Chapter 47
OVER THE RAINBOW: GOVERNMENT WITHOUT TAXES OR DEBT

"Toto, I have a feeling we're not in Kansas anymore. We must be over the rainbow!"

Going over the rainbow suggested a radical visionary shift, a breakthrough into a new way of seeing the world. We have come to the end of the Yellow Brick Road, and only a radical shift in our concepts of money and banking will save us from the cement wall looming ahead. We the people got lost in a labyrinth of debt when we allowed paper money to represent an illusory sum of gold held by private bankers, who multiplied it many times over in the guise of "fractional reserve" lending. The result was a Ponzi scheme that has pumped the global money supply into a gigantic credit bubble. As bond investor Bill Gross said in a February 2004 newsletter, we have been "skipping down this yellow brick road of capitalism, paved not with gold, but with thick coats of debt/leverage that requires constant maintenance."

The levees that have kept a flood of debt-leverage from collapsing the economy showed signs of cracking on February 27, 2007, when the Dow Jones Industrial Average suddenly dropped by more than 500 points. The drop was triggered by a series of events like those initiating the Great Crash of 1929. A nearly 9 percent decline in China's stock market set off a wave of selling in U.S. markets to satisfy "margin calls" (requiring investors using credit to add cash to their accounts to bring them to a certain minimum balance). The Chinese drop, in turn, was triggered by an intentional credit squeeze by Chinese officials, who were concerned that Chinese homeowners were mortgaging their homes and businessmen were pledging their businesses as collateral

to play the over-leveraged Chinese stock market, just as American investors did in the 1920s.[1] Commentators suggested that the Dow fell by *only* 500 points because of the behind-the-scenes maneuverings of the Plunge Protection Team, the Counterparty Risk Management Policy Group and the Federal Reserve.[2] But it was all just window-dressing, a dog and pony show to keep investors lulled into complacency, inducing them to keep betting on a stock market nag on its last legs. The same pattern has been repeated since, with assorted manipulations to keep the band playing on; but the iceberg has struck and the economic Titanic is sinking.

Like at the end of the Roaring Twenties, we are again looking down the trough of the "business cycle," mortgaged up to the gills and at risk of losing it all. We own nothing that can't be taken away. The housing market could go into a tailspin and so could the stock market. The dollar could collapse and so could our savings. Even social security and pensions could soon be things of the past. Before the economy collapses and our savings and security go with it, we need to reverse the sleight of hand that created the bankers' Ponzi scheme. The Constitutional provision that "Congress shall have the power to coin money" needs to be updated so that it covers the national currency in all its forms, including the 97 percent now created with accounting entries by private commercial banks. That modest change could transform the dollar from a vice for wringing the lifeblood out of a nation of sharecroppers into a bell for ringing in the millennial abundance envisioned by our forefathers. The government could actually *eliminate* taxes and the federal debt while *expanding* the services it provides.

The Puzzle Assembled

The pieces to the monetary puzzle have been concealed by layers of deception built up over 400 years, and it has taken some time to unravel them; but the picture has now come clear, and we are ready to recap what we have found. The global debt web has been spun from a string of frauds, deceits and sleights of hand, including:

- *"Fractional reserve" banking.* Formalized in 1694 with the charter for the Bank of England, the modern banking system involves credit issued by private bankers that is ostensibly backed by "reserves." At one time, these reserves consisted of gold; but today they are merely government securities (promises to pay). The banking system lends

these securities many times over, essentially counterfeiting them.

- *The "gold standard."* In the nineteenth century, the government was admonished not to issue paper *fiat* money on the ground that it would produce dangerous inflation. The bankers insisted that paper money had to be backed by gold. What they failed to disclose was that there was not nearly enough gold in their own vaults to back the privately-issued paper notes laying claim to it. The bankers themselves were dangerously inflating the money supply based on a fictitious "gold standard" that allowed them to issue loans many times over on the same gold reserves, collecting interest each time.

