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Drawing the Potential of the Future into Reality Today

Rescuing The Physical Economy

By Benjamin Gisin & Michael Krajovic

Rescuing the physical economy from more debt and a lack of circulating means of exchange.

Photo - Bain News Service

A 1909 photo of unemployed men marching to draw attention to the injustices of no employment. Estimates are that 2 million jobs have already been lost amidst the financial crisis.

Amidst attention to financial industry woes, the most significant aspect of the crisis has remained unattended – saving the physical economy. The bailout restored bank and investor losses and created needed liquidity. The physical economy, on the other hand, continues to collapse due to an insufficient circulating means of exchange and servicing crushing debt loads.

Over the years, the physical economy has evolved to function primarily on circulating money between producers and consumers. Evidence has emerged that credit — money created by the financial industry — doesn't fit the bill. (See Conscious Economics issues 1 and 2 which discuss how credit is the only means of exchange out there.) Credit volume is limited to finding enough qualified borrowers. Credit (money) is continuously taken out of circulation to pay off underlying debts or end up being concentrated — events that reduce and disfigure the larger economy.

The bailout retained a cadre of loan officers and investment bankers (who haven't lost their jobs) with phones and desks to make new loans. Can these over-worked bank employees (in the current landscape of more debts than existing qualified borrowers) find enough new qualified borrowers to create and distribute the credit needed to underpin the physical economy? Since the bailout began, the Bureau of Labor statistics reports 1.9 million (non-farm) jobs have been lost, pushing unemployment to over 10 million.

The flaw in using credit as money is the debt that stands behind it grows faster than the economy. Twelve years ago (1997), the Gross Domestic Product grew by $700 billion and the total debt in America grew by $1,200 billion. For the first 9 months of 2008, the Gross Domestic Product grew by $600 billion and the debt grew by $3,000 billion (See Chart 1). Chart 1 illustrates that not only does the debt grow faster than the economy, but the rate at which the debt grows faster than the economy is also increasing.

Historically, the financial industry, with the intervening hand of the Federal Reserve, drove the physical economy by creating and distributing credit (money). Becoming intoxicated with past debts, the financial industry is less able to drive the economy. It is time someone else, with a fundamentally different approach, take over the steering wheel.

Checking into the nation's capitol, the financial industry demanded treatment from the U.S. Government, the Federal Reserve Bank and the U.S. Treasury. The treatment was one of free infusions of capital and money — but the physical economy was bypassed. Have we forgotten who feeds, clothes and houses us?

The physical economy needs a circulating medium for employees and business to have the option of working for a living as opposed to being forced to live on welfare and defaulting on their obligations. The inability of the money — credit created by the financial industry to robustly circulate — is a broad social and economic failing whose correction is at our doorsteps.

Discovering A Different Option

Does waiting for the financial industry to reinvigorate the economy with more debt (the only approach the financial industry knows) make sense?

As of 9/30/08, the Federal Reserve reported $51.8 trillion of debt sloshing through the U.S. economy, that was used to facilitate economic activity of the past. The debt grows faster than the economy (See Chart 1). The prospects of the financial industry, adding trillions of dollars of new debt to solve the present crisis and avoid future crises is unlikely. It's one thing to keep existing borrowers employed to pay existing loans. It is another thing to find millions of new borrowers to fund the physical economy in an environment of rapidly disappearing jobs.

On a positive note, the U.S. Government believes it should temporarily take over the steering wheel from a financial industry weakened from creating more debt than can be repaid. The U.S. ►

Government is working on a stimulus package of approximately $1 trillion to re-energize the physical economy.

Within a financial system that only understands debt, the government has become the debtor (borrower) of last resort. Does it make sense for the government to stimulate the physical economy with more debt — an approach the financial industry is proving doesn't work? Fortunately, the government has other options.

The idea of creating money that is virtually debt and cost free is not new to the U.S. Government, the Federal Reserve and the Treasury. It is something that has been practiced for decades while creating and collateralizing currency (Federal Reserve Notes).

On 12/31/07, there was $792 billion of currency in circulation of which $741 billion was collateralized by U.S. Government Treasury Securities (national debt). Holding these securities, the Fed collected $40.3 billion in interest payments in 2007. For the privilege of issuing currency, the Fed paid $34.6 billion of the interest money back to the U.S. Treasury. The net effect was the cost to the Treasury (and taxpayers) of $741 billion — 8 percent of the national debt — was only $5.7 billion or .7 percent. The U.S. Treasuries held by the Fed are not owed to private investors and simply renewed at maturity.

To get to the point, the U.S. Treasury and the Fed can create money the same way for a stimulus plan. The Treasury can sell 30-year bonds to the Fed at little to no cost. These long-term bonds can be renewed in 30 years, making the whole process without the effects of debt — as the government can dictate the terms to the Fed like it is doing with the debt used to collateralize the currency.

