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EIR Economics

LaRouche campaign specifies how to nationalize the Fed

At a moment when all the "major" presidential candidates agree that the economy is the primary electoral issue, but none is offering a coherent program, the Advisory Committee to Lyndon LaRouche's Democratic presidential campaign announced the release on Feb. 25 of a draft Federal Reserve Nationalization Act of 1992. It is based on the candidate's proposal to return the United States to the method of central banking originally envisioned by Alexander Hamilton, the first Treasury secretary, and mandated in Article I of the U.S. Constitution. What follows is the motivating argument and draft text released to EIR News Service by the "Democrats for Economic Recovery—LaRouche in '92" campaign:

The current Federal Reserve method of money creation is unconstitutional, LaRouche said, because it leaves "the power to create fiat credit in the hands of a powerful cartel of private bankers led by Citibank and Chase Manhattan Bank."

LaRouche called instead for a return to "the constitutional obligation of the federal government" to ensure that the nation's credit goes to tangible production and necessary physical public services.

The Act is in the form of a draft, a LaRouche in '92 spokesman said Feb. 25, "because we are asking for broad discussion and suggestions from experts, and from the public, to stir debate on this critical idea."

LaRouche has also requested the draft of a companion "Banking Reorganization Act of 1993," to detail how the National Bank shall regulate the rapid write-off of the more than $5 trillion of worthless loans to non-productive activities already on the books of private U.S. banks.

The Federal Reserve Nationalization draft (see *Documentation*) completely rewrites the Federal Reserve Act of 1913, which created the Fed system, via amendments which:

1) Forbid creation of "fiat money" through Federal Reserve *open market operations,* now corruptly controlled by a private cartel of the New York banks;

2) Create instead over $300 billion in new credit through the new National Bank's *discount window,* using loans earmarked for new real physical capital investment, production, or transport of tangible wealth;

3) Shut down "Eurodollar market" speculation in the U.S., by re-imposing *reserve requirements* on deposits of private banks, thus cutting off the infinite "Keynesian multiplier" which underlies the 1980s' "junk finance."

Curtailing open market operations

The problem with the Federal Reserve is the method by which it creates money. The Fed now adds "fiat money" to the banking system by printing fresh Federal Reserve Notes, the familiar dollar bills, for the purpose of *buying a certain portion of the U.S. Treasury debt:* that which would not otherwise be purchased by money already in circulation. This is "monetizing the government debt," printing cash to finance the U.S. budget deficit.

Worse than the question of "how much fiat money?" is the question "whose?" The Federal Reserve does not purchase Treasury debt from the Treasury, but from the two dozen leading Wall Street government debt houses such as Salomon Brothers and Goldman Sachs, who buy up debt from the Treasury Department in anticipation. The corruption this entails has been but partially exposed by the recent indictments of Salomon Brothers officials in a major Fed Open Market Operations fraud.

These Treasury security dealers then deposit the proceeds of their Treasury debt sales—the new fiat money just printed by the Federal Reserve—into accounts at the top 20 New York commercial banks, led by Citibank and Chase Manhattan. These commercial banks now have additional deposits created for them out of thin air.

The banks then demonstrate the principle of the "Keynesian multiplier": They create more money out of thin air, by loaning out these deposits to a customer; the customer's loan is then redeposited, reloaned, and so on.

Under the deregulation of the 1980s, the total phase-out of reserve requirements has allowed the multiplier to grow at infinite rates. Under these arrangements, overall indebted-

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ness has risen toward $25 trillion. More than half of the present so-called Gross National Product can be accounted for by direct and indirect charges associated with servicing this debt.

So, with all this credit, why is the economy crashing?

The reason is that the control of the nation's credit rests with the above-described *private banking cartel.* This cartel directs credit toward speculation. Half the profits of the U.S. money center banks during the 1970s and early 1980s were made speculating in the inflationary offshore Eurodollar market, making usurious loans to foreign nations which could never be repaid. During the later 1980s the speculation turned inward, to the S&L debacle, real estate speculation, and junk bond schemes.

