Monetary Reform Manifesto

Several years after the financial crisis, anti-Wall Street sentiment remains high across the political spectrum (cite). After entering the job market amid the worst recession since the Great Depression, we set out to better understand how the financial system works. What we found is that while people have plenty of reasons to be upset with Wall Street that they are actually aware of, these represent merely the tip of a gigantic iceberg of parasitic wealth extraction. It turns out our financial system is propped up and shielded from accountability by our excessively convoluted monetary system, the mechanics of which we hope to make accessible to laypersons in this paper. Our current monetary system, obscure as it is to most of the public, is inherently extractive in nature. This is because it delivers the privilege of creating nearly our entire national money supply to commercial banks. This is especially perverse in light of the fact that the money which the banks create and lend to us only has value because it is backed by our public institutions and taxpayer guarantees. The implications of this arrangement are profound and far ranging. They include: the degree of economic inequality we face, the banks' impunity for financial crimes, the exacerbation of boom and bust cycles, our lack of control of the size of the money supply, the misallocation of credit towards speculation and away from the productive economy, and finally the usurpation of our democratic sovereignty. After years of study, we have come to believe that the establishment of a Full Reserve, Sovereign Money System which would remove the banks' power of creating money and restore it to the public, would most likely result in a fairly dramatic reversal of each of these very damaging problems.

Do banks really create money?

As bizarre and improbable as it may seem, commercial banks really do not only create money, they create almost all of it. Most recently the Bank of England published a report explicitly stating that the textbook account of how money is created is misleading, and that most money is in fact created by banks when they make loans(cite). This fact has been acknowledged on other occasions by the Federal Reserve(cite), and a US Treasury Secretary(cite) among other credible, inside sources. While this fact of our monetary system is acknowledged by various heterodox economists(cite), it is not part of the mainstream economic discourse, which is a significant factor in why it is so scarcely understood.

Not only do banks create almost the entire money supply, they also are able to retain almost the entire profit from doing so. This profit from money creation is called *seigniorage,* which in our current system accrues to the banks in the form of interest payments. One of the key ways the mainstream textbook account is misleading is that it holds that banks lend out deposits, keeping in reserve only the fraction of these deposits necessary to meet their obligations to depositors(cite). In reality banks can lend as much as they want and then borrow the necessary reserves later(cite). The crucial thing from the perspective of the banks is that they come up with these reserves at the end of the accounting period to settle payments with other banks and satisfy their reserve requirement, if they have one. This amount is a tiny fraction (cite a %) of the total volume of money that a bank creates over the course of an accounting period. The interest on these reserves ends up being all the bank has to pay for the privilege of creating for profit this vastly larger quantity of money.

This myth that the banks merely lend money that already exists is a byproduct the obscure complexity of the fractional reserve banking system. Most people (if they have any concept of how bank works at all) have some sense that banks are able to lend as much as they do because they do not need to keep in reserve all the money deposited in their accounts. This is typically framed as a good thing. After all, we know that people rarely wish to withdraw all their money and allowing the banks to lend out deposits would seem to free up money for use that would otherwise lie idle. By freeing up this money to be lent out, we lower interest rates and increase the amount of money in circulation, stimulating economic activity. As long as banks are able to meet their obligations, the system seems innocuous and beneficial enough.

However, the privilege of money creation is implicit in the privilege of fractional reserve lending, and with the transition to a fiat currency, this privilege has become virtually unrestrained. It may seem reasonable enough to allow banks to lend out deposits they are unlikely to need in order to meet their obligations, however this understanding misses four crucial factors that deliver the virtually unlimited power to *create* money to the banks.

1) First, even under the gold standard when the reserve base (at the time this meant the total amount of gold) was more or less fixed, a 10% reserve requirement did not really mean that a bank had to hold 10% of your gold deposits in reserve. It meant that your gold deposits could serve to cover the 10% reserve requirement of your bank for 9 times that amount in loans (the other 90%)-- loans it made essentially by creating the money it lent out.
2) Second, as mentioned earlier, banks don't really need to wait to have deposits in reserve to make loans. They just have to come up with the reserves by the end of the accounting period to settle their payment obligations and meet their reserve requirement.
3) Third, even though money that banks create through lending carries with it the obligation that the bank provide that same amount in reserves if that amount is withdrawn in full, this does not actually mean that the bank is in danger of having to borrow the full amount in reserves in order to fulfill this obligation. This is because when banks make loans, even if the full amount is immediately withdrawn to pay for something, most of this outflow of deposits is cancelled out in one of two ways. Either the payment is made into another account at that same bank, or it is cancelled out by the comparable inflow of payments to its depositors from accounts at other banks. In practice, the bank only needs to come up with the reserves to cover its reserve requirement, and settle the difference between the inflow and outflow of payments to and from its depositors. This is why banks end up only needing to borrow such a tiny fraction in reserves of the amount of money that they create through their lending.