To purchase the U.S. bonds, the Fed credits the Treasury's account at the Fed. The Treasury then issues checks (like your tax refund checks). When you deposit a Treasury check into your bank account, the Fed lowers the amount in the Treasury's account and increases the amount in your bank's account at the Fed. This process puts spending money into the hands of consumers while building the liquidity of the banking system.

By financing stimulus payments in this way, it provides a tremendous boom to the equities (stock) market as consumers buy the goods, services and recreation they need without incurring more debt.

In the absence of a fully functioning financial industry, rescuing the physical economy would simply be a process of determining the amount of money needed. We don't have to go to outside investors. The U.S. Government, the Treasury and the Federal Reserve can create and spend, at constructive points in the economy, all the money needed to keep the economy from collapsing.

Not including the millions of jobs that need to be re-created and sustained, there is $51.8 trillion in debt to be serviced. The amount of money needed to rebuild the nation's infrastructure (roads, bridges and dams) exceeds $1.6 trillion. Well-placed stimulus payments of $3 trillion may barely be adequate.

What You Can Do

You can contact your U.S. Congressman or Senator and suggest this simple concept: The U.S. Government should instruct the Federal Reserve to buy $3 trillion in U.S. Government Treasury ▶

Photo - Wikimedia

New York Stock Exchange is symbolic of cash flows through the physical economy. As cash flows weaken amidst the lingering financial crisis, the value of stocks plunge and unemployment and business failures rise. Investments in equities stand to improve with stimulus payments.

Chart 1 - Growth of Debt versus Growth of Gross Domestic Product

Little known is that the debt in America grows much faster than the economy. Even less known is that this debt is a function of what it is we use as money - credit.

The more money (credit) we use, the deeper in debt the nation becomes in all sectors. The idea that money somehow magically exists and is loaned out is untrue.

Banks have no money, they don't make loans and there is nothing on deposit. A Bank's credit (what they owe depositors) is the nation's principal form of exchange. And banks will not extend their credit until someone becomes indebted to them first.

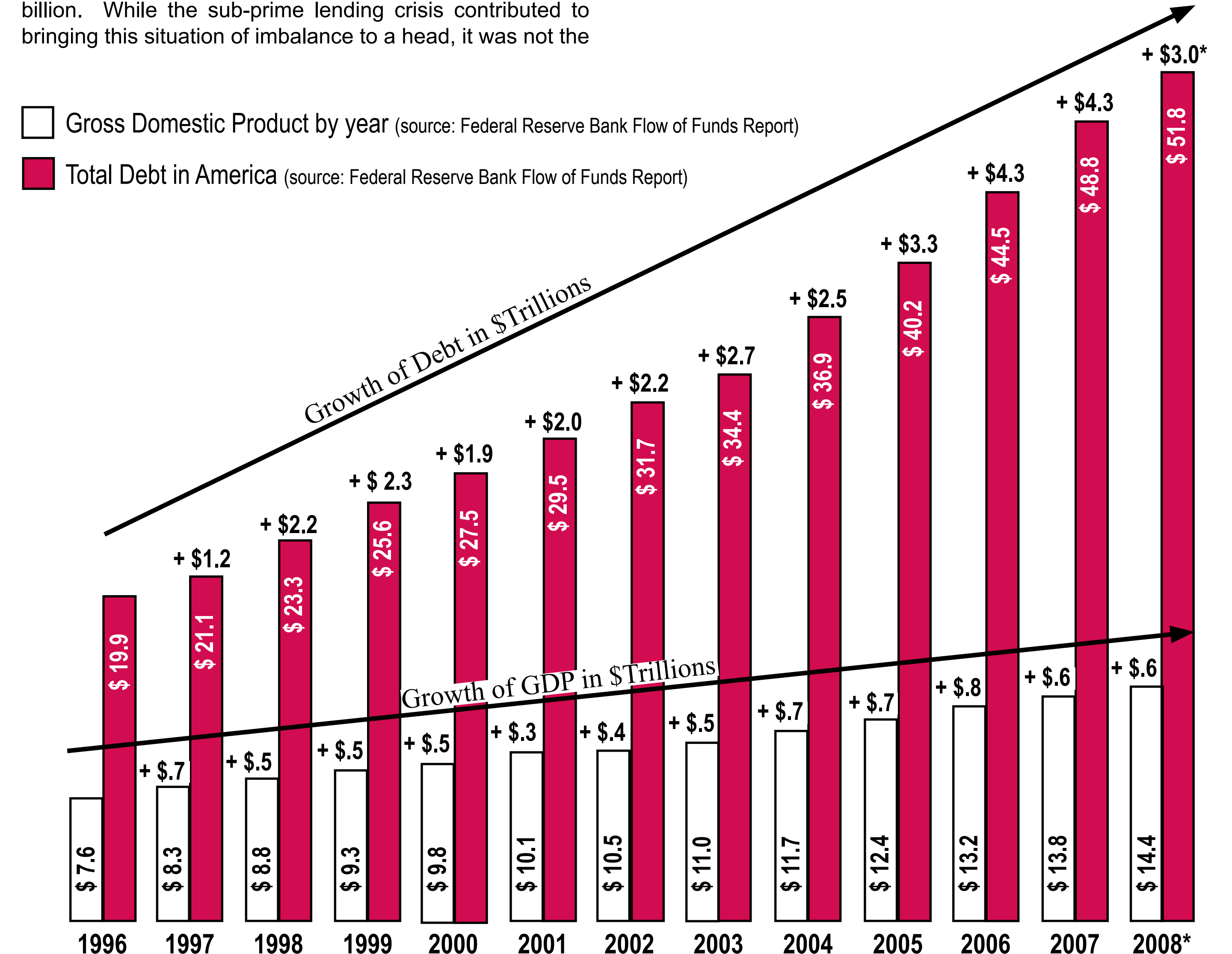
Making a poor means of exchange, bank credit must be re-loaned in the capital and other debt markets creating a pyramid of debt that grows faster than the economy.

