U.S. Treasury Secretary Henry Paulson: Coming Financial Crash Shows Need for Immediate Monetary Reform

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U.S. Treasury Secretary Henry M. Paulson, Jr., has joined the chorus of those in high places who are warning of a major worldwide economic downturn.

Paulson was quoted at length in a July 23, 2007, article in Fortune by Rik Kirkland entitled, "The Greatest Economic Boom Ever: Enjoy It While It Lasts." Paulson's remarks came in the context of assessing the ability of the highly-leveraged equity, hedge, and derivative markets to withstand the shocks to come. He told Fortune in an interview:

> "We haven't had a global financial shock since 1998. I believe that these large and dramatic increases in private pools of capital and in the credit derivatives markets since then have helped manage and disperse risk and make the economy more efficient. When we do have one—and it's when, not if; that's not me being negative, it's just that we're not going to defy economic gravity—we'll be seeing for the first time how some of these instruments perform under stress."

The Fortune article notes that the fate of the global economy depends in large measure on the ability of the U.S. consumer to continue to buy what the rest of the world produces. But, as Fortune indicates, the economic fundamentals continue to move in the wrong direction.

The U.S. current account deficit, they point out, continues to plunge, heading toward the $900 billion mark, almost nine percent of GDP. U.S. household debt as a percentage of personal income has shot up almost thirty-five percent since 2000. While real income stagnates for the U.S. middle class, asset and commodity prices are surging, with gasoline prices leading the way and the Goldman Sachs Commodity Index doubling since 2001. Financing in the business world is increasingly shaky, with loans to companies with "junk" credit ratings soaring from under $50 billion a year in 2001 to over $200 billion in 2006.

What are the politicians saying? Both President George W. Bush and Vice President Richard Cheney, who may be hoping to escape in one piece after eight years of economic malpractice, are silent on the subject of a possible downturn. Also silent, unfortunately, are Republican and Democratic front-runners Rudy Giuliani and Hillary Clinton.

So obsessed with his image of having been in the vicinity of the Twin Towers on September 11, 2001, Giuliani seems blissfully unaware that there is such a thing as an economy.

Though Clinton speaks of the need for economic fairness, she has few concrete proposals for getting us there. She must also bear some degree of association with the failed policies of her husband's administration which brought us the strong dollar, the dot-com bubble, and NAFTA, all of which led to the bust of 2000-2002 and the outsourcing of huge numbers of U.S. manufacturing jobs.

The only Republican who speaks to broad economic issues is Ron Paul, who has called for the Federal Reserve to be abolished as a step toward financial sanity. We'll see how Dr. Paul, a long-shot to say the least, fares in the Republican primaries. Party kingmakers are terrified of his rising grassroots support.

On the Democratic side, John Edwards has established his credentials in speaking for the millions of Americans in poverty who have been left out and is broadening his message to include the middle class as well. At the end of a three-day poverty tour to Appalachia, Edwards said in a July 18 speech in Prestonburg, Kentucky, "This cause, this march we're on, is not just about the poor. Everybody's at risk. Everybody's vulnerable."

Candidate Barak Obama has also discovered the anti-poverty theme, while Congressman Dennis Kucinich has consistently been emphasizing ideas of economic reform while proposing the creation of jobs through such proposals as a Federal Infrastructure Modernization Bank.

So there is hope that the 2008 presidential campaign may focus on real issues. In fact, as of this writing, it would seem that a Democratic ticket consisting of Edwards-Obama or Edwards-Kucinich could bring the urgency of change to the forefront, especially if the economy slips in a big way over the next several months.

How deeply any candidate will penetrate in his or her analysis is another question. The U.S. economy is groaning under a total societal debt load for individuals, households, businesses, and government of over $45 trillion. There is a gap between personal income and GDP of more than $3.5 trillion per year, with people having to run up ever-more household debt just for the necessities of life. With so many jobs outsourced, our population no longer even comes close to being able to purchase the amount of goods and services needed to sustain the economy.

The real answer is wholesale monetary reform.

Since the 1970s, the Federal Reserve, acting as an agent for the banking system, has been trying to manage affairs under the rubric of "monetarism." This is the system whereby the Federal Reserve attempts to regulate the economy by raising and lowering interest rates.

We take this system for granted, even though, historically speaking, it is a fairly recent innovation and despite the fact that it has been a total failure. Monetarism replaced a production-based economy with a debt-based one. This has caused growth of the financial industry to outstrip all others, with profits exceeding $500 billion in 2006.

Also, interest rates, on average, have been generally higher under monetarism than in previous eras. The Federal Reserve's claim that higher interest rates stem inflation is contradicted by the fact that during the monetarist "reign of error," inflation has eroded the value of the dollar by over 80 percent.

Also, since the Federal Reserve-induced recession of 1979-1983, every period of economic "growth" under the monetarist system has been a bank-created bubble.