4) Finally, whereas there was once a more or less fixed amount of gold reserves theoretically constraining the amount of money that could be created, now that we have gone off the gold standard, reserves are created by fiat by the Federal Reserve, without limit. While the textbook account holds that central banks such as the Federal Reserve are able to constrain money creation by setting interest rates for reserves, the reality is that refusing to provide banks with the reserves they need to settle payments amongst each other would be destabilizing to the system, and as a result they are effectively forced to provide the banks with reserves on demand(cite). It is as if the guard on duty to protect the value of the currency from being diluted by excessive money creation were armed with a water pistol.

Why is interest paid to the banks illegitimate?

The most basic reason why under the current system the interest we pay to banks is illegitimate is because they create the money we borrow when they lend it, and yet the reason the money has the value that it does is because it is backed by the same public to which it lends the money. It is as if we the taxpayers invited the bankers over to dinner and cooked a meal for everyone, and when we sat down to eat the bankers wanted to charge us to eat our own food, saying they wouldn't serve us if we didn't pay them. The money that the banks create, the US dollar, is fundamentally a public currency. The confidence the currency enjoys, which is the source of its value, is due to the fact that it is the *national* currency. There is a reason that Bank of America does not lend its customers Bank of America notes, and that is because they would have a very hard time building and maintaining confidence in their value. This is not to say that it can never be legitimate for a bank to charge interest, it is merely to say that the process of lending should be separated from the process of money creation. Because money creation is implicit in fractional reserve lending, this means that the privilege of fractional reserve lending must be revoked in order for banks to charge interest legitimately.

The abandonment of the gold standard in 1971 completely eviscerated any claim to legitimacy that money creation by private banks ever had, rendering this practice a sheer usurpation of a crucial prerogative of the democratic state. The fractional reserve system evolved in a time when people believed it was necessary for a currency to be backed by gold in order for it to retain the value it needed to function as a means of exchange. In this context, because our reserve base (gold) was more or less fixed, the advantage of fractional reserve lending was that it allowed us to expand the money supply, while still maintaining its gold backing. By allowing banks to lend out as much as they could while still meeting their obligations to settle payments, we increased the amount of money in circulation, and therefore the amount of economic activity that our limited supply of gold could facilitate. While we were on the gold standard, and given this understanding of how money works, it could have been said that the banks were responsible for the value of the currency as it was they who held the gold reserves, and expanded the money supply while preserving the currency's viability as a means of exchange. In this context, there was a coherent argument to be made that the banks should be entitled to profit from the creation of the currency, indispensable as they were to its value. Now that we have gone off of the gold standard and the banks no longer play this crucial and legitimizing role, they can no longer claim credit for the value of the money they create. Our national currency has been rendered purely a form of public infrastructure. It is now as if we the taxpayers who pay for the construction of roads and bridges were to allow the banks to set up toll booths on them and charge us to drive on our own roads and bridges. Now it is clear that there is no need to stretch the reserve base through fractional reserve lending, because we now create the system's reserves at will, by fiat. Now, every dollar that the banks create through fractional reserve lending is a dollar that the government could have created just as easily, that the government now does not get to create. Now, granting the banks the power of money creation actually crowds out the space in which the government could create money without causing excessive inflation. Denying the government this source of funding of course ultimately increases the tax burden that we the taxpayers must shoulder in order to pay for the same amount of infrastructure and services.

