U.S. Federal Reserve

by Jerry Voorhis

The Constitution of the United States says: "Congress shall have power to coin money and regulate the value thereof." Congress does no such thing, which is the heart of our trouble. Private banks coin our money and regulate its value. In doing so they take from the government and people of the United States a large chunk of their sovereignty, a large chunk of the taxing power, and the key to a prosperous economy without inflation.

For example, in testimony before the Banking and Currency Committee of the House of Representatives in 1935, Marriner Eccles, then Chairman of the Federal Reserve Board itself, said: "In purchasing offerings of Government bonds, the banking system as a whole creates new money, or bank deposits. When the banks buy a billion dollars of Government bonds as they are offered-and you have to consider the banking system as a whole as a unit-the banks credit the deposit account of the Treasury with a billion dollars. They debit their Government bond account a billion dollars; or they actually create, by a bookkeeping entry, a billion dollars."

Mr. Eccles' statement is exactly as true today as when he made it. Here is how it works: The private banking system of our country creates our money in the form of demand deposits on the banks' books. The reason it is able to do this is because no bank is required to have in its vault anything like the amount of money which its depositors think they have in the banks.

Banks are only required by the Federal Reserve System, which the banks are sure they own, to have in their vaults anywhere from $1 to $1.50 for every $10 of demand deposits on their books. Thus for 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.

This is, of course, the "fractional reserve system" of banking. It is more or less controlled by the Federal Reserve System, whose only stock is held by the private banks of the Federal Reserve System. Not a single share of such stock is held by the government or people of the United States, although if "national sovereignty" means anything at all, these banks of issue should be the property of the nation.

But what actually happens when our government engages in deficit financing? The obvious way the government can get more buying power into the people's hands is by itself putting more money into the stream of commerce than it takes out in taxes. The tragedy of the situation is that, up to date, the only way our government has enabled itself to spend more money than it takes in has been by forcing this sovereign nation to borrow its own credit from private sources.

This has been true, despite the fact that if deficit financing accomplishes its purpose at all it will increase production and trade, enhance tax revenues, and broaden the base of government credit.

To the extent that government bonds are sold for cash to individuals or to institutional purchasers other than banks the government is taking out of circulation approximately as many dollars as it will put back in when it spends the money.

To accomplish its purpose, deficit financing must result in the creation of new money, and the use of it to increase mass buying power. Only if this happens will there be any stimulation of idle plants to go back into production, or more employment.

Under these circumstances what ought to happen is that the credit of this great nation should be drawn upon directly by the government-not that it should go more deeply into debt.

For the credit of this or any nation is squarely based upon and derived from the production of wealth by the nation plus the power of the government to tax. A nation like the United States thus possesses an almost unlimited amount of credit. Otherwise it could not possibly have persuaded investors to buy $480 billion of government securities.

By whatever percentage it can be anticipated that production and hence potential tax revenues will increase as a result of deficit spending, by that same amount the credit of the nation and its government will be increased. This same percentage of the volume of money previously in circulation should appear on the books of the Treasury as a credit entry to be drawn upon just like tax revenues. To do that would be nothing more than rational and proper bookkeeping. It would also be morally right bookkeeping. And it would make some sense of Mr. Nixon's "full employment budget" idea.

But this is not what happens at all. Instead the sovereign government of the United States goes hat in hand to the private banking system and asks it to create the new money that the economy needs. The government gives-the word is used advisedly-it gives to the banking system, including the Federal Reserve banks, government bonds, the debt of all the people. Interest-bearing bonds, that is, bonds bearing as high an interest rate under today's regime as the banks decide to demand. Else they won't buy the bonds. The banks "buy" the bonds with newly created demand deposit entries on their books-nothing more. It is fountain-pen money and considerably more inflationary than would be the same amount of dollar bills created by the government. The deposits the banks create with which to own the people's debt are backed by nothing except the bonds themselves! In other words, they are backed by the credit of the American people.

What the government has "borrowed" from the banks, what the people must for years pay interest on, is nothing more nor less than the credit of the nation, which obviously the nation possessed in the first place or the bonds themselves would be no good!

At long last, a few years ago the Federal Reserve made tacit acknowledgment of these facts. 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 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.

But this is only part of the story. And the less discouraging part, at that. For where the commercial banks are concerned, there is no such repayment of the people's money.

When the commercial banks create money, as they do when they acquire government bonds, they levy a tax on every person in the United States. This is so because every new dollar that is created makes every dollar previously in existence worth somewhat less than it was worth before. This is the very heart of inflation.

It is also taxation without representation with a vengeance. Until this system is changed, our debt will continue to skyrocket without limit and the fixing of debt limits by the Congress will continue to be an exercise in utter futility.

What ought to be done?

Banks should lend existing money. But, as the Constitution clearly requires, the money (or credit) of the nation should never be created by any private agency, but by an agency of the nation itself. It is the duty of Congress to provide for this by a carefully drawn statute.

The stock in Federal Reserve Banks should be purchased by the government from their present private bank owners. The Federal Reserve should then become our national bank of issue. It should create reserve Bank Credit as it does now. But that credit should be credited to the United States Treasury, not charged against it and the people as debt. As much such new credit should be created each year as is needed to keep our economy running at or near capacity-and no more than that. A stable price level could result. Then and only then can we expect to overcome recessions, to put our people to work, and do this without the danger of inflation and the ever-increasing debt which are inescapable under the present monetary system.

-Jerry Voorhis, The Strange Case of Richard Milhous Nixon, 1973

HOW TO NATIONALIZE CREDIT . . . Congress [could] provide for governmental purchase of the capital stock of the 12 central Federal Reserve Banks from the member banks which now own it. This would cost $144,000,000 in round figures, and would correct the present anomalous situation of a privately owned bank of issue. The Federal Reserve Banks could then create money in the form of "Federal Reserve Bank credit" entries on their books just as they do now. A "National Credit Account" (in contrast to present national debt) could be established on the central banks' books in favor of the United States Treasury. To such an account would be credited each year such amounts of newly created "Reserve Bank credit" as would provide the increased purchasing power needed to maintain economic balance and a stable price level.

The Treasury would draw checks against their account and pay them out to those to whom the government owed money, thus getting it into the purchasing power stream.

In this way the whole nation would derive the benefit from the creation of the additional supply of money which its own growth had made necessary. No interest bearing debt would be incurred, but only a bookkeeping transaction between two public agencies. Should inflation threaten so that it was desirable to reduce the volume of money in circulation, the process could be reversed and the Treasury could transfer a portion of its tax revenues to the central banks for cancellation and retirement of the requisite amount of money to restore stability.