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If US Fed raises interest rates this week, brace for global financial earthquake

A decision this Friday by the US Federal Reserve to raise interest rates could set off an earthquake in the global debt bubble, which is now much bigger than at the time of the 2008 crash.

The shock waves will slam economies which have lots of debt inflated by years of record low interest rates—including Australia.

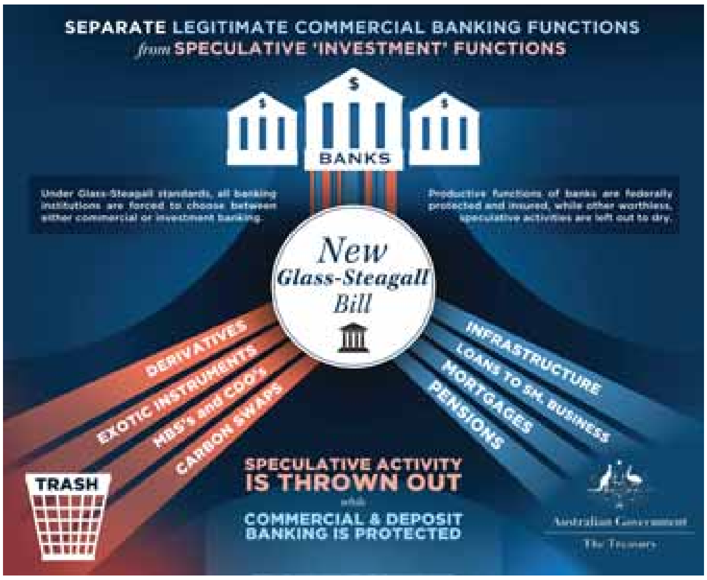
The International Monetary Fund, World Bank and Bank for International Settlements have all issued warnings ahead of the US Fed's decision, urging against a rate rise.

In a 14 September report, BIS chief economist Claudio Borio warned, "Debt ratios have reached extreme levels across all major regions of the global economy, leaving the financial system acutely vulnerable to monetary tightening by the US Federal Reserve." Of the recent market turmoil, Borio explained, "We are not seeing isolated tremors, but the release of pressure that has gradually accumulated over the years along major fault lines."

These warnings prove that *there has been no economic recovery since the 2008 crisis*; instead, the so-called developed economies have propped up their financial systems with virtually zero interest rates and the central bank money-printing called quantitative easing. If governments had directed this money into productive investments, such as infrastructure and industries, it would have fuelled a real economic recovery, but they didn't. It went instead into propping up the banks which caused the crisis, and those banks used it for speculation, in derivatives and mortgages, which just expanded the debt bubble. Business consultants McKinsey & Co. reported back in February that global debt as of 2014 was $57 *trillion* more than in 2007, a 17 per cent increase; total Australian debt in that time increased by 30 per cent.

The problem with the decision-makers, such as US Fed chairman Janet Yellen, is that they believe their economic theories, whether they be monetarist or Keynesian (two sides of the same coin), and the statistics that are based on those theories. Consequently, if she raises rates she might think she's pushing the "recovery" button, but instead push "detonate".

It's urgent that we change the entire system, beginning with a full Glass-Steagall separation of everyday retail banking from speculative investment banking. This is the equivalent of sheltering behind a wall while setting off a controlled detonation of a mine-field. It was the repeal of Glass-Steagall in 1999



which exposed the real economy to this danger; only restoring Glass-Steagall, worldwide, will protect the real economy.

Secondly, governments must immediately move to invest in the infrastructure projects and productive industries that will employ their populations and meet their needs. This can be done through government-owned national banks that use the same quantitative easing mechanism the central banks used after 2008, but for productive public investment—the policy that newly-elected UK Labour leader Jeremy Corbyn calls *People's Quantitative Easing*.

Thirdly, Australia and other developed nations must collaborate with the BRICS nations to establish a new model of international relations, based on co-operation on economic development projects that create prosperity and the basis for lasting peace.

Governments will only take these steps if the people force them to. That is starting to happen: in the support for Glass-Steagall advocates including Jeremy Corbyn in the UK, and Bernie Sanders and Martin O'Malley in the US, and in the anti-austerity movements in Greece, Spain and other European countries. The CEC is building a mass movement to force this policy shift in Australia—join the fight today!

Call 1800 636 432

for a **free copy** of the CEC's weekly magazine analysing financial and strategic developments that impact Australia and the world, the Australian Alert Service, which consistently forecast this present crisis.

How governments can create credit for infrastructure

UK Labour leadership front-runner Jeremy Corbyn's proposal for People's Quantitative Easing is Hamiltonian national banking by another name.

