Thinking Positively on Monetary Policy

How "Quantitative Easing" May be Harnessed for the Public Good

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Nervous pundits are predicting the end of American life as we know it, after Fed Chairman Ben Bernanke announced on March 18 that he would be dropping yet *another* trillion dollars in helicopter money – up to $300 billion to buy long-term government bonds and an additional $750 billion to buy private debt, with the Term Asset-backed Securities Loan Facility (TALF) to be opened up for the sake of consumers and small businesses. The dollar immediately experienced its worst drop in 25 years, amid worries that the Fed's intervention would spur hyperinflation. Typical of the concerned commentators expressing these sentiments was Mark Larson, who wrote in "Money and Markets" on March 20:

"This is Banana Republic-type stuff! And I'm not talking about the clothing store. Printing money out of thin air at the central bank, only to turn around and buy debt securities issued by your Treasury, is the kind of practice you typically see in emerging market regimes. We're essentially monetizing our country's debt and deliberately devaluing our country's currency."

Tim Wood wrote in "Financial Sense" on March 21:

"I'm now beginning to wonder if the powers that be are really in their minds trying to 'fix' things or if they are actually trying to destroy the dollar, the free markets and perhaps even the nation. To be honest, the latter is starting to make more sense to me because surely there is enough intelligence in Washington to understand the potential consequences of these actions."

Commentators on the Financial Sense Newshour suggested that the Fed's move toward "quantitative easing" would be looked back upon as the watershed event in the beginning of the end of the United States dollar. As explained in Wikipedia:

"The term *quantitative easing* refers to the creation of a pre-determined quantity of new money . . . In very simple layman's terms, the central bank creates new money out of thin air. It then uses this money to buy what is essentially an IOU [that is, to make a loan]. . . . Today the new money is generally created electronically rather than physically printed."

The Federal Reserve remains a privately-owned "bankers' bank," and it has not asked Congress's permission before engaging in its new policy of massive "quantitative easing." The Fed has the capacity to create money on its books and lend it to whomever it will. There is thus a danger that we may just see more money being funneled to those same Wall Street banks that got us into this crisis in the first place. But while the Fed's new "quantitative easing" tool is fraught with risk, it also has some interesting potential. This funding mechanism *could* be extended not only to replace the loans that banks have been unwilling or unable to make but to fund Obama's stimulus package – at little or no cost to the American taxpayer. What we are faced with today is not *inflation* but *deflation*. Lending has dried up not only from banks but from the "shadow banking system" – all those pension funds, hedge funds, and foreign investors who used to snatch up mortgage-backed securities – and that means the *velocity* of money has slowed. Money is sitting in bank accounts rather than being lent into the economy for consumer and homeowner use. The government's stimulus plan is meant to pick up the slack, but who is going to fund it? The Chinese and other foreign investors are balking at buying more of our debt, and the taxpayers are tapped out. That just leaves the central bank itself.

Thinking positively, in fact, we may look back upon this as the watershed moment when the Federal Reserve finally adjusted its focus and started to act more like a government central bank, one that advances "the full faith and credit of the United States" for the benefit of the United States and its citizenry, rather than just for the bankers who have held the government and its central bank hostage for so long. President Obama suggested a move in that direction when he said on the Tonight Show with Jay Leno on March 19:

"[W]e're taking a lot of steps to . . . *open up separate credit lines outside of banks* for small businesses so that they can get credit — because there are a lot of small businesses out here who are just barely hanging on. Their credit lines are starting to be cut. We're trying to set up a securitized market for student loans and auto loans *outside of the banking system*. So there are other ways of getting credit flowing again." [Emphasis added.]

The Fed now appears to be taking on the role of lender of last resort not just for its member banks but for consumers, businesses, and the government itself. Provisos and cautions aside, its new "quantitative easing" policy at least has the *potential* to be harnessed to serve the government and the people it represents; and that is a promising development.

Harnessing the Federal Reserve for Federal Purposes

The key to this potential is something that is little known or appreciated: *the Fed now rebates all of its profits to the government after deducting its costs. [cite]* 1 That means that it is actually the *government* that gets the benefit of the interest on the Fed's loans; and that is how it should be, since the U.S. dollar today is backed by nothing but "the full faith and credit of the United States." The dollar *is* the government's credit – its promise to repay value for value, nothing more. If the government is taking the risk that credit will not be repaid, the government should get the interest on the loans.