Finally, the too big to fail banks which account for (cite %) of lending, lend with the implicit guarantee of the taxpayer, making their lending a heads they win, tails we lose endeavor. It is because of the instability of the fractional reserve system that banks can be and have become too big to fail. The fractional reserve system is as unstable as it is for a variety of reasons. The most significant is that in an economy in which the money supply is created by bank lending and extinguished by the repayment of loan principal, a slowdown in bank lending contracts the money supply, stifling economic activity. Meanwhile, if there is a downturn in the economy, banks are likely to lose confidence that their loans will be repaid, and contract their lending as a result. This further pushes the economy into recession. Essentially, under the fractional reserve system, at any given moment the economy is on the precipice of a vicious circle which threatens to plunge the economy into depression. In this context, nothing threatens to send the economy into this downward spiral more than a bank failure. This is because banks all borrow reserves from each other routinely in order to make up the difference between inflows and outflows of payments between their account holders. If one bank fails, it means that bank will not be repaying the banks it borrowed from. This in turn threatens to bankrupt those banks, which in turn threatens to bankrupt other banks. This is why the stated aim in a financial crisis is to keep the dominos from falling(cite). Under the fractional reserve system, the too big to fail banks have our money supply hostage and with it the stability of the entire economy. This is why in addition to paying the banks to allow us to use our own money supply, we also have to pay to rescue them when enough of their loans go bad to threaten their solvency. This leverage the banks possess is a byproduct of a system which is not only unnecessary, but already severely detrimental to everyone except the banks, even before you take into account this leverage. In this light we begin to understand what Bank of England governor Mervyn King meant when he said "of all the possible monetary systems we could have, the one we do have is the worst." (cite) There is no upside, there is no legitimacy.

While we now generally consider the feudal system of the middle ages to be abhorrent, today a less visible equivalent of the feudal privilege of that era exists in the form of shares in the too big to fail banks. In a culture in which overt feudal rent-extraction is considered unacceptable, this more obscure form has emerged. Now it is through the money system that a feudal class harnesses the productivity of people who actually work for a living so that they may collect an income without making any legitimate contribution themselves. While many resent the taxes they have to pay to the government, these taxes are at least levied by a government that is in some sense democratic. The revenues are allocated by elected representatives, ostensibly in the public interest. In contrast, the interest payments we make to the banks are essentially a form of feudal tribute, shielded from democratic intervention by its obscurity, with the revenues going to further enrich people who are already among the wealthiest in the world. All the arguments against taxes typically made by the right apply just as well to the interest we pay to the banks. It is a form of wealth redistribution which weighs down the productive economy in order to subsidize idleness. The difference is that the interest we pay to the banks under the current system has none of the redeeming features the left cites in defense of taxes.

The implications of this extraordinary privilege and of reform.

The implications of this hidden privilege are fairly staggering, and conversely the removal of this privilege and its restoration to the public domain promises to alleviate, to a significant degree, an array of severe and chronic political and economic issues. Most notable among these are:

- The massive redistribution of wealth from the productive economy to the financial sector, and the corresponding severity of economic inequality.
- Impunity for financial crimes which results from the banks' systemic importance and too big to fail status.
- The exacerbation of boom and bust cycles, which contributes to economic instability.
- Our lack of control of the size of the money supply.
- The misallocation of capital into speculative bubbles and away from the productive economy
- The curtailment of our democratic sovereignty, leaving us at the mercy of a dictatorship of capital.

Economic Inequality

It is necessary to understand a variety of technical points with regard to how the system works in order to grasp just how much wealth it illegitimately redistributes and just how significant an impact reform would likely have on inequality. Because our money supply is created as credit through fractional reserve lending, each time the principal of a loan is repaid, that money is extinguished. This requires the economy to take on yet another interest-bearing debt to the banks all over again in order to re-create this portion of its money supply. *And over, and over again across the entire money supply.* Yet a public body could have just as easily created this money as a source of public funding to begin with, and should have been entitled to, as it is the public's backing that gives the currency its value in the first place. Reform would both 1) deny the banks their mechanism of perpetual, illegitimate rent-extraction and 2) restore to the public a significant source of funding. This could be used to pay down the debt, cut taxes or fund government programs and projects, as determined by congress through our standard budget allocation process. Regardless of how the money was spent, it would still at the very least represent a form of debt-free stimulus to the economy. Of course congress' legitimacy is in no way above being called into question either. The crucial thing to appreciate on this point is that even if congress were to spend the proceeds from money creation into circulation in the most wasteful and corrupt possible way, the above two merits of reform would remain intact and likely would fairly dramatically alleviate the economic inequality we see now.

