Towards a Solution to the Debt Crisis in California

The State could walk away & create its own credit machine

By Ellen Brown
Global Research, July 14, 2009
webofdebt.com 14 July 2009

Region: USA
Theme: Global Economy

Four Wall Street banks, which received $15-25 billion each from the taxpayers, have rejected California's IOUs because the State is supposedly a bad credit risk. The bailed out banks would seem to have a duty to lend a helping hand, but they say they don't want to delay an agreement on further austerity measures. State legislators are not bowing quickly to the pressure, but what is the alternative?

In the latest twist to the California budget saga, Citigroup, Wells Fargo, and JPMorgan Chase (which each got $25 billion in bailout money from the taxpayers) and Bank of America (which got $15 billion) have refused California's request for a loan to tide it over until October. Until the State can get things sorted out, it has started paying its creditors in IOUs ("I Owe You's" or promises to pay bearing interest, technically called registered warrants). Its Wall Street creditors, however, have refused to take them. Why? The pot says the kettle is a poor credit risk!

California expects to need to issue only about $13 billion in IOUs through September, and all its Governor has asked for in the way of a loan from the federal government is a guarantee for $6 billion. Total loans, commitments and guarantees to rescue the financial sector and stem the credit crisis have been estimated at $12.8 trillion. But California has not been invited to the banquet. The total sum California needs to balance its budget is $26.3 billion. That is about the same sum given to Citigroup, Wells Fargo and JPMorgan in bailout money; and it is only about one-tenth the sum given to AIG, a mere insurance company. Corporations evidently trump States and their citizens in the eyes of the powers controlling the purse strings. California has a gross domestic product of $1.7 trillion annually and has been rated the world's eighth largest economy. Its 38.3 million people are one-eighth of the nation's population and a key catalyst for U.S. retail sales. When the California consumer base falters, businesses are shaken nationwide. If AIG and the other Wall Street welfare recipients are too big to fail, California is way too big to fail.

Fitch Rating Agency has downgraded California's municipal bonds to junk bond status,triple B. Why? AIG and Lehman Brothers had A ratings right up until they declared bankruptcy. California has never defaulted on its bonds, and it cannot arbitrarily decide to default; the State Constitution mandates that debt principal and interest must be paid as promised. California bonds lost their triple A rating only when the municipal bond insurers (Ambac and MBIA) lost theirs. It was these insurers, not the State of California, that got into hot water gambling in derivatives. The State Attorney General has opined that California's IOUs are valid and binding obligations of the State. In rejecting them, however, Wall Street may have ulterior motives. A lower credit rating can justify investors in demanding higher interest rates. The interest offered on the IOUs is substantially lower than the interest banks can get on triple B rated municipal bonds.

There may be deeper motives than that. Considering the enormous importance of the California economy to the country, and the relatively small sum it needs in loans, the refusal to support the State financially seems highly suspicious, especially when much more has been given to less creditworthy private institutions. The banks say they want to keep the pressure on California legislators to work it out among themselves, but what does that mean? The options are even higher taxes, even more cuts in services, or even more fire sales of public assets; in short, the sort of austerity measures expected of supplicants reduced to Third World debtor status. State legislators are understandably reluctant to crawl into that debt pit. Governor Schwarzenegger has refused to approve higher taxes, while Democratic leaders say further cuts in services could leave some Californians starving in the streets.

Solution

There is an alternative to that dark future, and perhaps it is to keep the public from waking up to it that arms are being twisted to accept the new burdens quickly. If Wall Street and the Feds won't extend credit to California on reasonable terms, the State could simply walk away and create its own credit machine. California could put its revenues in its own state-owned bank and fan these "reserves" into many times their face value in loans, using the same "fractional reserve" system that private banks use. Many authorities have attested that banks simply create the money they lend on their books. Congressman Jerry Voorhis, writing in 1973, explained it like this:

> "[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."

President Obama himself has acknowledged this "multiplier effect." In a speech at Georgetown University on April 14, 2009, he said:

> "[A]lthough there are a lot of Americans who understandably think that government money would be better spent going directly to families and businesses instead of banks; where's our bailout?,' they ask, the truth is that a dollar of capital in a bank can actually result in eight or ten dollars of loans to families and businesses, a multiplier effect that can ultimately lead to a faster pace of economic growth."

If private banks can leverage deposits into multiple amounts of "credit" on their books, a state-owned bank could do the same thing, and return the profits to the public purse. One State already does this. North Dakota boasts the only state-owned bank in the nation. It is also one of only two states (along with Montana) that are currently able to meet their budgets. The Bank of North Dakota was established by the legislature in 1919 to free farmers and small businessmen from the clutches of out-of-state bankers and railroad men. By law, the State must deposit all its funds in the bank, and the State guarantees its deposits. The bank's surplus profits are returned to the State's coffers. The bank operates as a bankers' bank, partnering with private banks to lend money to farmers, real estate developers, schools and small businesses. It makes 1% loans to startup farms, has a thriving student loan business, and purchases municipal bonds from public institutions.

North Dakota is not suffering from unemployment or feeling the pinch of the economic downturn. Rather, it sports the largest surplus it has ever had. If this isolated farming State can escape Wall Street's credit crisis, the world's eighth largest economy can do it too!

To sign a petition that will go electronically to Governor Schwarzenegger and to elected officials in your State, click here. You could also try faxing this article or a letter to Governor Schwarzenegger at 916-558-3160. See http://gov.ca.gov/interact#contact.

***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.*