The Federal Reserve was originally set up in 1913 by a powerful Wall Street group to serve the private banking system, and it agreed to return its profits to the government only under duress. This happened after Congressman Wright Patman, head of the House Banking and Currency Committee in the 1960s, peered closely at its operations and pressed for its nationalization. The developments were chronicled by Congressman Jerry Voorhis, who wrote in 1973:

"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."2

The potential for the Fed to acts as a truly "federal" central bank that issues loans to the public and returns the profits to the government has been there since the 1960s; but until now, the Fed and the Administration have not made much use of it. The Fed has used its dollar-issuing power only to the extent necessary to provide the reserves to backstop bank runs. The vast majority of the money supply has continued to be created privately by banks in the form of loans; and as Congressman Voorhis observed, "where the commercial banks are concerned, there is no such repayment of the people's money" as there is with the Federal Reserve. Commercial banks do *not* rebate the interest they receive, although they also "'buy' the bonds with newly created demand deposit entries on their books – nothing more." This, Voorhis maintained, was a violation of the Constitutional provision that "*Congress* shall have the power to coin money [and] regulate the value thereof."

Bernanke's Greenback Solution

The Federal Reserve under Alan Greenspan continued to operate in its traditional role of serving the interests of its banker owners, but Ben Bernanke seemed to have other things in mind as far back as 2002, when he made his notorious "helicopter money" speech. The speech was made before the National Economists Club in Washington, D.C. on November 21, 2002 and was titled "Deflation: Making Sure 'It' Doesn't Happen Here." Dr. Bernanke stated that the Fed would not be "out of ammunition" to counteract deflation just because the federal funds rate had fallen to 0 percent and could not be brought down lower. Lowering interest rates was not the only way to get new money into the economy. He said, "*the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost*." Note that he said the *government* (not the central bank) has a printing press, and that the government could print money *at essentially no cost*. The implication was that the government could create money *without* paying interest and *without* having to pay it back to the Fed or the banks.

That fairly well characterizes the money created by "quantitative easing" today. The Fed rebates the interest only after deducting its costs, which are no doubt quite generous; but in 2008, it reported that it rebated 85% of the interest it received to the Treasury.3 Since interest on long-term bonds is now under 3%, that means the interest paid by the government is less than ½ % – clearly the best deal in town, particularly since the Chinese and other foreigners are now balking at buying more U.S. debt. This is comparable to what Australia did in the 1930s, when it avoided the serious depression conditions suffered in other countries by funding public projects with credit advanced by its government-owned central bank at a fraction of one percent interest.4

Not only are the Fed's loans nearly interest-free, but they are never paid back. The federal debt has not been paid off since 1838, when Andrew Jackson shut down the Second U.S. Bank. "Balancing the budget" just involves "servicing" the debt with interest. Money that comes from an interest-free loan that is rolled over indefinitely is essentially debt-free legal tender.

The infamous helicopter line in Bernanke's 2002 speech came in when he was discussing how the government's money-creating power could be used to cut taxes. He said, "A money-financed tax cut is essentially equivalent to Milton Friedman's famous 'helicopter drop' of money." Dropping money from helicopters was Professor Friedman's hypothetical cure for deflation. The "money-financed tax cut" discussed by Dr. Bernanke was one in which *taxes would be replaced with money that was simply printed up by the government and spent into the economy*. He added, "[I]n lieu of tax cuts, the government could increase spending on current goods and services or even acquire existing real or financial assets." The government could reverse deflation by printing money and buying hard assets with it – assets such as real estate or corporate stock.

And that, for a Federal Reserve official next in line to become its Chairman, was a pretty radical suggestion. It was basically a Greenback proposal, the sort of government self-funding used by Abraham Lincoln to finance the Civil War. It was also the sort of money system endorsed by Benjamin Franklin, Thomas Jefferson, and William Jennings Bryan, the system used by the American colonists and demonstrated to be particularly successful in colonial Pennsylvania.

Reviving the Banking Model of Benjamin Franklin's Day

In Pennsylvania in the first half of the 18th century, the provincial government not only printed its own money but owned its own bank. Colonial scrip was printed and lent to farmers at 5% interest, and this money recycled back to the government as it was repaid. The money went out and came back in a circular flow, preventing inflation. This was quite different from what happened in those Banana Republics that used the power to print money simply to pay off foreign debts owed in dollars. The invariable result was to invite speculators to jack up the price of the dollars relative to the local currency, causing the currency's rapid devaluation. The Bank of Pennsylvania, by contrast, issued its fiat currency as *loans* for domestic use, loans on which not only the principal but the interest came back to the government. Since the provincial government had the power to issue the local scrip, it could issue some extra to meet its expenses; and this money filtered through the economy to provide the additional sums needed to cover the interest on the loans. During the time this provincial system was in place, the Pennsylvania colonists paid *no* taxes, there was *no* government debt, and price inflation did not result.