- *The "Federal" Reserve.* Established in 1913 to create a national money supply, the Federal Reserve is not federal, and today it keeps nothing in "reserve" except government bonds or I.O.U.s. It is a private banking corporation authorized to print and sell its own Federal Reserve Notes to the government in return for government bonds, putting the taxpayers in perpetual debt for money created privately with accounting entries. Except for coins, which make up only about one one-thousandth of the money supply, the *entire* U.S. money supply is now created by the private Federal Reserve and private banks, by extending loans to the government and to individuals and businesses.

- *The federal debt and the money supply.* The United States went off the gold standard in the 1930s, but the "fractional reserve" system continued, backed by "reserves" of government bonds. The federal debt these securities represent is never paid off but is continually rolled over, forming the basis of the national money supply. As a result of this highly inflationary scheme, by January 2007 the federal debt had mushroomed to $8.679 trillion and was approaching the point at which the interest alone would be more than the public could afford to pay.

- *The federal income tax.* Considered unconstitutional for over a century, the federal income tax was ostensibly legalized in 1913 by the Sixteenth Amendment to the Constitution. It was instituted primarily to secure a reliable source of money to pay the interest due to the bankers on the government's securities, and that continues to be its principal use today.

- *The Federal Deposit Insurance Corporation and the International Monetary Fund.* A principal function of the Federal Reserve was to bail out banks that got over-extended in the fractional-reserve shell game, using money created in "open market" operations by the Fed.

When the Federal Reserve failed in that backup function, the FDIC and then the IMF were instituted, ensuring that mega-banks considered "too big to fail" would get bailed out no matter what unwarranted risks they took.

- *The "free market."* The theory that businesses in America prosper or fail due to "free market forces" is a myth. While smaller corporations and individuals who miscalculate their risks may be left to their fate in the market, mega-banks and corporations considered too big to fail are protected by a form of federal welfare available only to the rich and powerful. Other distortions in free market forces result from the covert manipulations of a variety of powerful entities. Virtually every market is now manipulated, whether by federal mandate or by institutional speculators, hedge funds, and large multinational banks colluding on trades.

- *The Plunge Protection Team and the Counterparty Risk Management Policy Group (CRMPG).* Federal manipulation is done by the Working Group on Financial Markets, also known as the Plunge Protection Team (PPT). The PPT is authorized to use U.S. Treasury funds to rig markets in order to "maintain investor confidence," keeping up the appearance that all is well. Manipulation is also effected by a private fraternity of big New York banks and investment houses known as the CRMPG, which was set up to bail its members out of financial difficulty by colluding to influence markets, again with the blessings of the government and to the detriment of the small investors on the other side of these orchestrated trades.

- *The "floating" exchange rate.* Manipulation and collusion also occur in international currency markets. Rampant currency speculation was unleashed in 1971, when the United States defaulted on its promise to redeem its dollars in gold internationally. National currencies were left to "float" against each other, trading as if they were commodities rather than receipts for fixed units of value. The result was to remove the yardstick for measuring value, leaving currencies vulnerable to attack by international speculators prowling in these dangerous commercial waters.

- *The short sale.* To bring down competitor currencies, speculators use a device called the "short sale" – the sale of currency the speculator does not own but has theoretically "borrowed" just for purposes of sale. Like "fractional reserve" lending, the short sale is actually a form of counterfeiting. When speculators sell a currency short in massive quantities, its value is artificially forced down, forcing down the value

of goods traded in it.

- *"Globalization" and "free trade."* Before a currency can be brought down by speculative assault, the country must be induced to open its economy to "free trade" and to make its currency freely convertible into other currencies. The currency can then be attacked and devalued, allowing national assets to be picked up at fire sale prices and forcing the country into bankruptcy. The bankrupt country must then borrow from international banks and the IMF, which impose as a condition of debt relief that the national government may not issue its own money. If the government tries to protect its resources or its banks by nationalizing them for the benefit of its own citizens, it is branded "communist," "socialist" or "terrorist" and is replaced by one that is friendlier to "free enterprise." Locals who fight back are termed "terrorists" or "insurgents."

