Nationalize the Federal Reserve

This report, and the proposed legislation that follows, was first issued by Lyndon LaRouche's 1992 Presidential campaign, LaRouche for President: Independents for Economic Recovery.

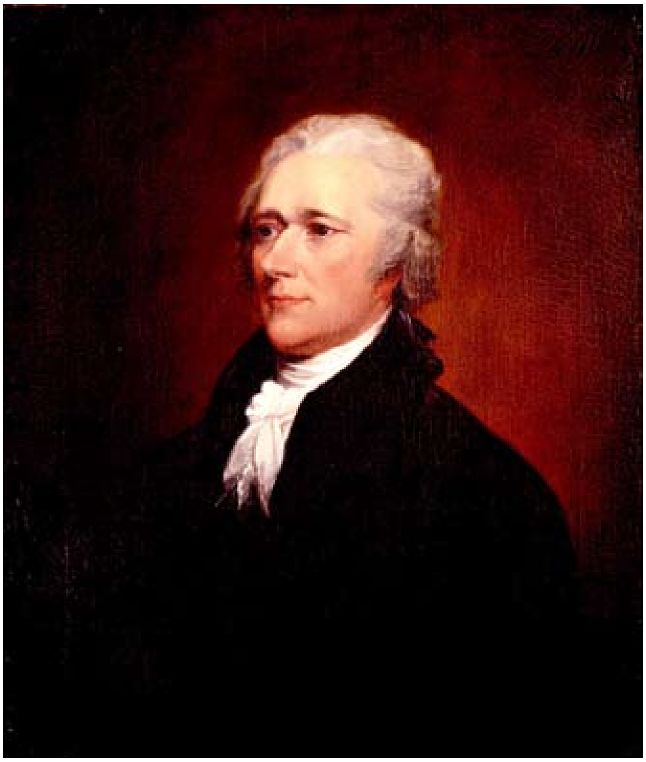
The Presidential campaign organization of Democrat Lyndon H. LaRouche, Jr. announced on Feb. 25, 1992 the release of a draft "Federal Reserve Nationalization Act" to recreate the U.S. central bank on the model of the First National Bank of Alexander Hamilton. The act would nationalize the Federal Reserve System, creating new National Bank of the United States, under the Treasury Department, returning to the U.S. government the right to issue legal tender (currency) granted in the Constitution.

The legislation is based on LaRouche's proposal to return the United States to the method of national banking originally envisioned by Hamilton, rather than the current British system of central banking represented by the Federal Reserve.

Article I Section 8 of the Constitution states: "The Congress shall have power… to pay the debts of the United States… to borrow money on the credit of the United States… to coin Money, regulate the Value thereof, and of foreign Coin, … and to make all laws which shall be necessary and proper for carrying into execution the foregoing powers…"

The current Federal Reserve System's method of monetary creation via Federal Funds "open-market operations" is "*unconstitutional*," LaRouche states, because it leaves "the power to create credit in the hands of a powerful cartel of private bankers" led by Goldman Sachs, Salomon Brothers, Citibank, and Chase Manhattan Bank. This encourages cash to flow to speculative, nonproductive activities.

LaRouche calls instead for a return to "the constitutional obligation of the federal government" to ensure that the nation's credit goes to productive manufacturers, agriculture, basic infrastructure, and other neces-



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Lyndon LaRouche's proposed 1993 legislation to nationalize the Fed is based on the method of national banking envisioned by the nation's first Treasury Secretary Alexander Hamilton.

sary public services, to *direct credit* to an expansion of physical wealth.

LaRouche has also requested the drafting of a second, companion Bank Reorganization Act of 1993, to detail how the National Bank shall regulate the rapid write-off of the more than $5 trillion of speculative loans, "derivatives," and paper for nonproductive activities, now on the books of U.S. financial institutions.