What the Fed is doing today could be considered comparable: it is generating the equivalent of debt-free government-issued colonial scrip with its "quantitative easing" tool, and it is advancing credit for private use, with the interest on the loans returning to the government.

The Case for Nationalizing the Fed

One major difference between the Federal Reserve and the bank of colonial Pennsylvania is that the Fed remains a private bank owned by other banks. There is the fear that the powerful tool of "quantitative easing" could turn into a dangerous weapon in the wrong hands. A private central bank can be driven by a small financial elite in secret boardroom meetings beyond congressional control. The power to create money is a double-edged sword even for a government, but at least a government must answer to the people in the public forum of a democracy.

That is true in theory, but we the people don't have much more control over Treasury Secretary Tim Geithner, a government official, than we have over Ben Bernanke. The Treasury's Troubled Asset Relief Program (or TARP) has been heavily criticized for moving “toxic” assets off the books of the culpable Wall Street derivative banks and onto the backs of the taxpayers. The problem is that government officials and Federal Reserve officials alike believe that the only way the nation can have a functioning credit system is to maintain business as usual on Wall Street. This is not true. A *public* banking system headed by a truly *federal* central bank could provide all the credit we need.

To prevent corruption and abuse, this system of money and credit would need to be made subject to the sort of public monitoring and control provided by the checks and balances built into the Constitution. Stephen Zarlenga, president of the American Monetary Institute, suggests that the money system should be organized as a fourth branch of government alongside the executive, judicial and congressional branches. The Fed is acting like a fourth branch now, but without the public oversight of a true government agency. Congressman Ron Paul has brought a bill (HR1027) to audit the Federal Reserve, and Congressman Dennis Kucinich told Congress earlier this month that he would soon be bringing a bill to nationalize the Fed. He said:

“Banking is not a proper function of the government, but oversight is. The Treasury Department should not be outsourcing to the Fed its oversight responsibilities. The Fed, which failed miserably to oversee the banks, should be put under Treasury instead. It’s time for the government to operate in the public interest, not in the interest of private banks. It’s time to stop bailing out banks and begin building up America.”

Note, however, that if the Fed is nationalized *and* it continues to issue credit for the benefit of consumers, small businesses, and the government itself, it will actually be *in* the banking business; and that, arguably, is how it should be. Our money system today is nothing more than a series of legal agreements between parties. “Credit” is merely an agreement to repay over time. While private parties and private banks should be free to lend their own money or their investors’ money, we also need the sort of “credit” that is created on a computer screen; and that sort of credit, as money reformer Richard Cook observes, is properly administered as a public utility. The dollar is backed by nothing but “the full faith and credit of the United States” and should be dispensed and monitored by the United States. As William Jennings Bryan declared in his winning presidential nomination speech at the Democratic Convention in 1896:

“*[W]e believe that the right to coin money and issue money is a function of government. . . .* Those who are opposed to this proposition tell us that the issue of paper money is a function of the bank and that the government ought to go out of the banking business. I stand with Jefferson . . . and tell them, as he did, that *the issue of money is a function of the government and that the banks should go out of the governing business. . . .* [W]hen we have restored the money of the Constitution, all other necessary reforms will be possible, and . . . until that is done there is no reform that can be accomplished.”

The loans the Fed creates by “quantitative easing” are no more inflationary than the credit created daily on a computer screen by private banks.5   At least, loans used to be created daily by private banks, until their ability to lend was frozen for accounting reasons. The Fed’s credit facility has the advantages over private banks’ that (a) it is not subject to the lending freeze, and (b) its profits are rebated to the government, which ultimately serves the taxpayers’ interest. Nationalizing the Federal Reserve is the ideal solution; but while we are waiting for that development, the government can do the next best thing and tap into the very cheap, readily available credit provided by its own central bank.

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 and www.ellenbrown.com.

Notes

1 "FAQs: Federal Reserve System," federalreserve.gov.

2 J. Voorhis, The Strange Case of Richard Milhous Nixon (1973), excerpted at

http://www.sonic.net/~doretk/ArchiveARCHIVE/ECONOMICSPOLITICS/FEDERAL%20RESERVE/Jerry%20VoorhisFedReserve.html.

3 See Benjamin Gisin, Michael Krajovic, "Rescuing the Physical Economy," Conscious Economics (January 2009); Ellen Brown, "Monetize this!", webofdebt.com/articles (February 22, 2009).

4 David Kidd, "How Money is Created in Australia," www.http://dkd.net/davekidd/politics/money.html (2001).

5 See Ellen Brown, "The Wall Street Ponzi Scheme Called Fractional Reserve Banking," webofdebt.com/articles (December 29, 2008).
