Restructuring the Banking System

This open letter to U.S. bankers is by Michael W. Sperry, a South Carolina banker, and longtime collaborator of the LaRouche political movement.

My concern is that banks must play a key role in solving the economic crisis, but two challenges confront us. First, the industry has (justly) earned the disdain of the public due to its irresponsible behavior over the past three to four decades. We have to re-earn the public trust. Second, the current generation of bankers is in desperate need of re-education.

Replacing the defunct global monetary system is a necessary precondition for solving our economy's problems, and a government-sponsored industrial redevelopment program is a necessary part of the solution. However, also essential, the private banking system must be restructured. It has devolved into a mutant caricature of its former self. Focused exclusively on the pursuit of profits, a compliant fellow-traveler (if not witting co-conspirator) in the transformation of our economy into a gambling casino of financial speculation, it has debased itself. It wasn't always so.

In happier times, before interstate banking, bankers defined themselves as facilitators of commerce, as contributors to the economic prosperity of their communities. Profit was viewed as a means to that end, not as an end in itself. Banking was considered as an honorable profession by virtue of its contribution to the common good. Today, with more than 70% of bank deposits concentrated in the ten largest banks, these core principles no longer pertain. Shareholder value is now the banker's Holy Grail, and the welfare of Main Street competes with the vicissitudes of Wall Street for the soul of its bankers.

The principles of the American banking system, conceived by Alexander Hamilton, derive from the defining principles of our republic and differentiate it from all others, just as our republic is different from all others. The uniqueness of our republic was the subject of a book by one of our early patriots. In his introduction to *The Bravo*, James Fenimore Cooper explains:

> A history of the progress of political liberty, written purely in the interests of humanity, is still a *desideratum* in literature. In nations that have made false commencement, it would be found that the citizen, or rather the subject, has extorted immunity after immunity, as his growing intelligence and importance have both instructed and required him to defend those particular rights which were necessary to his well-being.... It is scarcely necessary to tell the reader, that this freedom, be it more or less, depends on a principle *entirely different* from our own. Here the immunities do not proceed from, but *they are granted to*, the government, being, in other words, concessions of the natural rights made by the people to the state, for the benefit of social protection. So long as this vital difference exists between ourselves and other nations, *it will be vain to think of finding analogies in their institutions* [emphasis added].

In this nation, where authority resides with the people, the government is obliged to a different sovereign than that which wields power in nations otherwise constituted. Likewise, the justifications for its institutions are located in their contribution to the public welfare. For those who think banking is not an institution of our government, a review of the so-called "free banking era" (1837-1862) discredits this fantasy. But any doubts that might linger are dispelled by the current exigency. The current breakdown crisis, like its precedents in our history, is the consequence of a willful political decision to de-link the banking system from its mandate to serve the public.

As Hamilton, Lincoln, and Franklin Delano Roosevelt understood, the power to create money is the exclusive province of the Federal government. Banks are allowed to exercise this power as the most appropriate means of—*but exclusively for the purpose of*—promoting the interests of the nation. This delegation of power does not absolve government from its responsibility to regulate the value of the currency, and it does not empower the banks to create money in pursuit of other objectives. Over the course of our nation's history, every episode of economic advance or decline correlates with the adherence to, or deviation from, this principle. Now, once again, we relearn this history lesson.

Hamilton's idea was to structure the banking system in a manner which ensured that money growth flowed into productive activities. The distinction between productive and non-productive economic activities was critical, as the former created wealth, while the latter debased the currency. Creating money to finance a new steel mill results in more steel at lower costs; money growth is "stored" in the value of newly produced tangible goods. Conversely, money created to finance speculation in pork bellies merely results in moving capital from a loser to a winner of a gambling bet; nothing is created, and the value of all money declines.