The Federal Reserve Nationalization Act of 1993 completely revamps the Federal Reserve Act of 1913, which enacted the Federal Reserve System, establishing a National Bank under the Treasury Department, via amendments which:

1) Forbid creation of fiat money through central bank *open market operations,* known as creating "money supply";

2) Create, instead, large amounts of credit via the new National Bank's *discount window,* providing all loans presented for discounting by banks are earmarked for new physical capital investment, production, or transport of tangible wealth;

3) *Reregulate* bank deposits, strengthening reserve requirements and using them to ensure banks maintain an adequate proportion of lending for real physical production.

1. Curtailing Open Market Operations

The core of the problem with the Federal Reserve is the way in which it creates *central bank money*, also called "money supply" or "reserves." The Fed adds new money to the banking system each week by buying a certain portion of the U.S. Treasury debt. That portion of government debt which is not purchased by cash already in circulation in the banking system, is financed by the Fed creating new Federal Reserve Notes, either as computer entries or as the familiar dollar bill.

This is known as "monetizing the government debt," printing central bank fiat money to finance the U.S. budget deficit. Since the U.S. deficit has ballooned to $200 billion a year of new Treasury debt in the 1980s, the inflationary effects of Federal Reserve open market operations have skyrocketed.

Creation of new money by a government national bank is not by itself wrong. Hamilton, in his *Report on a National Bank*, praised the Bank as "an engine of paper credit" to foster agro-industrial growth. The real question is: "Whose money?" and "To what purposes?"

In practice, the Federal Reserve does not purchase Treasury debt directly from the Treasury. Rather, the entire process is controlled by three dozen Wall Street financial houses, either Treasury bill brokers such as Salomon Brothers and Goldman Sachs, or commercial banks such as Citibank and Chase Manhattan. The Treasury sells its debt each week to these financiers who "make a market" in Treasury debt, buying it for their own investment portfolios, for a customer, or to trade and resell. The level of corruption this entails has been but partially exposed by the mid-1992 indictments of Salomon Brothers officials in a major Fed Open Market Operations fraud.[1]

When the Federal Reserve creates new "reserves," it then buys a portion of these Treasury securities from those Wall Street financiers—with central bank money just created. The brokers and bankers then deposit the cash in accounts at the top 20 New York commercial banks, as "nonborrowed reserves"—new deposits vir-

1. "The Federal Reserve System: Purposes and Functions," Board of Governors of the Federal Reserve System, Washington, D.C., 1984 edition, p. 41.

tually created out of thin air. When the amount of debt issued by the Treasury is increasing, as it has since 1980, the Fed is issuing new cash to Wall Street at a rate even faster than the increase of debt.

The private commercial banks then demonstrate the principle of the *money multiplier*: They create more money out of thin air, by loaning out the central bank deposits to a customer; the customer's loan is then redeposited, and becomes a new deposit, and is reloaned, and so on.

Again, private commercial bank credit creation is not necessarily inflationary. Hamilton notes in the *Report on a National Bank* that commercial banks are a wonderful invention which "will be seen to abridge rather than to promote usury."

The problem again is, "whose money" and "to what purposes?" Until 1982, there were minimal regulations limiting the money multiplier to about 2.5 times the original central bank money printed de novo by the Federal Reserve. Under 1980s deregulation, however, certain "reserve requirements" which limit the multiplier were lowered or removed, and whole new classes of paper created in "derivative" markets which are now treated as cash. This allowed the multiplier to grow exponentially.

With all this credit, why then is the economy crashing?

Whose money is it, and to what purposes is it being used? Control of the *nation's* credit rests with the above *private financial cartel*, not with the U.S. government. Wall Street has a monopoly power over the creation *and deployment* of fiat money by the Federal Reserve. This is not a "technical issue." Technically, if loans and investments from this arrangement had gone to the goods-producing sector of the economy at low rates, many of our economic problems might have been avoided.

If fish had wings, they could fly. Wall Street has had no desire to make such investments; precisely the opposite. More than half of the profits of the U.S. financial houses during the 1970s and early 1980s were made speculating in the inflationary offshore Eurodollar market, and making usurious loans to foreign nations which could never be repaid. During the latter 1980s the speculation turned inward, to the Savings & Loan debacle, real estate speculation, junk securities, and derivative paper.

