THE CLIMATE CRISIS, THE MONETARY SYSTEM, AND REAL FINANCIAL REFORM

Introduction: the climate crisis, Friends testimonies, and the crises we face.

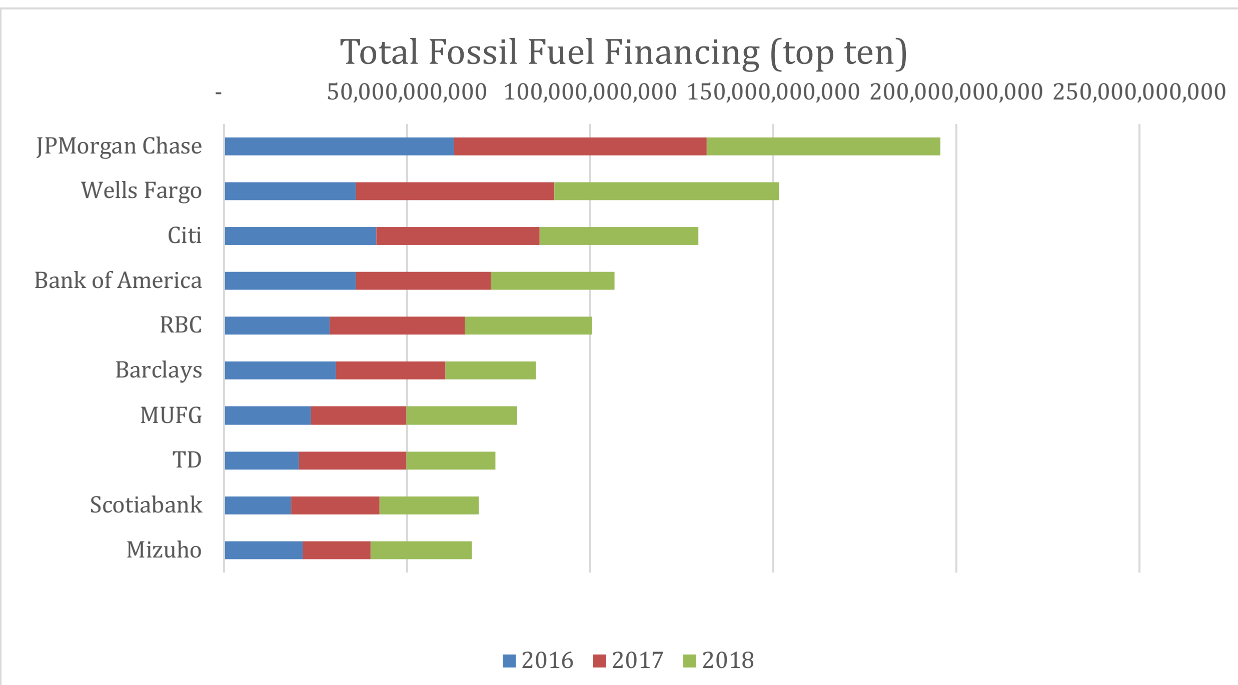
In October 2018, scientists of the Intergovernmental Panel on Climate Change reported to the United Nations that the destabilizing effects of the rising global temperature were occurring more rapidly than anticipated. Limiting the rise from the historic baseline to 1.5 C degrees, rather than the Paris Climate Accord's 2 C degree target, would be necessary to prevent a global climate catastrophe before the end of the 21st century.

The 1.5 C degree target would require a 45% reduction in global carbon emissions by 2030, and net zero carbon emissions by 2050. Achieving these reductions, they said, would be scientifically and technologically possible, but require rapid and unprecedented changes in humanity's economic, political, and cultural systems.

The climate crisis is just one of many existential crises the world faces. They confront the Society of Friends with unprecedented challenges to the application of our historic testimonies on non-violence, equality, and stewardship. Yet the testimony on integrity is especially challenging, because facing the truth about our economic and ecological predicament will be a corporate spiritual challenge for Friends.

