

THE FATAL PATH



BY DAN ARMSTRONG

PART 1

MONEY FOR NOTHING

"Our banking system as a whole creates and extinguishes deposits as they make loans and investments, whether they buy government bonds, whether they buy utility bonds or whether they make farm loans...If there were no debts in our monetary system, there would be no money."

—Marriner Eccles, Chairman of Federal Reserve Board
Speaking to Congress on June 24, 1941

Do you know how money is created? You might suppose it originates from a printing press somewhere in the bowels of the Treasury Building in Washington, D.C. Well, not exactly. The money must first be "created" before it can be printed. What does this mean. Ever since 1933, when the United States went off the gold standard, money is created, as stated above by Mr. Eccles, through loans and government bonds granted or bought by the Federal Reserve Bank by checks written to itself.

In the aftermath of the banking panic of 1907, it became apparent to Congress that the government needed to stabilize the banking industry. Late in the evening of December 23, 1913, after most of Congress had gone home for Christmas break, a handful of congressmen quickly passed the Federal Reserve Act. This law established the Federal Reserve Bank, a supposedly non-profit, private corporate entity, and gave it the responsibility to supervise and regulate the country's commercial banks. It was also given the power to issue credit money. Contrary to what you have probably taken for granted all your life the money that you borrow from a bank does not come from money deposited in that bank by bank patrons. Through our strange fractional reserve monetary system the bank actually creates the money it lends you, then extinguishes it from its ledgers as you pay it back. The money exists only as pixels irradiated on a computer screen. For this service the bank charges you interest — and surely a loan fee too.

Prior to 1933 the United States was on the gold standard. The government printed only as much currency as could be backed by the gold in the national vaults. You could actually take a greenback to the treasury and exchange it for its printed value in gold. Thus the richer the country the more gold in the vault, the more currency in circulation, and the more affluent the society. As long as gold has a verifiable value this is a very basic monetary system.

In 1933, however, deep into the Great Depression, President Franklin Roosevelt took us off the gold standard. Due to increasing economic pressures the government had circulated far in excess the amount of currency it could back with vaulted gold. Circumstances demanded that the Federal Reserve Bank exercise its power to create credit money. Roosevelt borrowed money from this government authorized private bank to finance farm subsidies and work projects like the Civilian Conservation Corps. This put money back in the pockets of the consuming public and stimulated the economy. In this way, through an interest-bearing loan, America's first "synthetic" money was created. (That is, money backed only by money's potential to

make more money.) Interestingly enough, when this loan was paid back the United States went back into another recession which only the stimulus of World War II would end.

This was the beginning of the fractional reserve monetary system that we presently use. With it the operators of the Federal Reserve Bank have been granted a monopoly on the creation of money. Twelve such banks now exist throughout the United States. In addition to holding the accounts of the U.S. Treasury the Federal Reserve operates as the banks' bank. It provides national check clearing facilities and maintains a cash deposit (called a *reserve balance*) as security for each commercial bank. The Fed also grants commercial banks the right (at the prime interest rate) to create money to a multiple of their reserve balance. That is, a bank only needs to have on reserve a fraction of what they loan — thus the name *fractional reserve*. This fraction is presently 3% for a bank with a Federal Reserve balance of \$25 million. This means the bank can loan out \$100 for every \$3 it has on reserve or \$830 million worth of loans from a \$25 million reserve. The bank literally has the capacity to create \$805 million out of thin air. And this "synthetic" money the commercial bank loans to you — at a little bit more than the prime interest rate — to an amount equal to your credibility or credit rating. In this way the Federal Reserve Bank provides fiscal services, regulates interest rates and collects interest on all money that is in circulation in the United States. Since we must always have currency this amounts to guaranteed income for the trustees of this private corporation — and compounded annually at the prime interest rate in a country the size of ours for 63 years, a whole lot of money for nothing.

This is what Robert H. Hemphill, credit manager for the Federal Reserve Bank of Atlanta for eight years, had to say about this monetary system:

"If all the bank loans were paid and no one would have a bank deposit, there would not be a dollar of currency in circula-



ion. This is a staggering thought! We are completely dependent on the commercial banks. Someone has to borrow every dollar we have in circulation, cash, or credit. If the banks create ample synthetic money, we are prosperous; if not, we starve. We are absolutely without a permanent monetary system. When one gets a complete grasp upon the picture, the tragic absurdity of our hopeless position is almost incredible. But there it is. The banking problem is the most important subject an intelligent person can investigate and reflect upon. It is so important that our present civilization may collapse unless it is widely understood and the defects remedied very soon."