Now the banks themselves, caught with all this worthless paper, are desperately absorbing every bit of new Fed credit. While the Fed pumps money hand over fist, cash does not reach the capillary system of the physical economy, because the aorta has a leak.

The Federal Reserve Nationalization Act of 1992 therefore limits the new National Bank's open-market operations. Section 3 of the Act sets a statutory limit to the amount of U.S. government debt the National Bank may hold. The bank may continue some open market operations, such as short-term buying and selling of Treasury debt to stablize markets; but it may not buy *new* debt.

This means Article I of the Constitution, which arrogates to the U.S. government a monopoly in emitting legal tender, will be re-implemented. Federal Reserve notes will be gradually withdrawn from circulation, and replaced by U.S. Treasury bills, as described below.

Expand productive credit

The Act proposes that new long-term, low-interest credit in the amount of approximately $300 billion per annum be issued by the U.S. Treasury, via the new National Bank, to the U.S. physical economy by a new mechanism. The National Bank will open wide its *discount window* for new lending of *directed credit* to industry, infrastructure, and related sectors of the physical economy. The bank may create credit indefinitely without fear of inflation as long as it serves to create new productive wealth.

All new credit and currency of the United States is to be thus issued by the U.S. Treasury under Article I of the Constitution, as *U.S. Treasury bills,* gradually replacing the old Federal Reserve notes in circulation.

Of the total $300 billion per annum issued, about $100 billion is to be spent by the U.S. Treasury itself in the form of *basic economic infrastructure projects* run by federal, state, and local agencies and subsidiaries. The objective is to employ approximately *3 million people* directly in water projects, power generation and distribution, transportation, urban infrastructure, construction of medical facilities, schools, etc.

These government projects will generate additional credit demand in the area of another $200 billion per annum of purchases and investments by private-sector firms supplying these government projects, a total of $300 billion in new productive activity. The private sector will also increase employment by 3 million operatives for a total new increase in productive employment of some *6 million persons.* Thus the Treasury will receive more than the initial monies outlaid through increase in the tax-revenue base of the government.

The Federal Reserve's present discount window currently provides marginal amounts of credit, largely for the banks' use, in their own emergency cashflow needs. Via the window, the Fed loans money to the banks, at a *discount,* against paper presented by the banks.

The advantage of conducting all National Bank credit at the discount window, is that the window may easily discount large amounts of *bills of trade.* These bills, held by the banks as loans to productive enterprises, are chits representing actual *physical production* of goods and services, so as to guarantee that new national bank credit goes to creation of new productive wealth.

This will constitute a system of *directed credit,* or what has been called a "two-tier credit system." Private enterprise will be encouraged, but productive enterprises more than others. Enterprises seeking to borrow at the banks for productive purposes, and their bankers, will find the banks can readily discount this paper for cheap credit. Those seeking to borrow for more speculative purposes will find their loans are discounted at a more expensive rate, or not at all.

Protective reserve requirements

To protect the banking system, and prevent banks from re-depositing for re-lending, the Act re-regulates *reserve requirements* for banks.

Until the deregulation of the 1980s, the Federal Reserve required banks to keep on deposit with the Fed a standard reserve fund, for use to pay depositors when loans went bad, which until 1982 was roughly calculated at an average rate of 16% of a bank's total deposits. This cost banks money, since the funds could not be loaned out at interest, and thus prevented banks from wildly multiplying the number of times they re-deposited and re-loaned Federal Reserve credit. Those safety reserve requirements, however, were largely done away with by the deregulation of the 1980s, making U.S. banks part of the off-shore Eurodollar market.

Under the new Act, the 16% reserve requirement which was standard post-war U.S. practice, will be re-imposed. Banks which maintain at least 60% of their loan assets in the real physical productive activities listed above will be subject to that standard requirement. For every 1% by which the banks' proportion of tangible wealth-creating loan assets falls below 60% of total assets, the National Bank shall require an additional 1% reserve charge, further discouraging banks from non-productive lending.