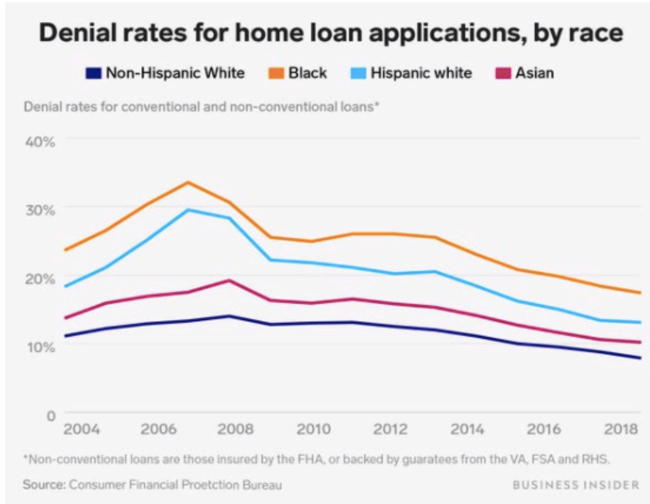
In our view, this will require recognizing and dealing courageously with the underlying conflicts between the world's current financial system, the stability of human societies, and the earth's physical and ecological realities. For examples, consider this evidence about the financial system's failures to address the systemic and inter-related crises we face: climate disruption, institutional racism, and the accelerating concentration of wealth.

About the climate crisis: From 2016 to 2018, thirty-three global banks, led by JPMorgan Chase, Wells Fargo, Citi Group, and Bank of America, provided over $1.9 trillion in financing to the fossil fuel industries. This included almost $600 billion to the companies most responsible for expanding fossil fuel production, even though the emissions from existing fossil fuel production will soon make a future global climate catastrophe virtually inevitable. In 2019 these banks provided even more, another $800 billion to the fossil fuel industries.

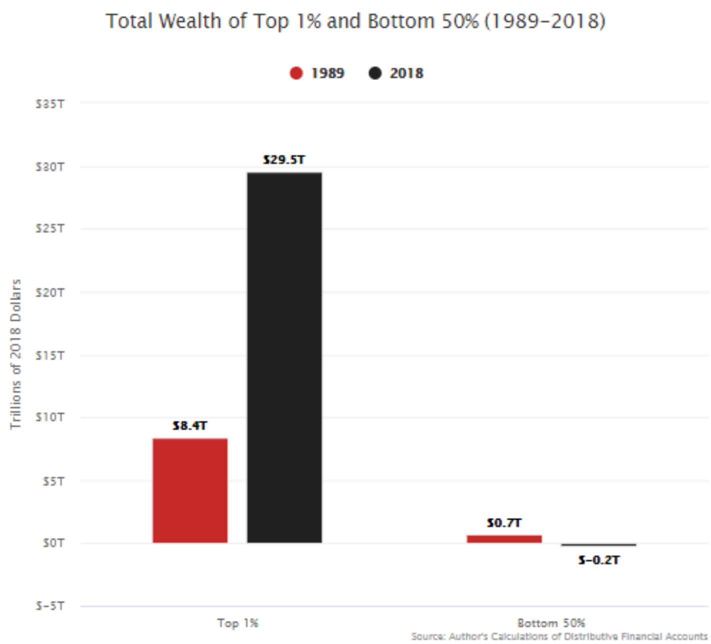


About institutional racism: If a bank is rooted in a community, it will want to help the community thrive, as long as it feels confident that its loans will be paid back. But banks have long been wary of lending to homeowners and businesses in less prosperous neighborhoods, and they often discriminate against minorities, especially African-Americans. This has far-reaching effects in all aspects of racial discrimination in our nation.

The graph that follows shows that black homeowners are unable to get loans more often that other racial minorities, and a lot more often than whites. Black homeowners and businesses are also typically charged higher interest rates. Banks may claim that their discrimination is because lending to African Americans is more risky. Yet there's plenty of evidence that their risk assessment is often pre-determined by skin color. The private banking system is a prime example of institutional racism throughout the nation.



About the concentration of wealth: In 2019, the Federal Reserve released new information about the distribution of wealth in the U.S. It shows that from 1989 and 2018, the combined net worth of the top 1 percent increased by \$21 trillion, from \$8.4 trillion to \$29.5 trillion, while the net worth of the bottom 50 percent decreased by \$900 billion and is now below zero. This means that in 2018, half of our people had more debts than assets.



