GlobalResearch
Center for Research on Globalization

The Global Economic Crisis: Central Banking at the Centre of Power

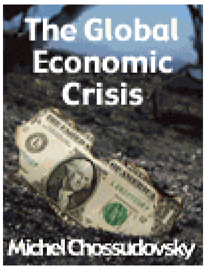
Excerpt from, "The Global Economic Crisis: The Great Depression of the XXI Century"

By Andrew Gavin Marshall
Global Research, March 08, 2011
7 March 2011

Region: USA
Theme: Global Economy

The following is an excerpt of a chapter by Andrew Gavin Marshall from the new book by Global Research Publishers, "The Global Economic Crisis: The Great Depression of the XXI Century."

The Global
Economic Crisis



Michel Chossudovsky
Andrew Gavin Marshall (editors)

Help us get the word out, "like" the book on Facebook, comment, and share with friends!

Introduction

To understand the historical context of the current crisis, it is pivotal to address the nature of the most vital and powerful force within the capitalist global political economy: the central banking system. One of the least understood, most widely ignored, and mysteries of capitalism, the central banking system, is also the source of the greatest wealth and power, essentially managing capitalism – controlling the credit and debt of both government and industry.

Any notion of a "free market" must be dispelled in its true meaning, for as long as the central banking system has been dominant, central bankers have managed and controlled capitalism for the benefit of the few and at the expense of the many. Comprehending the nature of central banking is necessary in order to understand the nature of the current economic crisis.

The Origins of Central Banking

Central banking has its origins in the development of bank-issued money, which falls under three categories: (1) Deposit money subject to written check or oral transfer; (2) Bank-issued paper money (bank notes); and (3) Bank-issued legal tender paper money. In 1609, the Bank of Amsterdam was founded "as a bank of deposit slipping secretly into the practice of monetary issue towards the middle of the 17th century." At the same time, "the goldsmiths of England are generally supposed to have introduced both deposit money and the earliest English unofficial bank note." And importantly, "In Sweden we find what are widely regarded as the first true bank notes in Europe being issued in 1661 by a private bank founded by Johan Palmstruch."[1]

As early as 1656, "the Bank of Amsterdam violated the one-hundred per cent reserve principle and, thus, created money," while "the goldsmiths in England became active as lenders in 1640." Further, the State Bank of Sweden "was founded November 30, 1656, and to Palmstruch, its founder, is attributed the first use of bank bills as credit money, not fully covered by the coin reserve."[2]

As economist John Kenneth Galbraith explained in Money, "The process by which banks create money is so simple that the mind is repelled. Where something so important is involved, a deeper mystery seems only decent. The deposits of the Bank of Amsterdam just mentioned were, according to the instruction of the owner, subject to transfer to others in settlement of accounts," and thus "the coin on deposit served less as money by being in a bank and being subject to transfer by the stroke of a primitive pen." Further, "another stroke of the pen would give a borrower from the bank, as distinct from a creditor of the original depositor, a loan from the original and idle deposit." Galbraith elaborated:

The original deposit still stood to the credit of the original depositor. But there was now also a new deposit from the proceeds of the loan. Both deposits could be used to make payments, be used as money. Money had thus been created. The discovery that banks could so create money came very early in the development of banking. There was that interest to be earned.[3]

Expanding on this notion of money-creation, economist Rupert J. Ederer explained, in regards to the Bank of Amsterdam, that both the depositor "and a borrower could affect a purchase with the same money at the same time, [thus] we had here some increase in the quantity of money." However, "the more serious infractions followed when the Bank began to lend money to the government of Amsterdam and eventually succumbed to the temptations offered by the [Dutch] East India Company." As Ederer articulated, "What this bank did surreptitiously was soon to be institutionalized and to form the essence of a new monetary technique." Thus, this bank established a "new monetary era":

A marvelous new power probably equal to the potentialities of the discovery of coinage had evolved. The Bank had created money literally for over a hundred years without being discovered. Even after it was discovered, the Bank could have continued in operation in this new way except for public prejudice. The public was not yet ready to accept a money with no guarantee save the word of public authorities. It had been too seriously and too frequently misled in the past, and, paradoxically enough, it had fled to the banks for a more efficient money. Out of this flight grew the private money creation which is the essence of modern commercial banking.[4]

The Bank of England

As John Kenneth Galbraith explained in regards to the Bank of England, "Of all institutions concerned with economics none has for so long enjoyed such prestige," as "most of the art as well as much of the mystery associated with the management of money originated there. The pride of other central banks has been either in their faithful imitation of the Bank of England or in the small variations from its method."[5] As economist Rupert J. Ederer explained, it was with the founding of the Bank of England "which constituted the first complete official approval of money issue by private interests. In other words, private money-issue became a socially and legally sanctioned institution during the 17th century."[6]