- *Inflation myths*. The runaway inflation suffered by Third World countries has been blamed on irresponsible governments running the money printing presses, when in fact these disasters have usually been caused by speculative attacks on the national currency. Devaluing the currency forces prices to shoot up overnight. "Creeping inflation" like that seen in the United States today is also blamed on governments irresponsibly printing money, when it is actually caused by *private banks* inflating the money supply with *debt*. Banks advance new money as loans that must be repaid with interest, but the banks don't create the interest necessary to service the loans. New loans must continually be taken out to obtain the money to pay the interest, forcing prices up in an attempt to cover this new cost, spiraling the economy into perpetual price inflation.

- *The "business cycle."* As long as banks keep making low-interest loans, the money supply expands and business booms; but when the credit bubble gets too large, the central bank goes into action to deflate it. Interest rates are raised, loans are reduced, and the money supply shrinks, forcing debtors into foreclosure, delivering their homes to the banks. This is called the "business cycle," as if it were a natural condition like the weather. In fact, it is a natural characteristic only of a monetary scheme in which money comes into existence as a debt to private banks for "reserves" of something lent many times over.

- *The home mortgage boondoggle*. A major portion of the money created by banks today has originated with the "monetization" of home mortgages. The borrower thinks he is borrowing pre-existing funds, when the bank is just turning his promise to repay into an

"asset" secured by real property. By the time the mortgage is paid off, the borrower has usually paid the bank more in interest than was owed on the original loan; and if he defaults, the bank winds up with the house, although the money advanced to purchase it was created out of thin air.

- *The housing bubble.* The Fed pushed interest rates to very low levels after the stock market collapsed in 2000, significantly shrinking the money supply. "Easy" credit pumped the money supply back up and saved the market investments of the Fed's member banks, but it also led to a housing bubble that will again send the economy to the trough of the "business cycle" as it collapses.

- *The Adjustable Rate Mortgage or ARM.* The housing bubble was fanned into a blaze through a series of high-risk changes in mortgage instruments, including variable rate loans that allowed nearly anyone to qualify to buy a home who would take the bait. By 2005, about half of all U.S. mortgages were at "adjustable" interest rates. Purchasers were lulled by "teaser" rates into believing they could afford mortgages that were liable to propel them into inextricable debt if not into bankruptcy. Payments could increase by 50 percent after 6 years just by their terms, and could increase by 100 percent if interest rates went up by a mere 2 percent in 6 years.

- *"Securitization" of debt and the credit crisis.* The banks moved risky loans off their books by selling them to unwary investors as "mortgage-backed securities," allowing the banks to meet capital requirements to make yet more loans. But when the investors discovered that the securities were infected with "toxic" subprime debt they quit buying them, leaving the banks scrambling for funds.

- *The secret insolvency of the banks.* The Wall Street banks are themselves heavily invested in these mortgage-backed securities, as well as in very risky investments known as "derivatives," which are basically side bets that some asset will go up or down. Outstanding derivatives are now counted in the hundreds of trillions of dollars, many times the money supply of the world. Banks have been led into these dangerous waters because traditional commercial banking has proven to be an unprofitable venture. While banks have the power to create money as loans, they also have the obligation to balance their books; and when borrowers default, the losses must be made up from the banks' profits. Faced with a wave of bad debts and lost business, banks have kept afloat by branching out into the economically

destructive derivatives business, by "churning" loans, and by engaging in highly leveraged market trading. Today their books may look like Enron's, with a veneer of "creative accounting" concealing bankruptcy.

- *"Vulture capitalism" and the derivatives cancer*. At one time, banks served the community by providing loans to developing businesses; but today this essential credit function is being replaced by a form of "vulture capitalism," in which bank investment departments and affiliated hedge funds are buying out shareholders and bleeding businesses of their profits, using loans of "phantom money" created on a computer screen. Banks are also underwriting speculative derivative bets, in which money that should be going into economic productivity is merely gambled on money making money in the casino of the markets.