How can our political system promote a transition to a low-carbon economy when our financial system continues to invest so heavily in fossil fuels? How can our nation overcome our legacy of slavery and today's racial divides when our banking system continues to disadvantage African Americans financially? How can Friends testimonies be advanced in the face of the systemic accelerating concentration of wealth? How must the financial system be changed to stop these things from happening? A fundamental aspect of these issues is the role and effects of the current banking system in creating our money supply, and real financial reform must address them.

Where does our money come from and how does it contribute to these crises?

Many people think the U.S. government creates the money supply for the U.S. economy. It's true that the Treasury produces the coins and prints the Federal Reserve Notes that we use as cash. The Treasury also finances the federal debt by selling Treasury notes and bonds to investors through the private banking system.

But to understand why the current financial system cannot deal with the climate crisis, institutional racism, or the accelerating concentration of wealth, we need to know that most of the money in our nation and the world is created by the private banking system. This surprises many people, who may find it hard to grasp.

Our currency involves two kinds of money, pocket money, the coins and bills in our pockets, and bank money, numbers in our bank accounts. In fact, more than 95% of our money is created by banks when they make loans and create debt by adding numbers to bank accounts. They can do this because they are legally allowed to lend much more money than they have as deposits from their customers. How can this happen? Here's a very simplified illustration.

Suppose there's a town with three banks. One day, in each of the banks, a customer makes a deposit of $100 in her personal account. This gives each bank an asset of $100, and a liability to provide $100 on demand.

Assets of $100 in deposits = liabilities of $100 payable on demand.

If the banks have a reserve requirement of 10%, i.e., that they have $10 in their possession for every $100 they lend, this enables each bank to make a loan of $1000 to three business customers. Each bank now has a contract for $1000 as an additional asset, and an additional liability to provide $1000 on demand.

Assets of $1100 in deposits and contracts = liabilities of $1100 payable on demand.

With their loans, Abby's business buys $1000 of goods from Bella's business; Bella's business buys $1000 of goods from Carla's business and Carla's business buys $1000 worth of goods from Abby's business, each paying by check. The next day, the three businesses deposit their checks, which pay back their loans, and the banks' assets and liabilities of $1000 disappear.

Yet for the town, the banks have used $300 in deposits to create $3000 in bank money. It's also made economic activity possible that could be considered a gross town product of $3000, while not a penny of their depositors' money left the bank. When the loans are paid back the $3000 disappears, but the banks can re-create those $3000 by making new loans to enable more economic activity, as long as their deposits aren't reduced.

This is the sunny side of banking. The same process applies when many bank customers spend money in their accounts by using checks that are deposited in other accounts in many other banks, and then cleared through the Federal Reserve System. Banks create money as numbers in accounts when they make loans, payments are made by shifting numbers among different accounts, and the money disappears when the loans are paid back.

It's quite a challenge to apply this simple illustration to the complexity and confusion of the huge financial system. (For more explanation about how our money supply is created by debt to the private banking system, and the problems described below that this creates, see www.ourmoneyus.org. or www.publicbankinginstitute.org. }

Bank lending finances almost everything, from home mortgages to store inventories, to the financial markets. For simplicity, the reserve requirement in the illustration is 10%, but it varies, and for large banks it can be less than 5%. That's why the banking system can create more than 95% of our currency.

However, this simple example ignores two major features of bank lending that relate to the accelerating concentration of wealth, the banking system's discriminatory lending, and its continuing investment in fossil fuels. We hope you will understand this as an urgent invitation to learn more, in order to examine the pros and cons of various proposals for real financial reform.

The first feature is that banks decide how much to lend, who they lend to, and how much interest they charge, all based on minimizing their risk and maximizing their profit. Thus, while they deny loans to households and small businesses in needy low-income communities, they lend billions to the fossil fuel industries at a time when carbon emissions must be reduced. Furthermore, the banking system does everything it can to keep public policy from interfering with their profit-seeking activities.

The second feature is that banks charge interest. It means that interest is paid to the banking system for almost every dollar there is, which steadily shifts money from everyone else to the financial system. It means that the private banking system systematically disadvantages poorer people and increases the wealth of richer people.