Ederer analyzed the history leading up to the creation of the Bank of England in his book, Evolution of Money. He explained that the slippage of the process of money creation from public to private hands "was but another manifestation of the intense struggle of king vs. parliament going on there at the time." Ederer elaborated:

It had been customary in 17th century England for the wealthy classes to deposit their surplus metallic money in the London Tower for safe-keeping. Here, they felt confident, it was safe. This confidence was dealt a rude blow when King Charles I in need of money to conduct a civil war which he had precipitated with Scotland confiscated the hoards. As it was, Charles refused to release these funds until the merchants agreed to make him a loan. He did not repay the loan except after a long delay marked by sharp and bitter protests. The depositors had learned their lesson and would look for another safe-deposit bank. Most suited to the task, it seemed, were the vaults of the goldsmiths.[7]

The goldsmiths, being savvy businessmen, "served notice to their depositors that they would accept money on deposit only on the condition that they could lend it out." The goldsmiths developed a cunning method of managing the money, as the smith would issue a "warehouse receipt" to depositors wishing to withdraw money, which was "a document showing that a certain quantity of metallic money was left on deposit by 'X' and could be claimed by him upon presentation of the receipt." Ederer explained:

These receipts were at first scrupulously honored thus establishing confidence that the money would always be available. As a result, the clientele whose original intention was to get away from using the sensitive and impractical coins, simply began circulating the receipts.[8]

The main obstacle to this development of money-creation was the state, as "Kings had insisted on the sole right to issue the monetary media ever since coinage began. Surrender of that right was fraught with dangers for the public welfare and for the very existence of the states involved." So the question was, as Ederer postulated, "How could these monarchs be induced to surrender or, at least, to share this power with private interests? The answer lay in the financially exposed position in which many monarchs found themselves during the 17th and 18th centuries because of constant wars and uprisings. They needed money desperately."[9]

In England, King Charles II "borrowed what money the smiths were able and willing to lend at 12 percent. The repayment was to come in the form of taxes which were to be paid directly to the goldsmiths." However, businessmen and other powerful interests did not want a return to coinage, having grown accustomed to the use of receipts, which had allowed their businesses to flourish. Naturally, there was a growing desire for banks to emerge, following on the heels of the example in Amsterdam. However, all that was needed "was a king who was especially in need of funds for some royal venture. When this monarch appeared, certain alert interests would be able to foist upon the public a system of private money issue."[10]

This opportunity emerged with King William and Queen Mary following the long war with Louis XIV, at a time in which the mercantile interests "had money that they were willing to lend on their own terms, and they were also aware of how lucrative banking in the new style could be, that is, when it involved the right to create money."[11] William was born a Dutch prince, whose mother was sister to King Charles II of England. He came to power in England in 1689 following the Glorious Revolution, in which King James II was forced to flee, which involved an invading Dutch army and resulted in the establishment of a constitutional monarchy and the English Bill of Rights, marking an end to the absolute monarchist era and the beginning of an era in which power was shared between monarch and the parliament.

Now, the monarch, desperate for funds, had to look to private interests, and the answer came from a Scotsman named William Patterson:

Speaking for the wealthy London businessmen he offered to lend money amounting to 1,200,000 pounds at 8% interest, provided that the lenders be granted a charter to establish a bank of issue. On their behalf he demanded the right to issue notes in an amount equal roughly to the amount of the debt, which would circulate as money.[12]

These notes "would go out as loans to worthy private borrowers. Interest would be earned both on these loans and on the loans to the government. Again the wonder of banking."[13] The plan initially being put through Parliament in 1691 met opposition from the King and goldsmiths. However, it was eventually passed in 1694, and thus, the Bank of England was created.[14]

In 1833, Parliament passed legislation that made the Bank of England have the only legal notes of tender, granting it a partial monopoly, as other banks still had notes in circulation. With the Bank Act of 1844, "the issues of all the other banks were limited to the amounts in circulation at that time." Confidence grew in the bank, acting as the government's banker and agent, "and when the widespread establishment of joint-stock banks in England began in 1826, the Bank of England had already come to be regarded as the custodian of the cash reserves of the private banks, and thus of the country's gold reserves." Eventually, the bank entered into the role of being the "lender of last resort" and had the responsibility to "maintain not only the currency but also the credit system of the country."[15]