- *Moral hazard*. Both the housing bubble and the derivatives bubble are showing clear signs of imploding; and when they do, banks considered too big to fail will expect to be bailed out from the consequences of their risky ventures just as they have been in the past . . . .

Waking Up in Kansas

It is at this point in our story, if it is to have a happy ending, that we the people must snap ourselves awake, stand up, and say "Enough!" The bankers' extremity is our opportunity. We can be kept indebted and enslaved only if we continue to underwrite bank profligacy. As Mike Whitney wrote in March 2007, "The Federal Reserve will keep greasing the printing presses and diddling the interest rates until someone takes away the punch bowl and the party comes to an end."[3] It is up to us, an awakened and informed populace, to take away the punch bowl. Private commercial banking as we know it is obsolete, and the vulture capitalist investment banking that has come to dominate the banking business is a parasite on productivity, serving its own interests at the expense of the public's. Rather than propping up a bankrupt banking system, Congress could and should put insolvent banks into receivership, claim them as public assets, and operate them as agencies serving the depository and credit needs of the people.

Besides the imploding banking system, a second tower is now poised to fall. The U.S. federal debt is approaching the point at which just the interest on it will be more than the taxpayers can afford to

pay; and just when foreign investors are most needed to support this debt, China and other creditors are threatening to demand not only the interest but the principal back on their hefty loans. The Ponzi scheme has reached its mathematical limits, forcing another paradigm shift if the economy is to survive. Will the collapse of the debt-based house of cards be the end of the world as we know it? Or will it be the way through the looking glass, a clarion call for change? We can step out of the tornado into debtors' prison, or we can step into the technicolor cornucopia of a money system based on the ingenuity and productivity that are the true wealth of a nation and its people.

Home at Last

In the happy ending to our modern monetary fairytale, Congress takes back the power to create money in all its forms, including the money created with accounting entries by private banks. Highlights of this satisfying ending include:

- Elimination of personal income taxes, allowing workers to keep their wages, putting spending money in people's pockets, stimulating economic growth.

- Elimination of a mounting federal debt that must otherwise burden and bind future generations.

- The availability of funds for a whole range of government services that have always been needed but could not be afforded under the "fractional reserve" system, including improved education, environmental cleanup and preservation, universal health care, restoration of infrastructure, independent medical research, and development of alternative energy sources.

- A social security system that is sufficiently funded to support retirees, replacing private pensions that keep workers chained to unfulfilling jobs and keep employers unable to compete in international markets.

- Elimination of the depressions of the "business cycle" that have resulted when interest rates and reserve requirements have been manipulated by the Fed to rein in out-of-control debt bubbles.

- The availability of loans at interest rates that are not subject to unpredictable manipulation by a private central bank but remain modest and fixed, something borrowers can rely on in making their

business decisions and in calculating their risks.

- Elimination of the aggressive currency devaluations and economic warfare necessary to sustain a money supply built on debt. Exchange rates become stable, the U.S. dollar becomes self-sustaining, and the United States and other countries become self-reliant, trading freely with their neighbors without being dependent on foreign creditors or having to dominate and control other countries and markets.

This happy ending is well within the realm of possibility, but it won't happen unless we the people get our boots on and start marching. We have become conditioned by our television sets to expect some hero politician to save the day, but the hero never appears, because both sides dominating the debate are controlled by the banking/industrial cartel. Nothing will happen until we wake up, get organized, and form a plan. What sort of plan? The platform of a revamped Populist/Greenback/American Nationalist/Whig Party might include:

1. A bill to update the Constitutional provision that "Congress shall have the power to coin money" so that it reads, "Congress shall have the power to create the national currency in all its forms, including not only coins and paper dollars but the nation's credit issued as commercial loans."
2. A call for an independent audit of the Federal Reserve and the giant banks that own it, including an investigation of:
    - The creation of money through "open market operations,"
    - The market manipulations of the Plunge Protection Team and the CRMPG,
    - The massive derivatives positions of a small handful of mega-banks and their use to rig markets, and
    - The use of "creative accounting" to mask bank insolvency.