The primary defect in the system is that our government is indebted to pay on the currency of its own economy. Think about this. If the first loan taken in 1933 was for \$100 at 10% interest, then \$100 would be created — yet \$110 would be owed. Another loan would be necessary to "create" the money to pay back the interest on the first loan. Now \$110 would have been created but a third loan would be necessary to create the money to pay off the interest on the second loan. The fractional reserve system bootstraps itself into a lending facility with a little cash, then operates indefinitely as a self-perpetuating money machine. Must be nice to be on the board of directors of the Federal Reserve Bank. They make money the old fashioned way — they collect interest.

Now, for the sake of curiosity, what happens when these "modern money mechanics," as the Federal Reserve calls them, are applied to the subject of our National Debt...

Back in the good old days of the gold standard it took little imagination to understand that the more money in circulation the richer the country was. Today under the fractional reserve system the larger the debt the more money is in circulation. But does this mean the larger the debt the richer the country? *Doubtful.* Because of the steady accrual of interest there can never be as much currency as there is debt. Meaning, if the debt is paid off we all go broke or "starve" as Mr. Hemphill put it.

In the 68 years from the end of the Civil War to the time we went off the gold standard the annual budget was balanced 48 times. In the 62 years since we've harnessed ourselves to the Federal Reserve the annual budget has been balanced 8 times. In each case a recession followed. The point is the National Debt has an entirely different meaning if the currency is created by credit than if it is back by gold. Our present debt is something to be managed like investment properties — not zeroed out like a credit card.

Whatever has been going on in the halls of Congress these past months appears quite suspect through this set of lenses. It looks more like a subtle deception to manipulate public opinion.

Let's presume that our logic is in place and that the National Debt really does represent investment in our country. If that is the case then management is key. Each expenditure needs to be evaluated as either a good investment or a bad one. Despite what the archaic GDP (Gross Domestic Product) formula proclaims, good investments are ones that add to the infrastructure of the nation, produce income, social security (reflexively human rights) and economic growth. Roads, utilities, educational facilities, health services, environmental protection. These are things that pay themselves back by providing a solid base for business and securing the future of the society. Employment services are also good investments as jobs mean taxable incomes and revenue back to the government. Even welfare is a reasonable investment. Not only does it provide care for the aged and poor and contributes to the moral fabric of our society but it also helps alleviate tensions in the urban setting and gives dollars spent by the recipients back to the business sector. Increased participation is increased economic stability.

Bad investments are operating costs. Excessive bureaucracy. Defrayed campaign costs. The wastes of investigating and prosecuting government scandals (Watergate, Conragate), political party frays (Whitewater), or graft (S&L frauds). But primarily bad investments are huge contracts to incestual corporations, where radically high profits merely settle into the bank accounts and trusts of the mega-rich and are inadequately trickled down to their employees. These investments tend to be detrimental to small businesses and the will of the working class — the precise things we must strengthen to provide the necessary diversity for a stable economy and society.

In relative terms the \$5 trillion National Debt is not as awful as it sounds. (Of course the fact that there is not that much currency in circulation — *remember the interest!* — completely confounds this statement.) In proportion to the Gross Domestic Product it represents a disturbingly high but workable quantity. A cursory review of the manner in which this debt has accrued, however, reveals the presence of many "bad" investments and an insight into the real horror and danger it offers: *Bad money subverts good money.*

When President Jimmy Carter left office in January of 1981 the debt was \$950 billion. When President Ronald Reagan left office in 1989 that figure had climbed to \$2.5 trillion. It has since doubled during the Bush and Clinton administrations. (And this does not include the half-trillion dollar cost of the massive Savings & Loan failures of the late 1980s and '90s. Clearly they were a bad "investment.")

What is astonishing to discover once we have swallowed the prickly black seed of interest — \$200 billion annually — is that the bulk of this debt comes from the cost of the Cold War and profligate military spending. To get a measure of the extent of this manifest absurdity, during the height of the Vietnam War National Defense spending never topped \$100 billion. Today all our enemies are gone yet still approximately a fifth of the annual budget — or \$250 billion a year for the last fifteen years (\$3.5 trillion) — goes to National Defense.

There are those who might argue the Cold War bill was worth the chilly "victory." The Soviet Union succumbed to the social "cost" of this war and the "evil" communist threat has for the most part disappeared. Unfortunately, we are presently staggering ourselves from the social insult and economic weight of this ugly industry promoted fifty year struggle — which some claim still persists in its vastly mutable form. Regardless of where the truth stops and the lies start, military spending in this day and age remains a highly regressive investment. The profits go primarily to the enlargement of the already gigantic military procurement industry, and the costs to create this ugly monster drop right into the lap of the American people. As Congress wrangles to find a way to subtly pin the Cold War bill on the middle class, we discover that these "defense" costs (that now

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