We had the buyout-acquisition-merger bubble of the 1980s, ending in the 1987 stock market crash and the recession which lasted the entire term of President George H.W. Bush. Next we saw the dot-com bubble of the 1990s under President Bill Clinton, ending in the 2000-2002 recession.

Then, under George W. Bush, came the housing bubble, which is now deflating with the exposure of the fraud-infested subprime market. The current equity-asset bubble, with an overpriced stock market setting ever-new records, will likely be the next to pop.

Meanwhile, with the crumbling of our private and public infrastructures, there is no bona fide economic driver left in the U.S. economy, except the little plastic cards in consumers' wallets. The fact that expendable cash and checking accounts, measured by the Federal Reserve as M1, has been declining for the last year, shows that the consumer economy is already in a recession.

It is past time for monetarism to be recognized as the flop it truly has been and thrown on the junk-heap of history where it belongs. It should be replaced by a mixed program of credit management reminiscent of the New Deal but with additional features suited to today's vastly changed reality.

A truly comprehensive program of monetary reform, as I have described in other articles, would provide purchasing power to consumers, businesses, and government at a rate that would match the incredible productivity brought into existence by modern science and technology. This injection of purchasing power, over and above earnings, should no longer be carried out through the unfair and outmoded methodology of bank-created debt.

In other words, there should be enough cash and credit in circulation to purchase what industry can produce, and for people to obtain what they need for a decent life, without our economy constantly having to go deeper and deeper into the red.

To accomplish this, the government can and should make direct cash allocations to individuals without recourse to taxation or borrowing. This infusion of purchasing power is needed because income from jobs cannot keep up with total production when a large portion of industrial earnings is withheld for future innovation, as must be done in today's technology-rich environment.

For a business entity to remain profitable, it must save and reinvest. These savings are recovered through prices that exceed purchasing power distributed through wages, salaries, and dividends. This leaves a "gap" which today is filled by bank-credit. But it's the wrong way to run an economy. The gap, which is a normal feature of industrial production, should instead be filled by free government-distributed credit through what has been called a National Dividend.

A National Dividend should not be tied to employment. It should be obvious that as fewer workers are needed to produce more and more goods and services, the benefits of rising productivity can only be realized if the government provides purchasing power to individuals and families whether they are working at the moment or not. Such allocations could be made without inflationary pressures as long as they did not exceed the economy's producing potential.

Similarly, the system of public finance whereby the banking system creates credit out of nothing in order to lend money back to the government has never made sense. As Thomas Edison and others in U.S. history have pointed out, the government can just as well create and spend interest-free money directly into circulation as was done successfully with the Greenbacks during the nineteenth century.

A comprehensive system of reform measures suitable to today's conditions would include 1) cancellation of substantial portions of existing debt; 2) direct issuance by the government of a guaranteed basic income/National Dividend that would average at least $12,500 per person per year; 3) direct spending by government on infrastructure improvements; 4) a new system of low-cost credit for consumers and small businesses; 5) abolishment of the Federal Reserve as a bank of issue with its retention only as a financial transaction clearinghouse; and 6) elimination from the capital markets of all bank lending for financial speculation through return to the "real bills" doctrine of lending.

These provisions would acknowledge the awesome power of credit creation as a public utility as provided for by the U.S. Constitution in the section that grants Congress the authority to regulate the money supply. Such a program would also allow a significant reduction in taxation. Day-to-day responsibility should be vested in a Monetary Control Board reporting to the executive branch, as provided for in the model American Monetary Act drafted by the American Monetary Institute.

These may seem like radical measures, but they are ideas that have been discussed for years by monetary reformers worldwide. They would recognize the fact that the private banking system, acting through the Federal Reserve under the philosophy of monetarism, has totally failed. The system has not produced the economic democracy which the global economy makes possible and has brought us to the brink of a worldwide financial catastrophe.

As New Zealand monetary reformer William Hugh McGunnigle wrote recently on an internet discussion site, "Basically today we are attempting to run a 21st century economy using financial tools that are five centuries out of date. It is like trying to control a sophisticated modern jumbo jet using the control mechanisms appropriate to the machines of World War I. The whole system is unstable, and the larger it becomes the more likely it is that it will collapse, simply because those controlling it have no inclination to prevent that collapse. We have learned nothing from the financial disaster of 1929-1934."

Richard C. Cook is a retired federal analyst, whose career included service with the U.S. Civil Service Commission, the Food and Drug Administration, the Carter White House, and NASA, followed by twenty-one years with the U.S. Treasury Department. His articles on monetary reform, economics, and space policy have appeared on Global Research, Economy in Crisis, Dissident Voice, Atlantic Free Press, and elsewhere. He is also author of "Challenger Revealed: An Insider's Account of How the Reagan Administration Caused the Greatest Tragedy of the Space Age." His website is at www.richardccook.com. He will be speaking at the national conference of the American Monetary Institute in Chicago in September.

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