The Bank of France

In 1788, the French Monarchy was bankrupt, and as tensions grew between the increasingly desperate people of France and the aristocratic and particularly monarchic establishment, European bankers decided to pre-empt and co-opt the revolution. In 1788, prominent French bankers refused "to extend necessary short-term credit to the government,"[16] and they arranged to have shipments of grain and food to Paris "delayed" which triggered the hunger riots of the Parisians.[17] This sparked the Revolution, in which a new ruling class emerged, driven by violent oppression and political and actual terrorism. However, its violence grew, and with that, so too did discontentment with the Revolutionary Regime, and its stability and sustainability was in question. Thus, the bankers threw their weight behind a general in the Revolutionary Army named Napoleon, whom they entrusted to restore order.

Napoleon then gave the bankers his support, and in 1800, created the Bank of France, the privately owned central bank of France, and gave the bankers authority over the Bank. The bankers owned its shares, and even Napoleon himself bought shares in the bank.[18] In 1803, Napoleon granted the Bank of France the exclusive right of issue, abolishing competition, “and so the Bank of France assumed the role of the central bank.” However, “the Bank’s independence was scarcely altered. At the time when it assumed the role as the country’s central bank, representatives of the 200 principal shareholders were still free to make policy themselves.”[19]

The bankers thus sought to control commerce and government and restore order to their newly acquired and privately owned and operated empire. However, Napoleon continued with his war policies beyond the patience of the bankers, which had a negative impact upon commercial activities,[20] and Napoleon himself was interfering in the operations of the Bank of France and even declared that the Bank “belongs more to the Emperor than to the shareholders.”[21] With that, the bankers again shifted their influence, and remained through regime change, while Napoleon did not.[22]

The Rothschilds ascended to the throne of international banking with the Battle of Waterloo. After having established banking houses in London, Paris, Frankfurt, Vienna and Naples, they profited off all sides in the Napoleonic wars.[23] The British patriarch, Nathan Rothschild, was known for being the first with news in London, ahead of even the monarchy and the Parliament, and so everyone watched his moves on the stock exchange during the Battle of Waterloo. Following the battle, Nathan got the news that the British won over 24 hours before the government itself had news, and he quietly went into the London Stock Exchange and sold everything he had, implying to those watching that the British lost.

A panic selling ensued, in which everyone sold stock, stock prices crumbled, and the market crashed. What resulted was that Rothschild then bought up the near-entire British stock market for pennies on the dollar, as when news arrived of the British victory at Waterloo, Rothschild’s newly acquired stocks soared in value, as did his fortune, and his rise as the pre-eminent economic figure in Britain.[24]

As Georgetown University History professor, Carroll Quigley wrote in his monumental Tragedy and Hope, “the merchant bankers of London had already at hand in 1810-1850 the Stock Exchange, the Bank of England, and the London money market,” and that:

In time they brought into their financial network the provincial banking centers, organized as commercial banks and savings banks, as well as insurance companies, to form all of these into a single financial system on an international scale which manipulated the quantity and flow of money so that they were able to influence, if not control, governments on one side and industries on the other.[25]

Creating a Central Bank of the United States: The Federal Reserve

The history of the United States from its founding through the 19th century to the early 20th century was marked by a continual political battle revolving around the creation of a central bank of the United States. Mercantilists such as Alexander Hamilton, who was the first Treasury Secretary, were in favor of such a bank, and his advice won over George Washington, much to the dismay of Thomas Jefferson, who was a strong opponent to central banking. However, "[Alexander] Hamilton, believing that government must ally itself with the richest elements of society to make itself strong, proposed to Congress a series of laws, which it enacted, expressing this philosophy," and that, "A Bank of the United States was set up as a partnership between the government and certain banking interests,"[26] which lasted until the charter expired in 1811.

Again, during the tenure of Andrew Jackson (1829-1837), the primary political struggle was with the entrenched financial interests both domestic and from abroad (namely Western Europe), on the issue of creating a central bank of the U.S. Andrew Jackson stood in firm opposition to such a bank, saying that, "the bank threatened the emerging order, hoarding too much economic power in too few hands," and referred to it as "The Monster."[27] Congress passed the bill allowing for the creation of a Second Bank of the United States, however Andrew Jackson vetoed the bill, much to the dismay of the banking interests.