Since 1979, when the Federal Reserve raised interest rates to 20% and above, loan rates for the public have also been kept usuriously high. Although during 1992 the Fed has brought its own lending rate to the banks down to 2-3% at the Fed discount window and in Federal Funds markets, banks and brokers have kept their lending rates to business above 7-8%, and consumer loan and credit card market rates at 12-19%.

Today, the banks themselves, caught with all this worthless paper, are desperately absorbing every bit of new Fed credit issued just to maintain their own balance sheets from day to day. Scandalously, the Treasury is paying these same banks 8% and more on Treasury debt, so that the banks are making a clear 5% profit on the difference between the Fed Funds they borrow and what the Treasury is paying—right out of taxpayers pockets. Even with the Fed pumping money hand over fist, the money does not reach the capillary system of the physical economy, because the aorta has a leak.

The Federal Reserve Nationalization Act of 1993, therefore, forbids the new National Bank to use open market operations to create central bank fiat money. Section 3 of the act sets a statutory limit to the amount of U.S. government debt the National Bank may hold, and forbids the National Bank's purchase of net *new* Treasury debt.

This means Article I of the Constitution, which arrogates to the U.S. government a monopoly in emitting legal tender, will be reimplemented. New Federal Reserve bank notes will no longer be issued as the currency of the United States.

2. Expand Productive Credit via Discount Window

The act then proposes that new long-term low-interest *national bank credit* in the amount of approximately $1 trillion per annum be issued by the U.S. Treasury, via the new National Bank, to the physical economy. Loans are to be made by an entirely new mechanism: the National Bank is to open wide its *discount window* for lending of *directed credit* to the productive, infrastructure, and related physical economy. The Bank may create such credit indefinitely without inflation, provided it go toward lending for productive wealth.

All new credit and currency of the U.S.A. is to be thus issued by the U.S. Treasury under Article I of the Constitution, as *U.S. Treasury bills*. Such Treasury bills will replace, over time, the old Federal Reserve notes in circulation.

As LaRouche outlined the details in his March 8, 1992 national television broadcast "The Industrial Re-

A shrinking number of powerful Wall Street financial houses have controlled the process of money emission and credit. The level of corruption this entails was partially exposed by the mid-1992 indictments of Salomon Bros. officials in a major Fed Open Market Operations fraud.

covery of the United States," under the act, the President will request Congress to authorize "the issue of more than a trillion dollars in U.S. Treasury bills from the Treasury, to be deposited with the new National Bank, to be loaned at low interest. The federal government will so issue over $600 billion in low-cost loans to *state and federal authorities* for basic economic infrastructure projects" run by federal, state, and local agencies, and subsidiaries. The objective is to employ approximately *3-4 million people* directly in government-run water projects, power generation and supply, transportation, urban infrastructure, construction of hospitals and schools, etc.

These projects will generate additional credit demand of a similar magnitude or more from *private-sector firms* contracted in these projects, which will seek private bank loans. For private firms supplying these government projects, and other desireable high-technology capital investment projects, the National Bank will make up to an additional $400 billion in government credit available for private bank loan discounting. The results in the private sector are estimated to increase employment by an additional 3-4 million operatives.

This will result in a total of over $1 trillion in new productive activity since the private banking sector supplements a portion of this government credit. The total new increase in productive employment of some *6-8 million persons* means that the Treasury will receive more than the 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 financial paper and bills of trade on third parties presented by the banks.

The advantage, however, of conducting general national bank credit operations via 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 wisely managed 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 speculative purposes will find discounting difficult.

For example, Chrysler Corp. would be easily able to get a low-interest long-term loan from a Detroit bank, if it can document the funds will be used for productive purposes, because the bank knows it can to take such a loan agreement to the National Bank and discount it for cash at low rates.

To ensure private enterprise continues to be privately run, and to ensure that the private sector bear its share of the risk, the National Bank will require that a private bank put up at least 50% of the value of any loan from its own deposit base. If banks bears 50% or more of risk, banks will make sounder loans.

If Chrysler, however, seeks loans to diversify into real estate, or to relocate old plant and equipment to cheap-wage Mexican *maquiladoras,* its Detroit bank will advise them that the National Bank may not discount such a loan, and therefore the bank must decline, or charge higher interest rates.

