the U.S. Constitution says, "The Congress shall have Power … To coin Money [and] regulate the Value thereof …" When the Constitution was ratified, coins were the only officially recognized legal tender. By 1860, coins made up only about half the currency; and today, they make up only about $1.19 billion of a $21.352 trillion circulating money supply (M2). These coins, along with about $239 million in U.S. Notes or Greenbacks originally issued during the Civil War, are all that are left of the Treasury's money-creating power.

The vast majority of the money supply today is created privately by banks as deposits when they make loans, usurping the power to issue the national money supply from the people to whom it constitutionally belongs. Lincoln avoided a massive debt to private British-backed banks by restoring the government-issued money of the American colonists. In the 1860s, these newly-issued U.S. Notes or Greenbacks constituted 40% of the national currency. Today, 40% of the circulating money supply would be $8.5 trillion. Yet, this massive money-printing during the Civil War did not lead to hyperinflation. Greenbacks 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 "printing money." Rather, it 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.

Congress could avoid its debt crisis today by calling for a new issue of debt-free U.S. Notes. That, however, would require legislation, probably a greater uphill battle in the current Congress, even than getting the debt ceiling lifted.

Reducing the Federal Debt

Another way to alleviate the debt 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 this part of the debt, which stood at $6.097 trillion as of Dec. 2, 2022. That alternative would be legal, but it would require persuading not just Congress but 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.

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. Not only does the Constitution give Congress the power to coin money and regulate its value, he said, but no limit is put on the value of the coins it creates.

In 1982, Congress chose to choke off this remaining vestige of its money-creating power by imposing limits on the amounts and denominations of most coins. But it left one exception, the platinum coin, which a special provision allowed to be minted in any amount for commemorative purposes (31 U.S. Code § 5112). When Congress was gridlocked over the debt ceiling in 2013, attorney Carlos Mucha proposed issuing a platinum coin to capitalize on this loophole; and the proposal the proposal got picked up by Paul Krugman and some other economists as a way to move forward.

Philip Diehl, former head of the U.S. 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).

What about Inflation?

Prof. Randall Wray explained that the coins would not circulate but would be deposited in the government's account at the Fed, so they 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.

An alternative for stabilizing the money supply and avoiding inflation without resorting to taxes was developed by the Pennsylvania colonists in Benjamin Franklin's day. The American colonies were then printing paper scrip, following the innovative lead of Massachusetts in 1691. This paper money was considered an advance against taxes, but it was easier to issue the scrip than to collect it back in taxes; and the result was to inflate and devalue the currency.

The Pennsylvania colonists avoided price inflation by forming a "land bank." The colonial government issued paper scrip in return for goods and services, and it lent scrip to the farmers at a reasonable rate. The interest returned to the colonial treasury, balancing the budget.

Today we could do the same: we could offset the money issued for government expenses with interest instead of taxes. But that would effectively mean nationalizing the banking system, again not something that is likely or even desirable in a major economy with many competing economic interests. As U.K. Prof. Richard Werner observes, nationalizing the banking system in Soviet Russia did not work out well. But the Chinese approach, involving many small local public banks, proved to be very efficient and effective; and German local bankers developed such a system long before the Chinese, with their network of local public Sparkassen banks. We could follow suit with a network of public banks spreading to local needs, thus turning banking into a public utility while keeping credit under local management and distribution.

We Could Go Further…

As the chairman of the Coinage Subcommittee observed in the 1980s, the entire federal debt could actually be paid with some large denomination coins. Again, the concern will be that it will inflate the money supply and devalue the currency; but the Federal Reserve showed after the "Great Recession" that it could issue trillions of dollars in accounting-entry quantitative easing without triggering hyperinflation. Indeed, the exercise did not trigger even the modest inflation for which it was designed.

Japan has gone further. As of May 2022, 43.3% of its national debt was held by the Bank of Japan; yet its consumer price index (the annual percentage change in the cost of consumer goods and services) was at negative 0.2%. And China increased its money supply by nearly 1800% over 24 years (from 1996 to 2020) without driving up price inflation. It did that by increasing GDP in step with the money supply.

As with QE, paying off the federal debt with trillion coins deposited in the Treasury's account would just be an asset swap, replacing an interest-bearing obligation (bonds) with a non-interest-bearing one (bank deposits paid to the bond sellers). 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.Joseph Wang, a former senior trader on the Fed's open market desk, explained the difference between QE and direct payment of stimulus checks in a Jan. 9, 2023 article. He wrote:

The enormous fiscal stimulus in 2020 created a few trillion out of thin air and just gave it away to the public – predictably supercharging growth and inflation. Note that fiscal stimulus is very different from QE, which merely exchanges Treasuries for cash. QE changes the composition of liquid assets held by non-banks (fewer Treasuries, more cash), but not their purchasing power. In contrast, stimmy checks and forgivable loans are essentially free "helicopter money" that increase potential demand.

"*QE changes the composition of liquid assets held by non-banks (fewer Treasuries, more cash), but not their purchasing power*." The non-bank holders of Treasuries could have sold their securities at any time if they had wanted cash. They had their money in government securities in the first place because they wanted to save it rather than spend it. If they were cashed out, they would presumably continue to save the money, probably by investing it in other interest-generating securities.

Something to Think About at Least

Granted, those proposals are unlikely to pass now, and it would take unusual courage just to introduce them; but we are living in unusual times. The time will soon come for bold leaders to take the reins and do something radical. The alternative that is barreling down on us is the World Economic Forum's "Great Reset," in which "you will own nothing and eat bugs" (basically neo-feudalism).

The status quo is clearly unsustainable, and the Fed's current tools cannot set it right. The inflation problem has been thrust in its lap, although fiscal spending and supply shortages are key drivers of today's price hikes; and the Fed's traditional tools won't fix those problems. The higher that interest rates are raised, the harder it will be for people and businesses to pay their credit card debts. That means businesses will go bankrupt, people will get laid off, and tax receipts will go down, further driving up the budget deficit.

We need a new approach, at least one that is new in modern times. We would do well to return to the solution of our forefathers – a monetary system backed by "the full faith and credit of the United States," a government "of the people, by the people, and for the people," as Lincoln intoned. That may not be the government we have now, but it could be and should be. Before we can have a trustworthy national currency, we need a transparent and accountable government that is responsive to the will of the people. When the old system finally breaks and we are primed for a new one, those are the principles that should guide us in its development.

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This article was first posted on ScheerPost.

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