Furthermore, because banks charge interest, they always create more debt than money. This means borrowers must earn more than they borrow just to pay their debts, which helps drive economic growth. It also means the banking system must make more loans this year than last year to create enough money this year to pay last year's debt. Thus the economy must keep growing to support the debt-based money supply, and the amount of debt must keep growing, or there won't be enough money to pay all the debts that are owed.

Because a debt-based money supply creates an economy that must keep growing to keep going, it also makes the entire financial system inherently unstable. Sooner or later, for many possible reasons, banks won't increase their lending, or businesses won't increase their borrowing, which means the money supply will stop growing, and will probably contract. When this happens, economic activity is reduced, many borrowers become poorer, and some will go bankrupt, which leads to a recession or worse.

Responsibly managed community banks have had and can have a major role in the economic development of our communities and nation. But banking deregulation since the 1980s, ostensibly to promote economic growth, has increased profit-seeking with little regard for the common good, and resulted in many fewer and much larger banks, with no loyalty to people or place. This has intensified the concentration of wealth, which feeds on itself, drives indiscriminate growth of the financial system and stagnation in the real economy, and contributes to our inability to deal with the crises we face.

The role of the Federal Reserve

Not only are we led to think that our money is created by the government. We're also led to think that the Federal Reserve is a government agency. But just as the federal government lets the banking system create our money supply, it established the Fed, as it's commonly known, to be the central bank of the private banking system, to manage and serve the nation's for-profit banks in order to promote growth and prevent inflation.

How does the Fed serve the banking system? Every bank is required to maintain some of its legally required reserve funds in its account with the federal reserve bank for its region. This enables the Fed to "clear" checks every day by moving numbers between the banks' accounts with the Fed.

When checks are cleared, transfers out to other banks are largely offset by transfers in from other banks. The Fed makes loans to banks as needed to maintain their account balances and reserve requirements. The Fed also provides banks with the Federal Reserve Notes they need to convert numbers in accounts to cash on demand, and debits their accounts accordingly. All this is what enables banks, with so little cash in their possession, to create so much bank money, simply by adding numbers to borrowers' accounts.

The Fed tries to manage the money supply either by lowering the interest rate it charges banks to increase their lending, or by raising the rate to reduce their lending. It can also increase the money supply of the banks by buying government debt from the banks, or decrease the money supply by selling government debt to the banks at a favorable rate of interest. But in the current system, the Fed's only way to manage the money supply is by trying to influence what the banks choose to do. This doesn't always succeed.

During the financial crisis of 2008, the Fed tried to get the banks to increase their lending in order to provide more money to support more jobs in the real economy. It did this by a process it called "quantitative easing," buying financial assets of dubious value from the large banks to increase the amount of money in the banking system. (As is widely understood, in our current economic crisis with so much unemployment, the federal government must give people enough money to buy what they need just to keep the economy going.) But instead of increased lending in the real economy, many banks increased lending in the financial economy and/or bought shares of their own stock, which increased its value in the financial markets, thereby benefiting the remaining stockholders, including the banks' executives who receive stock as bonuses. This is why it took so long for the economy, i.e., economic activity, to recover from the recession. It's also why, as we're seeing now, its possible for financial markets to be booming while the real economy is in such dire straits.

The legally specified purpose of the Fed is to promote full employment without creating too much inflation. The experiences of recently years have made it increasingly evident, even to those with responsibility for managing the banking system, that the Fed's capabilities are no longer able to make the private banking system serve the public interest when this does not maximize the financial benefits to their stockholders and executives.

What is public banking? How can it help address the crises of climate, racism, and wealth concentration?

Public banks are owned by a government, and can take several forms. One is a depository bank that provides banking services for individual customers, small businesses, and others. They are somewhat like a credit union because they don't exist to maximize profit. The US had a postal savings system from 1911 to 1967. Germany and a number of other nations have postal depository banks now. They make banking services more widely available, especially to rural and low-income individuals and households. In September of 2020, Senators Killibrand and Sanders re-introduced their 2018 Postal Banking Act, which would make affordable banking services available in low-income and rural communities that are otherwise exploited by sub-prime lending, check-cashing agencies, and payday loan sharks. It would also provide additional revenue to help strengthen US Postal Service.