But how would it work?

Corbyn is proposing to establish a National Investment Bank to invest in infrastructure for the UK. The money that is invested will not be borrowed from private lenders or from overseas, nor will it come from taxes; the National Investment Bank will create the money it invests, by using the same Quantitative Easing (QE) mechanism that the Bank of England used after the 2008 Global Financial Crisis to create £375 billion. The main difference is that the Bank of England's QE went to prop up private banks and corporations, whereas People's QE will be spent on public investments for the public's benefit.

The Bank of England's Monetary Policy Committee has been purchasing assets financed by new money that the Bank creates electronically.

Bank of England video "Quantitative Easing Explained".

The mechanics of QE

Here's how the mechanics work. For its QE program, the Bank of England bought government bonds off corporations. A government bond is a loan from the bondholder to the government, so these purchases transferred the government's debt from the corporations to the Bank.

Central banks buy and sell bonds all of the time, but what is unique about QE is that to pay for the bonds, the Bank of England created the money, out of nothing! The Bank has explained QE is "new money, created electronically" (see image). And not just a little bit: £375 billion! Likewise, the US Federal Reserve created $4 trillion in QE from 2009-13, and the Bank of Japan and European Central Bank also created trillions—all using the same bond-buying mechanism. However, all of this new money didn't increase economic activity as promised, because the banks that received this cash didn't lend it out into the economy, but used it to for their own financial speculation.

People's QE

Corbyn's National Investment Bank would similarly create money, but strictly for public investment. A Corbyn government would identify an investment project, and the cost, and issue bonds for that amount of money, which it would sell to the National Investment Bank. The Bank would pay for the bonds with new money created for the purpose—precisely as the Bank of England conducted its QE. Thus, a Corbyn government would borrow, from its own bank, new money that the bank would create specifically for public infrastructure. Corbyn argues, correctly, that if the equivalent of the £375 billion created through QE to prop up the banks was created instead for public investment in the UK, it would create millions of jobs, boost national productivity, and alleviate poverty. Moreover, the government would not increase its debt to private or foreign bondholders, but would owe this money to its own bank. As the government repaid its debt to the National Investment Bank from taxes generated by the increase in productive economic activity, the bank would be able to expand.

The first US Secretary of the Treasury Alexander Hamilton used a similar mechanism to establish the First Bank of the United States—the world's first National Bank. Hamilton got the equivalent of the US government's bondholders to use their bonds (known as debt certificates) to subscribe to 80 per cent of the capital of the First Bank (the government put up the balance of 20 per cent in gold and silver). In this way the government became indebted to its own bank, and because Hamilton had pledged to honour that debt in full, the Bank was able to use that pledge as its capital, against which to make loans for productive investments in the real economy.

In Australia during WWII, the Curtin-Chifley government used the same mechanism to create credit to finance the war effort. The Treasury borrowed from the government-owned Commonwealth Bank by issuing Treasury Bills, so-called T-Bills (a form of bond), to the Bank, to purchase which the Commonwealth Bank created new money. T-Bills financed a massive expansion in government expenditure during the war.

Other methods

This particular mechanism to create credit, of issuing new money against the government's promise to pay a debt, whether in the form of bonds, or debt certificates, or T-Bills, is not the only way to do it. At the height of the Great Depression in 1931, Labor Treasurer Ted Theodore proposed to create £18 million to invest in agriculture and public works, by simply printing and spending it, £6 million on farmers and £12 million on projects; he called it a Fiduciary Note Issue (fiduciary meaning its value based on the reputation of the government, and not on gold). Labor's political opponents blocked Theodore's plan, but it would have worked.

In the US a year or so later, Franklin Roosevelt had a similar plan, to invest in infrastructure projects, but he got around his opponents by using an existing financial institution, the Reconstruction Finance Corporation (RFC). The RFC was already capitalised, Congress having voted to appropriate $2 billion for its funding for the years 1933-34, ironically for the purpose of bailing out banks. Knowing the same Congressmen would block spending on infrastructure, Roosevelt simply used the RFC as a bank, which lent out multiples of its capital, as banks do in their normal business. Over the next 20 years, the RFC lent out $50 billion for New Deal infrastructure projects and later the war effort, all of which was repaid.

Conclusion

These various approaches for creating credit share one important intention: the money is used for public investment. It doesn't really matter how the money is created, as long as it is invested in the projects that increase the productivity of the economy for the benefit of all. There is a limiting factor on this process, but it is not the rules of accountants or private bankers—the only limit is the availability of manpower and resources to do the work.