The impact of the reversal that reform offers would be indirect for most, but likely dramatic nonetheless. Because virtually all money is created by bank lending, this means that virtually no other money exists for the public to earn without someone first going into debt to the banks. If a public body created the money supply for congress to spend into circulation as a debt-free stimulus, there would be the entire money supply that people could earn without anyone ever having to go into debt in order for that money to be created. In contrast, under our current system, the fact that money is basically only created as debt means that there is all the more necessity for us to go into debt, in order for our money supply to be created. This is because under the current system, if we didn't go into debt to the banks, there would be virtually no money supply. While of course no one goes into debt with the purpose in mind of expanding the money supply, the shortage of money in circulation is nonetheless felt by the economy and pushes individuals and businesses into borrowing in order to cover their expenses. Conversely, under a full reserve, sovereign money system the economy would be far less reliant on borrowing, because money would exist to be earned *prior to being borrowed into circulation*. An economy that is less reliant on debt is able to spare itself the expense of servicing such a large debt burden. Under the current system fiscal discipline is a recipe for economic contraction as it actually destroys the money supply we rely on to facilitate economic activity. Reform offers us, for the first time, the luxury of being able to stay out of debt without imposing what is ultimately a self-defeating austerity on ourselves. This further contributes to the promise of reform to deliver such a dramatic alleviation of economic inequality.

Impunity for Financial Crimes

Ending the impunity for financial crimes currently enjoyed by our largest financial institutions in part as a result of their too big to jail status is absolutely indispensable to protecting consumers from predatory and fraudulent practices in the financial sector. It is difficult to overestimate the extent to which it is now duck season for consumers and taxpayers as a result of the impunity for financial crimes that now exists in part because our biggest financial institutions are too big to fail-- a status which can only exist under fractional reserve systems. Most notably the financial crisis itself was a direct result of blatant fraud on a mass scale. Investment banks knew that they had captured the ratings agencies and that if they resubmitted badly rated mortgage-backed securities, a significant portion would be re-rated highly, allowing them to be sold to pension funds which thought they were buying securities which were as safe as possible. The Justice Department knows about this and has publicly stated that it refrains from prosecuting the culprits because of their systemic importance(cite). More recently the libor scandal revealed that the banks were fixing the benchmark rate to which hundreds of trillions of dollars worth of financial contracts are tied. By manipulating this rate, the banks essentially stole money from their counterparties, which included countless American cities. In the case of Philadelphia, the city was famously pushed into closing schools as a result of its fiscal distress [do I have this right?]. Yet these financial institutions cannot be meaningfully held accountable in part because the design of the banking system protects them.

Whereas in the current system several banks have grown too big to fail or jail, contributing to their impunity for financial crimes, under a sovereign money system banks could be prosecuted and allowed to fail without destroying the money supply and collapsing the economy. Moving to a full reserve, sovereign money system would mean that for the first time, we would have a stable money supply. Rather than money constantly being lent into circulation and then extinguished upon repayment of the principal, money would be spent into circulation and allowed to circulate indefinitely. This means that bank failures would no longer contract the money supply, choking off economic activity when an ensuing downturn leads to reduced lending. Further, because banks would be required to keep the full amount of our checking account deposits in reserve, in the event of a bank failure our deposits would remain secure, to be transferred into the care of another bank. FDIC would therefore no longer be necessary and the government would no longer be liable for redeeming depositors' money in the event of a bank failure which exhausted FDIC funds. There would be no more need to bail out failing banks when they collapsed under the weight of their own fraud, nor would we be exposed to the threat of bail-ins as we currently are under Dodd-Frank(cite)("bail-ins" are when failing banks confiscate deposits in order to recapitalize their balance sheets, as we've seen in Cyprus)(cite).

While monetary reform would not on its own resolve the regulatory capture which is essential to the financial sector's impunity, it would still do three important things to undermine the dynamics which enable it. First, by stripping financial institutions of their too big to jail status it would remove all excuse for failure to prosecute. Second, monetary reform would put government in a much stronger fiscal position, granting it a greater capacity to retain its independence from the financial institutions which have captured it. Third it would cut off a key revenue stream the banks use to capture their regulators. This said, implementing the reforms that would be necessary to seriously address regulatory capture, such as campaign finance reform, as well as others, undoubtedly represent extremely challenging and important projects in themselves.

Boom and Bust Cycles

Whereas the current monetary system encourages bubbles and contributes to the severity of economic contraction once a bubble bursts, a sovereign money system would both limit the propensity for bubbles to inflate and minimize the severity of downturns, likely making the economy far more stable. This would mean that we could avoid both the excessive indebtedness of the boom period, as well as the recession and seizure of assets by the banks of the bust period. While booms might superficially seem like a good thing for the general public, it is absolutely critical to note that the money creation mechanism of the current system means that in order for the economy to temporarily prosper, it must go deeply into debt to the banks. When the bubble eventually bursts, the ensuing seizure of assets is devastating. This is how countless [a number would be good here] homes were foreclosed upon in the aftermath of the most recent crisis, as well as how small farmers lost their land in the wake of the crash of 29(cite). Ultimately the banks seize real wealth, ruining lives in the process, merely by creating money as debt, out of thin air.