A second form is a state or municipal public bank that receives the government's funds as deposits and uses them as reserves to lend community depository banks and credit unions, enabling them to lend more at lower interest to their region's people and communities. North Dakota has had a public bank since 1919 that has enabled the state's economy to prosper, and minimized the effects of economic turbulence and hardship from natural disasters. It's currently the only public bank in the US, though there are more than 600 world-wide.

BND provides banking services and loans to the state and its governments' agencies, and provides low interest student loans to college and university students. But it has no branch offices or ATMs, and does not compete with North Dakota's private banks. Rather, it makes low interest loans to enable local private banks to provide larger loans at lower interest to businesses and non-profits for purposes that serve its mission. And BND has been typically more profitable for the state than Wall Street and other for profit banks are for their stockholders.

Fractional reserve banking enables a public bank, like the Bank of North Dakota, to fund many more investments for public purposes than a government could do through its operating budget. This kind of public bank is being advanced in several states including New Jersey, and many municipalities including Philadelphia. In October 2019, California enacted legislation that provides a framework for its county and municipal governments to establish their own public banks. And in April, 2020, an article in the Hill, the weekly newsletter for members of Congress and their staff, asserted that states and municipalities may be forced to establish public banks in order to finance their costs of COVID-19 and then of the climate crisis. It's quite telling that the Hill was willing to publish this article, and quite disturbing that Congress has been unwilling to provide the state and local governments with the financial assistance they desperately need that they must otherwise borrow from the for-profit banks.

The movement to promote public banking in and within states is gaining. But the unfortunate reality is that it would currently take a state quite some time to establish a public bank, and even longer for a county or municipality, except in California. Enabling the Fed to provide quantitative easing to states during a crisis would take virtually no time at all if Congress passed and the President signed legislation to allow it.

A third kind of public financial institution is a public investment bank. A government can establish an independent agency that is able to sell bonds and then use the fractional reserve system to provide loans to finance public investment in a large number of projects without increasing the government's budget or its debt. The income and/or benefits from the projects are then used to repay the loans.

These agencies can exist at many levels, but the largest by far was the Reconstruction Finance Corporation, commonly known as the RFC. Established in 1932 by the Hoover Administration to aid failing banks, the RFC was then used by the Roosevelt Administration to provide billions of dollars for financing many New Deal projects and a whole lot of WW II military production. The RFC was terminated in the 1950s, but the nation continues to benefit from projects it funded like the Tennessee Valley Authority, and its spin-offs like the Small Business Administration.

In March of 2020, a bill was introduced in the House to establish a national Infrastructure bank that would be a 21st century version of the Reconstruction Finance Corporation. Though the whole idea is undoubtedly an anathema to the private banking system, the needs for public investments, and the means to finance them, to deal with the many crises we face may make it more likely than other financial reform bills to gain some traction on Capitol Hill.

Then in October 2020, Representatives Tlaib and Ocasio-Cortez introduced a Public Banking Act that would provide affordable banking services in low income and rural communities. But it would also direct the Treasury and Federal Reserve to enable state and municipal governments to charter their own public banks with the Fed and become part of the Federal Reserve System.

The Public Banking Act would enable public banks to fund public investment in a comparable way that private banks fund private investment, yet without charging interest at commercial rates of private banks. Furthermore, in times of crisis the Fed, through quantitative easing with public banks, would be able to provide financial aid to governments of and within states. Though neither of these bills will become law in the near term, and many people have never heard of public banking, they will bring public banking to the attention policy-makers in DC.

Public banking may be essential to help finance the massive costs of transitioning to a low carbon economy. For examples, a Philadelphia Public Bank could help finance the costs of turning the city's lower income neighborhoods into models of energy conserving communities. A federal green investment bank could help finance a nation-wide system of decentralized, renewably generated electricity, and a nation-wide food production and distribution system based on regenerative agriculture and low carbon technologies.

However, these forms of public banking all function within the framework of our nation's private banking system. Our money supply will continue to be created by interest-bearing debt, and our economy's stability will continue to require increasing indebtedness and growth. It will not prevent the private banking system's outsized investments in ecologically destructive industries, the increasing concentration of wealth and erosion of civic values, or the financial system's self-serving influence at all levels of decision-making in our nation and world.

The growth dilemma, and real financial reform.