In 1997, the GDP (Gross Domestic Product) grew by $700 billion, but the debt grew by $1,200 billion. In 2007, the GDP only grew by $600 billion, but the debt grew by $4,300 billion. While the sub-prime lending crisis contributed to bringing this situation of imbalance to a head, it was not the underlying reason for the financial crisis and the resulting externalization of the physical economy.

The mechanisms are in place, albeit unconventional, for the U.S. Government, Treasury and Federal Reserve to virtually move beyond credit as money. A key to rescuing a frightening decline in the physical economy that feeds, clothes and houses everyone.

The concept of punishing the physical economy, while the financial system works through trillions of dollars of non-performing loans, may not be in anyone's best interests, including the financial system's.

The shrinking size of the GDP, relative to the volume of debt needed to sustain it, should have even the financial institutions and financial investors seeking fundamental change in what we use as a means of exchange. Our retirement plans, our physical status as a 1st world country and our childrens' future hang in balance. ■



*All years are for a full 12 months except 2008 which is only for 9 months ending 9/30/08. Note that 2008 still averaged debt growth of $1 trillion every quarter for the first three quarters.

Bonds at a rate that only covers the Fed's cost of administration and credit the U.S. Treasury's account for the same amount. In addition, require the U.S. Treasury to spend this money solely for citizen stimulus payments, infrastructure building, building food stocks and education.

Does it all sound too good to be true? Yes, it is true. It is that simple. And it is powerful. The financial sector will have to reconcile that their services of creating and lending credit (money) have been displaced by $3 trillion — a feat they may be incapable of doing anyway. An infusion into the economy of $3 trillion would go a long way in helping existing borrowers make good on their debts without further government bailout. Investors and bankers would avoid bad press that comes from receiving free capital infusions from the public and for not disclosing how it was used. This simple action will actually help save the financial industry.

Bankers and financial investors may well try to limit the amount of the stimulus package, or, through fear of being more permanently displaced, lobby against this plan.

The equities market, materially based in the physical economy, stands to gain tremendously from this plan. As most goods and services are provided by publicly traded companies, an economic stimulus of $3 trillion would fill their cash registers and attract new capital for growth and expansion. In addition, the plan would spin off more tax revenues making it easier for the government to balance its budget.

The Future

Funding a $3 trillion stimulation package with virtually no cost to the taxpayer buys time for the nation. The nation is at a crossroads as to whether it will continue down a path that only uses credit as money, or takes a path that begins to include much greater options such as those discussed in this edition of Conscious Economics.

After receiving hundreds of billions of dollars in public funding, there is an obligation on the part of the financial industry to support and lobby for sharing the privilege of creating and distributing money with the U.S. Government. It may well be what saves their industry, not to mention saving the fiscal ability of the U.S. Government to function.

America, the U.S. Government and the world cannot wait any longer for the financial industry to figure out how to facilitate the physical economy with its one and only approach — more debt to support credit as money. Waiting for the financial industry to work through its problem loans before it can focus on new credit with volumes sufficient to picking up the physical economy is not good for them, the public, or the U.S. Government. ■

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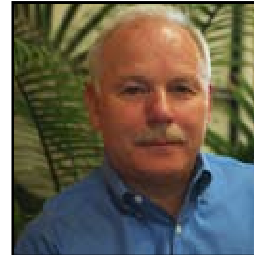

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