The current system encourages bubbles by allowing unrestrained money creation to inflate asset prices. Whereas banks are often defended as indispensable sources of credit to small businesses, the reality is they primarily lend to finance the purchase of already existing assets such as real estate and shares in publicly traded corporations (cite). The more the banks lend to finance these purchases, the more the price is bid up. The more the price is bid up the more demand there is to borrow to purchase these assets as people hope to profit from the ongoing climb in valuation. This in turn of course fuels further lending, which means further money creation and further asset price inflation. Once such a bubble is inflated, it only takes a pinprick for it to burst. This pinprick can come in the form of any number of disruptive and destabilizing events or trends. When the bubble bursts, the economy descends into a downward spiral as contraction undermines confidence which in turn restricts lending, shrinking the money supply and contributing to further contraction. In contrast, a full reserve, sovereign money system would feature a stable money supply which would not grow and shrink according to the lending decisions of private banks. The feedback loops that propel the booms and busts of the bubble economy would be largely neutralized as a result.

Finally, reform would allow the public body charged with managing the money supply to directly inject new money into the economy through debt-free government spending if it determined that stimulus was necessary to stay within its mandated target range of inflation. This is in contrast to the much more constrained ability of the government and central bank to stimulate the economy in a downturn within the current system. Now, monetary stimulus by the Federal Reserve only creates new reserves, leaving it to the banks to choose do the lending necessary to expand the money supply. As for the government, in order to spend money directly into the economy it now has to borrow, which is much more costly and therefore politically difficult. Both of these constraints are entirely meritless and severely debilitating.

The Lack of Control of the Size of the Money Supply

While the Federal Reserve actually has a very limited ability to influence the size of the money supply under the current system, reform would grant direct control of it to the public body charged with its management (most likely a fully nationalized Federal Reserve). This makes it far more likely that a reformed system would maintain a more or less optimally-sized money supply. Inevitably, whenever someone first has of the idea of Sovereign Money pitched to them, their initial reaction is that such a system would be inflationary (presumably more so than the current one). While the monetary system clearly is not something that most people have ever thought much about, people often at least have this impression nonetheless. It turns out this impression is entirely unfounded. Above all, our bias against Sovereign Money is that it seems too easy, and therefore too good to be true. However, if we examine the reality of how the current system works, and then contrast it with the proposed system, it becomes fairly clear that even on the question of guarding against excessive inflation (or deflation), a Sovereign Money System is very likely to be preferable to the one we have now.

In order to evaluate each system's design in terms of its ability to hit inflation targets, we must assess its merits with regard to two separate points:

1) Its ability to generate and maintain the will to aim for appropriate targets in those managing the money supply.
2) The effectiveness of the tools it grants those charged with this task.

On the first point, it seems most likely that a reformed system would at least be no worse than the current one, if not actually somewhat better. On the second point, a reformed system would likely be far superior.

While the money creation committee under a reformed system could and should be more accountable to congress for fulfilling its mandate than the Fed currently is, as long as it stayed within its mandate, it would be as protected from political meddling as the Fed is now. The most common concern with regard to the idea of making the central bank fully public is that congress would pressure it to create money to pay for things they want to do. However, in order to do this congress would either have to change the central bank's mandate or neglect to hold it accountable when it strayed from it. Both ways of meddling in the process of money creation would be as visible and therefore likely as non-viable as the family alcoholic trying to help himself to a drink in front of the entire family. In any case, to the extent that we are so poor at democratic accountability that we the family would be unable to intervene to prevent our alcoholic family member from drinking himself into a stupor in front of everyone, the fact is the same hazard exists no less under the current system. The main institutional differences between the Fed's current quasi public structure and its structure if it were made fully public is that it would not keep for itself (rather than returning to the treasury) 5% of the profits from its operations, it would not pay dividends to the private banks which are now its shareholders, and private banks would have no say in appointing its officials. Each of these changes merely prevent the banks from unduly profiting from and influencing the operation of our central bank. None of them make the process of money creation more likely to be corrupted by a congress intent on securing additional funding.