Economic growth is necessary for our current financial system to function, so that banks will keep lending and debts can be paid. Most of us don't realize how much the financial system has been changing since the 1980s, ostensibly to promote growth. But increasing debt is how banks make profit, and creating more money by increasing future debt is needed so current debt can be paid. This has led to a steady increase in all kinds of debt: credit-card debt, student loans, mortgage and household debt, business, corporate, and government debt, all of which contributes to the accelerating concentration of wealth.

In our immediate circumstances, there is good growth and bad growth. A lot of good growth will be needed to transition to a low carbon economy. Yet in our current system, making money has little to do with what's good and what's bad, and most economic growth is indiscriminate. It does not differentiate what is ecologically and socially restorative from what is ecologically and socially destructive, or between what people truly need and what they want because of needs that have been created for us. It's also becoming clear that we must increasingly rely on the ability of renewable resources to renew themselves. What may seem to be good growth becomes bad growth if it undermines the regenerative capacities of our renewable resources.

As long ago as the 1960s, the prominent Quaker economist Kenneth Boulding pointed out that for humanity, earth was becoming like a spaceship in the sense that our civilizations have already "filled the earth." He anticipated that most of earth's physical resources would become more costly to extract and exploit, and there already was no longer an "away" on our spaceship to throw the garbage and trash we want to get rid of without consequences, especially if it causes pollution. While he was a strong advocate for the importance of markets, he also asserted that market mechanisms had to be invented to protect the resources that are essential for living systems, and to promote conservation and frugality, rather than driving consumption and growth.

Some years later he famously chided his academic colleagues by saying "the only people who think that infinite growth is possible on a finite planet are madmen and economists." Yet we all still live, and seem to be trapped, in a financial system based on money created by debt, that must keep growing to sustain itself. A sustainable economic system will require a debt-free monetary system that can function without creating ever more debt.

The climate crisis is only the most immediate example of the many ways humanity has already exceeded the limits to growth. Until we change the way money is created by our current financial system, things will only get worse. We think that the growing movement in support of public banking may provide an opening for our society to begin to change course.

Real financial reform, at a minimum, must change the monetary system so it does not drive indiscriminate growth, exploitive indebtedness, wealth concentration, political corruption, and ecological disintegration. In our view, real financial reform would make the Fed an independent monetary authority within the Treasury.

The Fed would issue the nation's money through the Treasury without creating debt, and would increase or decrease the money supply directly, according to the needs of the economy as a whole. The Fed would also be able to finance public investment by buying government debt directly from the Treasury, rather than only through the private banking system as is now the case.

This may seem like a totally new idea. Most Friends have never heard of the idea, and many don't realize that the banking system lends money it creates rather than the money of its depositors. Only a few favor it and there are others who think it's dangerous. But these are dangerous times, so we hope you'll be open to considering the idea, and hopefully to learning more about it.

The Chicago Plan and the Canadian experience

Most people, including many economists, don't know that a proposal for this kind of monetary reform was developed in1933 by a group of the nation's leading economists from the University of Chicago. They knew the

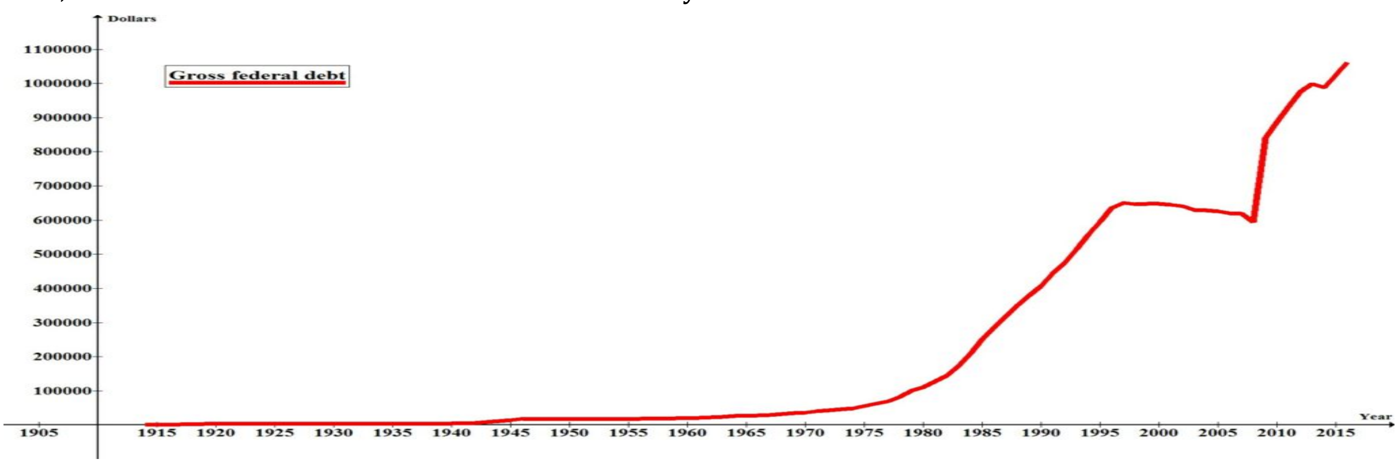
Federal Reserve System had been designed by Wall St bankers to benefit the private banking system. As one of them put it, the purpose of the Chicago Plan was "to enable capitalism to survive."