The job of banks was to grant loans that were economically justified (i.e., produced, or increased the productivity of producing, tangible goods). The banker's duty was to base loans on their potential impact on the economic health of their communities. Loans for other purposes were not prohibited, but they were to be funded with existing deposits, not newly created "fiat" money. A fair return on capital was justified; however, loans that expanded the currency were to be limited to activities that created new tangible wealth. It is not the rate of growth in money, but the direction of its flow, that was regulated by government policy.

Munn's *Encyclopedia of Banking and Finance*, first published in 1924, is a widely recognized source of banking industry terms. In its seventh edition, published in 1973, this aspect of the banker's role was addressed in its discussion of the term "credit" as follows:

> While the relationship between the volume of credit and the volume of business and the movement of prices is not always simple to interpret, it appears to be sufficiently close to make it *a matter of first importance* that the volume and flow of credit should at all times be tested by the contribution which additions to the volume of credit make to the total of economic production. Additions to credit which cannot be economically validated by a commensurate effect in actual production are speculative, and as such should be closely watched, so that business and industry may be maintained in a healthy state.[1]

This unambiguous statement of the relationship between *credit expansion* and *actual production* does not appear in the tenth edition of the encyclopedia, published in 1994. The entire paragraph is edited out! Somewhere between 1973 and 1994, this principle—the definitive characteristic of the American banking system—became passé, and the current generation of bankers is totally unaware of it.

In his 1790 *Report to Congress on a National Bank*, Hamilton left no room for doubt concerning the relationship between a bank's duty to its shareholders and its duty to the public:

> It is naturally to be expected, that . . . the interest and accommodation of the public . . . are made more subservient to the interest . . . of the Stockholders, than they ought to be. It is true, that unless the latter be consulted, there can be no bank . . . but it does not follow, that this is alone to be consulted, or that it even ought to be paramount. *Public utility is more truly the object of public Banks, than private profit*. And it is the business of Government, to constitute them on such principles, that while the latter will result, in a sufficient degree, to afford competent motives to engage them, the *former be not made subservient to it*[2] [emphasis added].

The notion that private banks existed to benefit the public, that profit was merely a necessary means to that end, was revolutionary. No nation ever before contemplated such an idea. But then, no nation ever before founded itself on the principle that government existed solely for the benefit of its people. It was a concept drawn directly from the Constitution, exactly what one would expect from the man whose efforts contributed more than those of any other Founder to the design, public support, adoption, ratification, and implementation of that document.

The American System of Political Economy was not modeled on any system that preceded it. It was a new approach to the relationship between public and private economic interests, designed for a new approach to the relationship between a people and its government. Accordingly, its banking system was a new twist on the functional relationship between its public and private components.

The banking industry must be reacquainted with its purpose and reoriented to its proper economic function. It must reassume its role as a private sector delivery system for the execution of public policy, thereby justifying the government guarantee of the public's claims on it assets. In the current exigency, this transformation cannot be achieved without intervention. Congress must act to rescue the banks from their folly, but it must also reassert its sovereign power to dictate that they conduct themselves in a manner conducive to the welfare of the public.

This transformation cannot be accomplished except as a component of a broader effort that will enable us to resolve asset valuation inequities in an orderly manner, replace the defunct monetary system with one that will work, and put in motion necessary economic recovery initiatives. The proposal authored by Lyndon LaRouche, Jr., known as the "Homeowners and Bank Protection Act," contains the essential elements of such a plan. It includes actions to deal with the immediate crisis, redesign the global monetary system, and reorient national policy to the rebuilding of a sound economy. It is the only viable strategy, and requires the support all who count themselves among the nation's patriots, most especially its loyal bankers.

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1. Glenn G. Munn, *Encyclopedia of Banking and Finance,* seventh edition, revised by F.L. Garcia (Boston: Bankers Publishing Company, 1973), p. 239.

2. Alexander Hamilton, *The Papers of Alexander Hamilton* (New York and London: Columbia University Press, 1963), Vol. VII, p. 325.