It was in the latter half of the 1800s that "European financiers were in favor of an American Civil War that would return the United States to its colonial status, they admitted privately that they were not necessarily interested in preserving slavery," as it had become unprofitable.[28] The Civil War was not based upon the liberation of slaves, it was, as Howard Zinn described it, a clash "of elites," with the northern elite wanting "economic expansion – free land, free labor, a free market, a high protective tariff for manufacturers, [and] a bank of the United States. [Whereas] the slave interests opposed all that."[29] The Civil War, which lasted from 1861 until 1865, resulted in hundreds of thousands of deaths, during which, "Congress also set up a national bank, putting the government into partnership with the banking interests, guaranteeing their profits."[30]

As Lincoln himself stated:

The money powers prey on the nation in times of peace and conspire against it in times of adversity. The banking powers are more despotic than monarchy, more insolent than autocracy, more selfish than bureaucracy. They denounce as public enemies all who question their methods or throw light upon their crimes.

I have two great enemies, the Southern Army in front of me, and the bankers in the rear. Of the two, the one at my rear is my greatest foe. As a most undesirable consequence of the war, corporations have been enthroned, and an era of corruption in high places will follow. The money power will endeavor to prolong its reign by working upon the prejudices of the people until the wealth is aggregated in the hands of a few, and the Republic is destroyed.[31]

Throughout much of the 1800s and into the 1900s, the United States suffered several economic crises, one of the most significant of which was the Great Depression of 1873. As Howard Zinn explained:

The crisis was built into a system which was chaotic in its nature, in which only the very rich were secure. It was a system of periodic crises – 1837, 1857, 1873 (and later: 1893, 1907, 1919, 1929) – that wiped out small businesses and brought cold, hunger, and death to working people while the fortunes of the Astors, Vanderbilts, Rockefellers, Morgans, kept growing through war and peace, crisis and recovery. During the 1873 crisis, Carnegie was capturing the steel market, Rockefeller was wiping out his competitors in oil.[32]

Massive industrial consolidation by a few oligarchic elites was the rule of the day, as J.P. Morgan expanded total control over railroad and banking interests, and John D. Rockefeller took control of the oil market, and expanded into banking. Zinn explained:

The imperial leader of the new oligarchy was the House of Morgan. In its operations it was ably assisted by the First National Bank of New York (directed by George F. Baker) and the National City Bank of New York (presided over by James Stillman, agent of the Rockefeller interests). Among them, these three men and their financial associates occupied 341 directorships in 112 corporations. The total resources of these corporations in 1912 was $22,245,000,000, more than the assessed value of all property in the twenty-two states and territories west of the Mississippi River.[33]

In the early 20th century, European and American banking interests achieved what they had desired for over a century within America, the creation of a privately owned central bank. It was created through collaboration of American and European bankers, primarily the Morgans, Rockefellers, Kuhn, Loebs and Warburgs.[34]

After the 1907 banking panic in the U.S., instigated by J.P. Morgan, pressure was placed upon the American political establishment to create a "stable" banking system. In 1910, a secret meeting of financiers was held on Jekyll Island, where they planned for the "creation of a National Reserve Association with fifteen major regions, controlled by a board of commercial bankers but empowered by the federal government to act like a central bank – creating money and lending reserves to private banks."[35]

It was largely Paul M. Warburg, a Wall Street investment banker, who "had come up with a design for a single central bank [in 1910]. He called it the United Reserve Bank. From this and his later service on the first Federal Reserve Board, Warburg has, with some justice, been called the father of the System."[36]

Senator Nelson W. Aldrich, "in the early years of the century, was by common calculation the most influential man in the Senate." He "had an unabashed commitment to high tariffs, sound money, [and] the untrammeled operations of big bankers and to all other measures which would, with reasonable certainty, enhance the wealth or power of the already rich, a community that very definitely included Aldrich himself." Further, his daughter married John D. Rockefeller, Jr.[37]

In 1912, Aldrich "introduced legislation to establish a National Reserve Association along with fifteen regional associations. These would hold the reserves – the deposits – of the participating banks. To them the banks would turn for loans, including rescue in a time of emergency. All would be solidly under the control of the bankers whom they comprised." Although, when the System was finally created, "the ultimate legislation was the work not of Aldrich and his fellow Republicans but of the Democrats."[38]

President Woodrow Wilson followed the plan almost exactly as outlined by the Wall Street financiers, and added to it the creation of a Federal Reserve Board in Washington, which the

President would appoint.[39] It was two days before Christmas in 1913 that "Woodrow Wilson signed the Federal Reserve Act into law. It provided not for a central bank but for as many as twelve – the number later chosen. Washington guidance was to be by a Federal Reserve Board of seven, of which the Secretary of the Treasury and the Comptroller of the Currency were to be ex officio members. The powers of the board were slight. The regional idea had, in fact, triumphed, and the real authority lay with the twelve banks."[40] The regional banks:

…were each to be governed by a board of nine directors, six of whom were to be selected by the participating or member banks, although only three of these could be bankers. The remaining three were to be appointed by Washington.[41]

The Federal Reserve, or Fed, "raised its own revenue, drafted its own operating budget and submitted neither to Congress," while "the seven governors shared power with the presidents of the twelve Reserve Banks, each serving the private banks in its region," and "the commercial banks held stock shares in each of the twelve Federal Reserve Banks."[42]

Notes

[1] Rupert J. Ederer, The Evolution of Money, Public Affairs Press, 1964, p. 102.
[2] Ibid., p. 103.
[3] John Kenneth Galbraith, Money: Whence it Came, Where it Went, Houghton Mifflin Company, Boston, 1975, p. 18-19.
[4] Rupert J. Ederer, op. cit., p. 118-119.
[5] John Kenneth Galbraith, op. cit., p. 30.
[6] Rupert J. Ederer, op. cit., p. 103.
[7] Ibid., p. 119-120.
[8] Ibid., p. 120-121.
[9] Ibid., p. 121-122.
[10] Ibid., p. 122.
[11] Ibid., p. 122.
[12] Ibid., p. 123.
[13] John Kenneth Galbraith, op. cit., p. 31.
[14] Rupert J. Ederer, op. cit., p. 123.
[15] M.H. De Kock, Central Banking, 3rd edition, Staples Press, London, 1969, p. 12.
[16] Donald Kagan, et. al., The Western Heritage. Volume C: Since 1789, Ninth edition, Pearson Prentice Hall, 2007, p. 596.
[17] Curtis B. Dall, F.D.R: My Exploited Father-in-Law, Institute for Historical Review, 1982, p. 172.
[18] Carroll Quigley, Tragedy and Hope: A History of the World in Our Time, New York, Macmillan Company, 1966, p. 515; Robert Elgie and Helen Thompson (eds.), The Politics of Central Banks, New York, Routledge, 1998, p. 97-98.
[19] Robert Elgie and Helen Thompson (eds.), The Politics of Central Banks, New York, Routledge, 1998, p. 98.
[20] Carroll Quigley, op. cit., p. 516.
[21] Robert Elgie and Helen Thompson, ed., op. cit., p. 98-99.
[22] Carroll Quigley, op. cit., p. 516.
[23] Sylvia Nasar, "Masters of the Universe", The New York Times, http://query.nytimes.com/gst/fullpage.html?res=9C04E3D6123AF930A15752C0A9669C8B63, 23 January 2000; BBC News, "The Family That Bankrolled Europe", http://news.bbc.co.uk/1/hi/uk/389053.stm, 9 July 1999.

[24] New Scientist, "Waterloo Windfall", New Scientist Magazine, Issue 2091, http://www.newscientist.com/article/mg15520913.300-waterloo-windfall.html, 19 July 1997; BBC News, "The Making of a Dynasty: The Rothschilds", http://news.bbc.co.uk/2/hi/uk_news/5099.stm, 28 January 1998.
[25] Carroll Quigley, op. cit., p. 51.
[26] Howard Zinn, A People's History of the United States, Harper Perennial, New York, 2003, p. 101.
[27] Michael Waldman, My Fellow Americans: The Most Important Speeches of America's Presidents, from George Washington to George W. Bush, Longman Publishing Group, 2004, p. 25.
[28] Dr. Ellen Brown, "Today We're All Irish: Debt Serfdom Comes to America", Global Research, http://www.globalresearch.ca/index.php
[29] Howard Zinn, op. cit., p. 189.
[30] Ibid., p. 238.
[31] Steve Bachman, "Unheralded Warnings from the Founding Fathers to You", Gather, http://www.gather.com/viewArticle.jsp?articleId= 281474977031677, 19 June 2007.
[32] Howard Zinn, op. cit., p. 242.
[33] Ibid., p. 323.
[34] Murray N. Rothbard, "Wall Street, Banks, and American Foreign Policy", World Market Perspective, http://www.lewrockwell.com/rothbard/rothbard66.html, 1984.
[35] William Greider, Secrets of the Temple: How the Federal Reserve Runs the Country, New York, Simon and Schuster, 1987, p. 276.
[36] John Kenneth Galbraith, op. cit., p. 121-122.
[37] Ibid., p. 120-121.
[38] Ibid., p. 122.
[39] William Greider, op. cit., p. 277.
[40] John Kenneth Galbraith, op. cit., p. 123-124.
[41] Ibid., p. 124.
[42] William Greider, op. cit., p. 50.