While the improved accountability of the reformed system is important, in terms of designing a monetary system which will deliver an optimally-sized money supply, the improved tools of a Sovereign Money System is where reform really shines. Under the current system, the central bank attempts to influence money creation by the banks by raising or lowering interest rates (through a variety of fairly convoluted mechanisms), so as to hit inflation targets. In contrast, under a reformed system, the money creation committee would directly control the amount of money in circulation. It would do this by creating more or less money, or if necessary, by taking money out of circulation. The relative directness and ease of this approach as compared with that of the current system is dramatic. It is the difference between having to make one clear, straight shot in a game of pool, as opposed to having to clear an entire table with a single bank shot. While under the current system, we do have, in the central bank, a single institution charged with managing the money supply, the institutions which actually create money not only do so in an uncoordinated manner, they don't even do it with the purpose in mind of creating the optimal amount of money for the economy. A Sovereign Money System, for the first time, would give the body charged with managing the money supply the tools to control it directly. This means it would be able to make adjustments to the size of the money supply with relative ease and quickness in response to evidence that there was either too little or too much money in circulation. This is in contrast to the current system in which the banks have to be coaxed into lending or slowing lending based on their assessment of whether that course of action is most profitable for them at that time.

The awkward and ineffectual nature of the current tools is illustrated by the episodes of Paul Volcker's taming of inflation, and the current quantitative easing campaign. While Volcker was ultimately able to break the back of the inflation of the late 70s, he had to raise interest rates dramatically in order to do it, throwing the economy into recession(cite). Now that the Fed aims to stimulate lending through quantitative easing, it still struggles to induce the banks to lend in spite of all the new reserves they have injected into the system(cite). The difference in difficulty of managing the two systems is the difference between herding cats and taking a walk in the park.

Misallocation of Capital into Speculative Bubbles and Away from the Productive Economy

Whereas under the current system lending is largely allocated toward speculation (cite), reform would help ensure that it is primarily allocated toward the productive economy, promoting authentic wealth creation as opposed to the mere wealth extraction that is so prevalent now. In addition to being dysfunctional, the current allocation of credit represents a glaring missed opportunity. If capital were instead invested in the productive economy, it would help grow the economic pie as surely as watering a dying garden would help restore life to its plants. The lack of credit to the productive economy is a problem felt by small businesses across the country(cite). This is a problem that persists in spite of the bailouts which were justified in part as necessary to get the banks to resume lending (cite). Of course, even before the crisis the banks did not lend a great deal to the productive economy (cite). Though getting the banks to resume lending was used as a justification for the bailouts, no strings were legally attached. Ultimately, the same banks that crashed the economy through systemic fraud accepted our bailout money with no strings attached and then declined to voluntarily fulfill a key purpose used to justify their rescue. This represents merely another example of the banks' larger pattern wealth extraction as opposed to wealth creation.

Currently money is created without restraint via lending, most often to fuel speculation in housing and stock market bubbles [also derivatives?]-- an extremely dysfunctional way of allocating credit. This is dysfunctional because speculation is a fundamentally unproductive way of allocating capital which rewards gambling rather than actual contributions to society. It is the difference between buying shares through an initial public offering and buying shares from another investor. IPO money actually goes to the company to fund its productivity, whereas buying shares from another investor does not, and as a result just means the speculator is placing a bet that the share price will go up. That this is how most credit is allocated means that our economy is enriching gamblers at the expense of actual productive members of society, whose purchasing power is eroded against the inflationary speculative profits of our financial sector that result from unrestrained money creation by the banks.

In contrast, reform would undermine the dynamics which lead to credit largely being allocated toward speculation and allow the public to ensure that banks lend primarily to productive uses. Whereas money creation is unrestricted in the current system, under a reformed system the money supply would be much more stable, limiting the potential for bubbles to inflate and therefore also limiting the profits to be made from speculation. Meanwhile banks would only be able to lend money that already exists. This would consist of investment accounts, money borrowed from the central bank and the banks' own capital. In the case of investment accounts, because depositors would not have access to these deposits while they were lent out, the bank would actually be lending out customers' money rather than just creating the money it lent. This and the fact that depositors would be taking on an explicit risk of losses would mean that customers could exercise much more control over where bank lending would be directed. Our hope is that banks could be induced to compete for depositors by offering investment accounts that are to be allocated to specific uses. Similarly, central bank loans could come with a requirement that the money be invested in the productive economy. What relatively little lending remained to be allocated toward speculation would be rendered far more innocuous. Finally, it is important to note that the reallocation of credit toward the productive economy that would result from reform is in addition to making the economy less reliant on debt as described earlier. The combination of these two factors would likely have a very significant positive impact on general prosperity.

