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Rather Than Sink Main Street by Raising Interest Rates, the Fed Could Save It. Here's How.
By Ellen Brown

The central bank has the tools to help American families suffering from rising food and energy bills right now, with a bit of updating to its rules.

Inflation is plaguing consumer markets, putting pressure on the Federal Reserve to raise interest rates to tighten the money supply. But as Rex Nutting writes in a *MarketWatch* column titled "**Why Interest Rates Aren't Really the Right Tool to Control Inflation**":

It may be heresy to those who think the Fed is all-powerful, but the honest answer is that raising interest rates wouldn't put out the fire. Short of throwing millions of people out of work in a recession, higher rates wouldn't bring supply and demand back into balance, a necessary condition for price stability.

The Fed (and those who are clamoring for the Fed to raise rates immediately) have misdiagnosed the problem with the economy and are demanding the wrong kind of medicine. …

Prices are going up because crucial inputs—labor, electronics, energy, housing, transportation—are in short supply. Normally, the way to solve this imbalance would be to give workers and businesses incentives to increase their supply. …

The Fed has been assigned the job of fixing this. Unfortunately, the Fed doesn't have the tools to do it. Monetary policy works (in theory) by tweaking demand, but it has no direct impact on supply.

The Dire Effects of the "Wrong Kind of Medicine"

Not only will raising interest rates not fix the supply crisis, but **according to Alasdair Macleod**, head of research at GoldMoney in London, U.K., that wrong medicine is likely to trigger the next financial crisis. He thinks it is imminent and will **start in Europe**, where negative interest rates brought the cost of doing repo trades to zero. As a result, the European repo market is now over €10 trillion ($11.4 trillion), far more than the capital available to unwind it (to reverse or close the trades). Rising interest rates will trigger that unwinding, says MacLeod, and the ECB lacks the tools to avoid the resulting crisis. Meanwhile, oil prices have risen over 50% and natural gas over 60% in Europe in the past year, "due to a supply crisis of its governments' own making," writes Macleod. Member governments are heavily in debt, yet European Central Bank president Christine Lagarde wants to borrow more to finance the transition to carbon neutral. **Macleod writes darkly**:

As for the euro's future, it seems unlikely that the ECB has the capability of dealing with the crisis that will unfold.… The deconstruction of this shabby arrangement should prove the end of the euro and possibly of the European Union itself.

German journalist Ernst Wolff paints an even darker scenario. He contends that the globalist European leaders heading the World Economic Forum (WEF) are crashing the global economy intentionally, in order to clear the chessboard for the **WEF's "Great Reset**." They're doing this, he says, because they have to. The global bankers' boom-and-bust financial system is now so top-heavy and debt-laden that it cannot be sustained. Problem/reaction/solution: desperate people will welcome the WEF's Great Reset, in which they **will own nothing** but will be offered a marginally adequate Universal Basic Income with onerous strings attached. This subsistence income will be doled out through a central bank digital currency (CBDC) controlled nationally by the country's central bank and globally by the **IMF as issuer of the reserve currency** and, ultimately, of a single global currency.

There are indications, however, that the U.S. Fed is not going along with this Eurocentric globalist push. Financial blogger Tom Luongo points to Jerome Powell's **clash with Christine Lagarde** in May last year over her insistence that central banks require private banks to monitor the business of their clients, and to the **Fed's raising its repo rate** to 0.25% in June, attracting investors earning zero interest in the European repo market into the U.S. dollar and away from the euro. Luongo suggests that the Fed's resistance to the globalist plan comes from the **Wall Street banks that own the New York Fed**, which are not willing to give up the U.S. dollar's status as global reserve currency and could be driven out of business by a CBDC distributed directly through individual central bank accounts.

Preserving the current Wall Street-dominated system, however, hardly helps Main Street. The pandemic **added $5 trillion** to the fortunes of the billionaire class; but government-instituted lockdowns permanently **shuttered more than 100,000 U.S. businesses** and left vast portions of the population living on the edge. **According to a recent study** from Johns Hopkins University, the detrimental impact of global lockdowns substantially outweighed their public health benefits.