Documentation

The following are excerpts from the Draft Federal Reserve Nationalization Act of 1992:

Section 1 Section 1 of the Federal Reserve Act of 1913 is hereby amended to read:

"Under Article I of the Constitution pertaining to the monopoly of the U.S. government in emitting legal tender, the Federal Reserve System is hereby nationalized and placed under the jurisdiction of the Department of the Treasury of the United States. Its name is hereby changed to the 'National Bank of the United States.' Regional headquarters of the Federal Reserve System shall henceforth be known as the appropriate regional branches of the National Bank of the United States. . . .

"Offices and personnel of the former Federal Reserve System shall continue normal functions at the new National Bank except for the amendments set forth below. . . ."

Section 2 Section 1 of the Federal Reserve Act is hereby amended to read:

"The Federal Reserve shall immediately cease issuance of Federal Reserve notes as legal tender. As of the passage of this Act, the successor National Bank of the United States shall commence issuance of all new legal tender obligations of the United States in the form of U.S. Treasury bills, to be deposited with the National Bank by the Treasury Department. . . .

"Previously issued Federal Reserve notes may continue to be circulated as currency until such time as the Treasury shall formulate a currency reform plan for their orderly withdrawal, said plan to be promulgated no later than one year from the passage of this Act. . . ."

Section 3 Section 14 of the Federal Reserve Act of 1913 is hereby amended to include the following:

"The power of the National Bank of the United States to purchase or sell bills, notes, and bonds of the United States shall be limited to these functions:

"a) The anticipation of tax revenues accruing not more than one year form the date of purchase of said bills, notes, and bonds, in order to help maintain an orderly flow of disbursements by the Treasury;

"b) To maintain an orderly market in the bills, notes, and bonds of the United States, and to meet the temporary liquidity needs of the Bank and private banks;

"c) The purchase of such liabilities of the United States as may be presented by foreign governments for sale to the National Bank by said governments;

"The Federal government, however, may not create money supply by monetizing United States govenment debt. To ensure this, the total holdings by the National Bank of bills, notes, and bonds of the United States shall be set as an annual ceiling as of the enactment of this Act. Said holdings may vary in size in the course of each year, but may not increase in size at the end of the year, following enactment of this Act and at annual intervals, except by repurchases of U. S. debt from foreign governments."

Section 4 Section 14 of the Federal Reserve Act of 1913 is hereby amended to read:

"Upon the endorsement of any U.S.-chartered bank, any branch of the National Bank may discount up to 50% of the face value of notes, drafts, and bills of exchange arising from the production of tangible wealth or capital improvements. . . . This shall be defined as the purchase of raw and intermediate materials and capital goods, construction of facilities, or employment of labor to produce or transport manufactured goods, agricultural commodities, and construction materials; to work mines; to build manufacturing, transportation, and mining facilities or dwellings; to produce and deliver energy in all forms; and to provide public utilities for communications.

"Such definition shall not include notes, drafts, bills, or loans issued or drawn for the purpose of conducting business except in the areas so defined, or for trading stocks, bonds, or other investment securities.

"Any National Bank branch may discount the full value of acceptances which are based on the exportation of goods, or 50% of the value of acceptances which are based on the importation of goods conforming to the above.

"All National Bank branches shall meet all such requests for discount of or participation in notes, drafts, bills, and loans made by U.S.-chartered banks, once the National Bank has determined that the purpose of such credit conform to the restrictions set forth above. There shall be no restrictions applied to such discounts."

Section 5 Section 19 of the Federal Reserve Act of 1913 is hereby amended to include the following:

"The above reserve requirements shall apply in the case that private banks maintain 60% of their total assets in the form of loans, bills, drafts, and advances to tangible wealth-creating borrowers, of a type eligible for discount under Section 4 of this Act. For every 1% by which the bank's proportion of tangible wealth-creating assets falls below 60% of total assets, the National Bank shall require that banks place an additional 1% of demand deposits in reserve with the National Bank system.

"This rule shall immediately apply only to new assets of banks after the enactment of this Act. Previous assets shall be subject to a Bank Reorganization Act, supplying a deadline by which all assets must meet this rule."