   Any banks found to be insolvent would be delivered into FDIC receivership and to the disposal of Congress.
3. Repeal of the Sixteenth Amendment to the Constitution, construed as authorizing a federal income tax.
4. Either repeal of the Federal Reserve Act as in violation of the Constitution, or amendment of the Act to make the Federal Reserve a truly federal agency, administered by the U.S. Treasury.

5. Public acquisition of a network of banks to serve as local bank branches of the newly-federalized banking system, either by FDIC takeover of insolvent banks or by the purchase of viable banks with newly-issued U.S. currency. Besides serving depository banking functions, these national banks would be authorized to service the credit needs of the public by advancing the "full faith and credit of the United States" as loans. Any interest charged on advances of the national credit would be returned to the Treasury, to be used in place of taxes.
6. Elimination of money creation by private "fractional reserve" lending. Private lending would be limited either to recycling existing funds or to lending new funds borrowed from the newly-federalized Federal Reserve.
7. Authorization for the Treasury to buy back and retire all of its outstanding federal debt, using newly-issued U.S. Notes or Federal Reserve Notes. This could be done gradually over a period of years as the securities came due. In most cases it could be done online, without physical paper transfers.
8. Advances of interest-free credit to state and local governments for rebuilding infrastructure and other public projects. Congress might also consider authorizing interest-free credit to private parties for properly monitored purposes involving the production of real goods and services (no speculation or shorting).
9. Authorization for Congress, acting through the Treasury, to issue new currency annually to be spent on programs that promoted the general welfare. To prevent inflation, the new currency could be spent only on programs that contributed new goods and services to the economy, keeping supply in balance with demand; and issues of new currency would be capped by some ceiling -- the unused productive capacity of the national work force, or the difference between the Gross Domestic Product and the nation's purchasing power (wages and spendable income). Computer models might be run first to determine how rapidly the new money could safely be infused into the economy.
10. Authorization for Congress to fund programs that would return money to the Treasury in place of taxes, including the development of cheap effective energy alternatives (wind, solar, ocean wave, etc.) that could be sold to the public for a fee, and affordable public housing that returned rents to the government.

11. Regulation and control of the exploding derivatives crisis, either by imposing a modest .25 percent tax on all derivative trades in order to track and regulate them, or by imposing an outright ban on derivatives trading. If the handful of banks responsible for 97 percent of all derivative trades were found after audit to be insolvent, they could be put into receivership and their derivative trades could be unwound by the FDIC as receiver.
12. Initiation of a new round of international agreements modeled on the Bretton Woods Accords, addressing the following monetary issues, among others:
    - The pegging of national currency exchange rates to the value either of an agreed-upon standardized price index or an agreed-upon "basket" of commodities;
    - International regulation of, or elimination of, speculation in derivatives, short sales, and other forms of trading that are used to manipulate markets;
    - Interest-free loans of a global currency issued Greenback-style by a truly democratic international congress, on the model of the Special Drawing Rights of the IMF; and
    - The elimination of burdensome and unfair international debts. This could be done by simply writing the debts off the books of the issuing banks, reversing the sleight of hand by which the loan money was created in the first place.
13. Other domestic reforms that might be addressed include publicly-financed elections, verifiable paper trails for all voting machines, media reform to break up monopoly ownership, lobby reform, sustainable energy development, basic universal health coverage, reinstating farm parity pricing, and reinstating and strengthening the securities laws.

Like the earlier Greenback and Populist Parties, this grassroots political party might not win any major elections; but it could raise awareness, and when the deluge hit, it could provide an ark. We need to spark a revolution in the popular understanding of money and banking while free speech is still available on the Internet, in independent media and in books. New ideas and alternatives need to be communicated and put into action before the door to our debtors' prison slams shut. The place to begin is in the neighborhood, with brainstorming sessions in living rooms in the Populist tradition. The

Populists were the people, and what they sought was a people's currency. Reviving the "American system" of government-issued money would not represent a radical departure from the American tradition. It would represent a radical return. Like Dorothy, we the people would finally have come home.