Is It Time to Amend the Federal Reserve Act?

The U.S. dollar is backed by the full faith and credit of the United States: it retains its value because the American public is willing to take it in exchange for their goods and services. But the public has not been allowed access to the bottomless pool of central bank liquidity that backstops this public credit.

According to Cornell Law School Prof. Robert Hockett, however, the framers of the Federal Reserve Act intended for Main Street businesses to be able to tap this liquidity pool. He argues that the Fed already has the monetary tools it needs to rescue the real, productive economy. They just haven't been used – for over a century. The Fed can stay in its own lane and stimulate local production using monetary policy baked into the Federal Reserve Act itself.

Cornell Law School's **Prof. Robert Hockett wrote in Forbes** in March last year that the Federal Reserve System was originally designed to be "something akin to a **network of regional development finance institutions**. … Each of the twelve regional Federal Reserve Banks was to provide short-term funding directly or indirectly (through local banks) to developing businesses that needed it. This they did by '**discounting**' – in effect, purchasing – commercial paper from those businesses." ***Investopedia* explains**:

Commercial paper is a commonly used type of unsecured, short-term debt instrument issued by corporations, typically used for the financing of payroll, **accounts payable** and inventories, and meeting other short-term liabilities…. Commercial paper is usually issued **at a discount** from face value and reflects prevailing market interest rates.

In determining what kinds of commercial paper to discount, wrote Hockett, "the Federal Reserve Act both was – and ironically remains – quite explicit about this: Fed discount lending is solely for 'productive,' not 'speculative' purposes."

In **a follow-up article**, Hockett explained that the drafters of the Federal Reserve Act, notably Carter Glass and Paul Warburg, were essentially following the Real Bills Doctrine (RBD). Previously known as the "commercial loan theory of banking," it held that banks could create credit-money deposits on their balance sheets without triggering inflation if the money were issued against loans backed by commercial paper. When the borrowing companies repaid their loans from their sales receipts, the newly created money would just void out the debt and be extinguished. Their intent was that banks could sell their commercial loans at a discount at the Fed's Discount Window, freeing up their balance sheets for more loans. Hockett wrote:

The RBD in its crude formulation held that so long as the lending of endogenous [bank-created] credit-money was kept productive, not speculative, inflation and deflation would be not only less likely, but effectively impossible. And the experience of German banks during Germany's late 19th century **Hamiltonian 'growth miracle,'** with which the German immigrant Warburg, himself a banker, was intimately familiar, appeared to verify this. So did **Glass's experience** with agricultural lending in the American South.

According to Prof. Carl Walsh, writing in *The Federal Reserve Bank of San Francisco Newsletter* in 1991:

The preamble sets out very clearly that one purpose of the Federal Reserve Act was to afford the means of discounting commercial loans. In its report on the proposed bill, the House Banking and Currency Committee viewed a fundamental objective of the bill to be the "creation of a joint mechanism for the extension of credit to banks which possess sound assets and which desire to liquidate them for the purpose of meeting legitimate commercial, agricultural, and industrial demands on the part of their clientele."

"Liquidating" loans backed by "real bills" basically meant turning a company's receivables into bank-issued credit that could be spent on the workers and materials needed to produce its goods and services, bringing supply in balance with demand. That "monetization" of debt might not drive up prices, but external factors obviously could. Today those factors include supply chain problems, worker shortages, and resource shortages. In the 1920s, the trigger was speculation in the stock market.

The real bills policy was discredited after the stock market crash of 1929, due to overly-strict application by the Fed. **As the tale is told in *Wikipedia***:

Fed Board member Adolph C. Miller in 1929 launched his Direct Pressure initiative. It required all member banks seeking Federal Reserve discount window assistance to affirm that they had never made speculative loans, especially of the stock-market variety. No self-respecting banker seeking to borrow emergency reserves from the Fed was willing to undergo such interrogation, especially given that a "hard-boiled" Fed was unlikely to grant such aid. Instead, the banks chose to fail (and the Fed let them), which they did in large numbers, almost 9000 of them.