The Compromise of Democratic Sovereignty

While the current system abdicates our democratic sovereignty in three key ways, reform would restore this sovereignty, granting the public far greater ability to act on its own behalf via democratic processes. While Americans across the political spectrum hold dear the idea of democracy, and yet believe the government does not truly represent them, few realize how seriously the monetary system constrains the expression of the will of the public. Through the monetary system, we have abdicated democratic sovereignty to a dictatorship of capital in the following three ways:

1. By allowing the economy to be so dependent on credit and granting the Federal Reserve the discretion to raise and lower interest rates free of meaningful accountability, we have delivered to our Central Bank a great deal of power to influence the economic conditions under which incumbents run for re-election. Because the influence of monetary policy on the economy is so scarcely understood, this means that the Federal Reserve can have a very significant impact on the outcomes of elections, as incumbents are either blamed or given credit for the state of the economy when they run for re-election. This allows the Federal Reserve to pressure those in office to implement policies of its choice as resisting this pressure would invite a major obstacle to their re-election. According to Secretary of Labor under Bill Clinton, Robert Reich, this is how Alan Greenspan arm-twisted the Clinton Administration into abandoning its approach to fiscal policy in Clinton's first term (cite). This means that the mandate with which Clinton was elected was overruled by the Federal Reserve, which is of course owned and captured by the banks(cite).

2. By allowing the government to be dependent on borrowing from the bond market for funding, our monetary system also grants what can sometimes amount to a form of veto power over our fiscal policy to government creditors. Because holders of government debt can threaten to dump their holdings onto the market, driving up government borrowing costs, the need to placate what are called "the bond vigilantes" has often been cited as a key reason why the government cannot afford to execute its democratic mandate (cite).

3. More broadly, a money system is a mechanism which distills power into each unit of the currency. Therefore, the banks' privilege of creating money makes them the supreme arbiters of power in our society. The degree of sovereignty that our democracy could afford if it retained the proceeds from the creation of its own currency would be far beyond what it currently can(cite). By granting the banks the privilege of profiting from the creation of our money supply as well as of deciding where this money is allocated, we cede to them what could be the backbone of our democratic sovereignty. This is a problem which is further compounded when the banks use this revenue to influence politicians through lobbying and campaign contributions.

Each of these abdications of democratic sovereignty are entirely unnecessary and without merit.

In the case of the Federal Reserve, it or whatever body is endowed with the power of money creation under the reformed system could and should be much more constrained in its mandate, as mentioned earlier. The discretion entailed in the Fed's current mandate to promote price stability and minimize unemployment could be curtailed with a more precise mandate. The money creation committee could and should be required to stay within a narrow range of acceptable rates of inflation, for instance between 1.5% and 2.5%. Any deviation from this mandate could be considered grounds for review and even removal of money creation committee members by congress.

As for the veto power of the bond market, reform would make it systemically possible for the first time for government to stay out of debt and avoid becoming beholden to creditors. While it may seem that government could do this now if only it were more fiscally disciplined, the fact that under the current system reserves are largely created through the purchase of government debt by the Federal Reserve (cite) means that without government debt the system would be denied the reserves which it relies on for banks to settle payments between each other. This would completely cripple the functioning of the system. If money were instead primarily created free of debt and simply transferred to the treasury to be spent into circulation, government debt would cease to be the inescapable necessity it is today. Not only would it become systemically unnecessary [might already be systemically unnecessary with QE], it would also become far less fiscally necessary. While it would still be a matter of fiscal discipline for the government stay out of debt, it would now have this alternate source of funding in money creation which would make fiscal discipline an infinitely more viable and realistic ambition than it currently is. In terms of policy, all it would take to afford this is revoking what is essentially a massive subsidy to the banking industry in the form of their privatization of the proceeds from the creation of the public currency. Whether government resolved to stay out of debt after reform was implemented or not, sovereign money creation would provide government with a significant space within which to exercise the sovereignty of the democratic public, without relying on debt or taxes.