The new Act states in Section 4: "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. . . .”

3. Protective Bank Re-Regulation

To protect the safety of the banking system, and ensure private banks do not abuse the money multiplier in speculative lending as credit is eased, the act *re-regulates* strong reserve requirements and other bank regulations.

Until the 1980s deregulation, the law required banks to keep on deposit with the Fed a standard “reserve fund” on all deposits, for use to pay depositors when loans went bad, 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 redepositing and relending of Federal Reserve credit.

Bank safety laws, however, were gutted by the deregulation of the 1980s. Reserve requirements were reduced on several basic categories of domestic bank deposits. Worse, the 1982 creation of International Banking Facilities (IBFs) at major U.S. banks removed reserve requirements completely on international deposits, those by “foreigners.” Because in practice it is impossible to tell which deposits are foreign and which are domestic deposits being moved in and out from offshore, the creation of IBFs effectively merged the U.S. banking system with the offshore Eurodollar market, run out of London.

The rise of the “derivatives” market in unregulated financial instruments created entire new categories of what in fact are types of cash, subjected to no reserve requirements. The resultant speculation has bankrupted our financial houses.

Under the Act, the 16% reserve requirement, a standard post-war U.S. practice, will be reimposed—on *all* deposits in U.S. banks. If foreigners do not choose to keep their “Eurodollars” in U.S. banks as a result, that becomes their problem, not America’s, especially since “Eurodollars” were never legitimately issued by the Treasury.

Furthermore, 16% will be a floor rate for bank reserves, such that only banks which maintain at least 60% of their loan assets in the real physical productive activities listed above will be assessed this standard requirement. Otherwise, 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 requirement charge. That will discourage banks from falling below 60% of productive assets.

The derivatives market will be shut down by provisions in the forthcoming Bank Reorganization Act of 1993.

The Federal Reserve Nationalization Act of 1993

Sec. 1 Sec. 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 be known as the 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. . .

Sec. 2 Section 1 of the Federal Reserve Act of 1913 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 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 Department of 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. . .”

Sec. 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 from the date of purchase of said bills, notes, and bonds, in order to help maintain an

The new National Bank will open wide its discount window for lending of directed credit to the economy for productive industry, agriculture, and infrastucture. Shown: the First Bank of the United States, Philadelphia.

orderly flow of disbursements by the United States 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 regional branches of the National Bank system, and commercial banks in their districts;

"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 government 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 thereafter, except as a result of purchases of official liabilities of the United States from foreign governments."

Sec. 4 Section 13 of the Federal Reserve Act of 1913 is hereby amended to read: "Any regional branch of the National Bank may receive from any bank, and from the United States, deposits of current funds in lawful money, Treasury bills or notes, or checks and drafts upon solvent U.S.-charted banks, payable upon presentation; or, solely for exchange purposes, may receive from other regional branches of the National Bank, deposits of current funds in lawful money; or checks and drafts upon solvement private banks or other branches of the National Bank, payable upon presentation. . . .

"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, or the necessary trade credits and working capital thereunto. . . .

"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 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 carrying on or trading in 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, provided that such goods conform to the restrictions set forth in the preceeding paragraphs.

"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 in furtherance of tangible wealth creation on the basis of private banks capital positions. . . .

Sec. 5 Section 19 of the Federal Reserve Act of 1913 is hereby amended to include the following: "A minimal *reserve requirement* of 16% is hereby imposed on all bank deposits, whether of domestic or foreign origin, said designation "deposits" to include all cash accounts, Negotiable Orders of Withdrawal (NOW) accounts, and any other accounts at regulated U.S. banking institutions which may be in any way construed as deposits. All exceptions to this regulation under previous Acts of Congress are hereby rendered null and void.

"The above reserve requirments 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 Sec. 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.

"To permit orderly transition to this later rule, however, it shall apply initially only to the quality of new assets of banks negotiated after the date of enactment of this Act. Prior existing bank assets shall be subject to a subsequent Bank Reorganization Act, supplying a deadline by which all assets must be brought into conformity with this requirement. . . ."