But the policy's original objective remains sound: "creation of a joint mechanism for the extension of credit to banks which possess sound assets and which desire to liquidate them for the purpose of meeting legitimate commercial, agricultural, and industrial demands on the part of their clientele."

Walsh noted that discount window borrowing is currently available only for easing very short-term reserve shortages. When the Fed wants to expand bank lending, it purchases government securities from the banking sector, allowing bank reserves to expand. But he observed that this maneuver does not necessarily increase bank lending, and that some commentators argued that the Fed should be allowed to purchase existing loans from banks that could then use the funds to back new loans on the "real bills" theory.

Compare North Dakota's "Mini-Fed"

How might that work today? For some idea, we can look to the highly successful state-owned Bank of North Dakota, which has been described as a "mini-Fed" for the local banks of that state. Again **quoting *Wikipedia***:

The BND serves as a **wholesale bank** for the state's **community banks** and **credit unions**. It participates in loans created by the local banks by expanding their size, providing **loan guarantees**, and "buying down" interest rates. Additionally, it buys loans from bank **portfolios** as well as community bank **stocks**. The bank provides other banking services to local banks, such as **clearing checks**, acting as depository for their **reserves**, and providing **federal funds**.

According to a May 2020 article in *The Washington Post* titled "**North Dakota Businesses Dominated the PPP**":

Small businesses there secured more PPP [Paycheck Protection Plan] funds, relative to the state's workforce, than their competitors in any other state ….

What's their secret? Much credit goes to the century-old Bank of North Dakota ….

According to Eric Hardmeyer, BND's president and chief executive, BND connected the state's small bankers with politicians and U.S. Small Business Administration officials and even bought some of their PPP loans to help spread out the cost and risk.

… BND offers few retail services or direct loans, with the notable exception of student loans. Instead it partners with local banks, multiplying their lending power and guiding them through the ever-evolving global financial system….

BND has already rolled out **two local successor programs** to the PPP, intended to help businesses restart and rebuild. It has also offered deferments on its $1.1 billion portfolio of student loans.

Updating the Federal Reserve Act

The Paycheck Protection Plan was one of many relief programs established in March 2020 that were funded with Fed credit and capitalized with money from the Treasury. But Treasury backing would not actually be necessary to restore the Fed's Discount Window to its original function. The Federal Reserve Act would just need a bit of tweaking to bring it into the 21st century.

To start, Hockett says we need many more Federal Reserve branches than the original twelve, which are not distributed proportionately to today's populations. The three-month limit on commercial loans and six-month limit on municipal government loans in Federal Reserve Act §10b also need to be extended; and **we need a national funding agency for infrastructure**, similar to the Reconstruction Finance Corporation that restored the depression-ridden U.S. economy in the 1930s. Hockett has drafted a bill for implementing his proposals, found **here**.

That could work for long-term production, but families faced with rising food and energy bills need help right now. Until production catches up with demand, the innovative Cornell professor suggests that the Fed can counteract the speculation that is driving up those prices with "Open Market Operations," using its new Chicago Fed trading desk to short them in the market. Direct market intervention is **highly controversial** and could obviously be misused; but the tool exists, and, if properly directed, it could help satisfy the Fed's mandate to maintain consumer price stability. For more on that rather complicated subject, see **here** and **here**.

To sum up: today's price inflation was triggered not so much by "too much money" as by "too little supply," due to lockdowns and mandates. The Fed can help restock consumer supplies using tools already in its toolbox. They include Open Market Operations to counteract speculation, and the Discount Window to purchase loans from local banks that would be willing to fund Main Street businesses if they had some help from the national Lender of Last Resort. We need the sort of Discount Window envisioned by the drafters of the Federal Reserve Act, one providing the liquidity to backstop bank advances against the future productivity of local businesses.

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