While reform will by no means end once and for all the dilemmas of fiscal policy, it is the case that any hope of a coherent expression of the democratic will is severely undermined by the confusion created by the obscure, convoluted and ultimately corrupt nature of our monetary system. The dilemma between fiscal discipline and government spending is one of the most divisive wedge issues in American politics. Conservatives, of course, tend to prioritize avoiding the accumulation of debt, while progressives consider it more important to stimulate the economy through various social programs and infrastructure projects. What very few on either side seem to appreciate is that to a significant extent it is the banks' appropriation of our seigniorage which creates this dilemma in the first place. If we were to restore the power of money creation to the public domain, there would be far more room for each side to attend to its priority issue. As of now, left and right essentially fight over a small piece of a pie without noticing that the banks have quietly helped themselves to the rest of the entire pie, in spite of the fact that they did nothing to create it [wondering how accurate these proportions are].

While fear of authoritarian government will cause many to wince at the thought of transferring the privilege of money creation to a government institution, the fact remains that *someone* must wield this power, and a democratically accountable public body appears to be best suited to this role. While our democratic mechanisms of accountability no doubt leave a great deal to be desired, the accountability sometimes imposed by the market has in no way tamed or civilized the banks as trustees of the privilege of money creation. On the contrary, they have quite clearly run completely amok, looting with truly breathtaking brazenness. The great advantage of the proposed reforms as compared with the current system is that whereas the structure of the current system itself is already corrupt prior to its being abused, the proposed system not only has the potential to function beautifully, but many of its key benefits are robust to abuse of the system, as described earlier. While we have become alienated from our own democratic government to a regrettable extent, to say the least, it nonetheless makes no sense whatsoever as a response to cede this facet of our sovereignty to almost entirely unaccountable private banks. Not only would this be to submit to our serfdom, it would be to give up on democracy itself.

Conclusion

While by now we are fairly confident that our analysis is more or less correct, we believe that the next step is a broader public hearing and the cultivation of an exhaustive public debate, first in academic, policy, and activist circles, and later among the general public. This will allow us to see how well our analysis and proposal stands up to scrutiny, adjust it as necessary, and make the issues entailed known to and understood by the public. The basic analysis and proposal have already withstood a great deal of scrutiny as a result of the work of Positive Money UK. They have remarkably even earned the endorsement of Financial Times journalist Martin Wolf, who was called by the New York Times Book Review “as grand and important as an economic journalist can ever become”. Our hope is that the absurdity of the current system is so overwhelming that if it were to become widely enough understood, sufficient pressure could be brought to bear upon the government to pass a reform bill.

The size of the US economy and the dollar’s role as the world’s reserve currency warrant extra caution in implementing a reform package. Most likely some version of the reforms described here would be adopted in a smaller, less systemically critical country first. This would allow us to demonstrate on a small scale that the system can work as our analysis suggests it will, before scaling it up. Encouragingly, the government of Iceland has already issued a report on the Sovereign Money proposal, finding it promising and meriting further exploration. The dollar’s status as the world’s reserve currency raises potential complications which will need to be researched and debated thoroughly. We welcome and encourage the input of all who care to take on the challenge of addressing such obstacles to the success of the cause of establishing a monetary system which works in the interests of the general public rather than a small aristocracy of financial elites. The more people engage with the subject, the better the chance not only that we broaden awareness sufficiently to implement reform, but that when we do implement reform, the system we establish will work more or less as intended.

If our analysis is correct, at stake here is the difference between freedom, democracy, prosperity and dignity on the one hand, and serfdom, dictatorship, poverty and humiliation on the other. It’s actually that stark. For those who find it too demoralizing to surrender the world we live in to the domination of modern day marauding barbarians, we hope you will join our effort to establish a system that is not so completely at odds with human dignity. To those who are unprepared to actively work toward reform, even just counting yourself in favor of the proposal so that when the time comes you can vote in support of it is still very much of value to the cause. In order for reform to succeed, the basic points of the critique and reform proposal will have to become common knowledge throughout the country. This is no doubt an extremely tall order. Those who benefit from the current system are counting on the difficulty of this task to protect them from bids at reform. Each of us needs to decide whether we personally are prepared to tolerate a democracy that has become an empty gesture of deference merely intended to placate a potentially unruly public; whether we are prepared to work a significant portion of our adult lives paying off illegitimate debts to a class of parasitic feudal lords; whether we are prepared to forego the opportunity to live in a society where we and those around us are granted the best possible chance to flourish and make the most of our lives. Most of all we need to decide whether it is more difficult for us to work for the lives we want in the world we want, or to submit.