A bill that became the Banking Act of 1935 was introduced in the House in 1934. It would have made the Fed able to issue money through the Treasury, to buy government debt directly from the Treasury, and to increase the banks' reserve requirement over time.

But in the Senate, amendments were added to prevent the Fed from lending directly to the Treasury, and to limit the Fed's ability to raise the reserve requirement. Thus the Banking Act of 1935 preserved the Fed as an extension of the private banking system rather than enabling it to begin functioning as a public central bank.

In 1938, there was a renewed effort to promote the Chicago Plan by Irving Fisher, who was widely viewed then as the nation's pre-eminent economist. Fisher was supported more than 400 of his colleagues. But by that time, President Roosevelt had become absorbed with the threat posed by Hitler's Germany, and was unwilling to alienate Wall St bankers by considering it.

Yet that same year the government of Canada made the Bank of Canada a public central bank. Canadian banks continued to use the fractional reserve system. But Canada's governments were able to use the Bank of Canada for financing many of their costs during World Ward II, and many post-war internal improvements, while accumulating very little national debt. These included the Trans-Canada Highway, the St Lawrence Seaway, and much of the infrastructure for Canada's healthcare and educational systems. But in 1974, under pressure from its financial sector and global financial interests, that cynically blamed the Bank of Canada for inflation caused by a quadrupling of oil prices, the government started borrowing through the private banking system again. Since that time, Canada's national debt has increased dramatically.



Furthermore, the Basil Committee of the Bank for International Settlements was formed in 1974. It consists of leaders of the banking systems in the US, UK, the major European economies, and also Canada. Like the Fed, the Basil Committee has become an extension of the global private banking system. Though the reason for the Canadian government's decision is obscure, I suspect the privatization of its finances was in some way related to Canada's participation in the Basil Committee.

Renewed interest in making the Fed a public central bank

Beginning in the 1990s, there was renewed interest in monetary reform akin to the Chicago Plan, in both the US and UK. This was largely in response to the effects of banking deregulation and the huge growth of the financial economy compared with the real economy. A monetary reform bill was introduced in 2011 by Rep. Dennis Kucinich and one co-sponsor, but promptly buried in a committee.

The following year, an International Monetary Fund Working Paper by two of its economists analyzed the Chicago Plan in relation to today's economy. Their study affirmed the advantages identified by the original Plan's authors: increased control of market fluctuations, increased stability of the banking system and money supply, a major reduction of public debt and the potential to significantly reduce private debt.

This kind of reform would gradually increase the private banks' reserve requirement to 100%, thus ending fractional reserve banking. Private banks would still function independently and for profit as they do now, providing banking services and making loans to households and businesses. But they would only lend the money their customers deposit with them, which is what most people think banks do now. Local banks would become a channel for the Fed, through its regional reserve banks, to promote good growth in their communities, and thus in the nation, as the Bank of North Dakota does now, through banks and credit unions, for the state and people of North Dakota.

It goes without saying that a great many details would have to be worked out to make the Fed a public central bank, but the basic outlines are clear. And it would be far more disruptive of "business as usual" than it would have been in the 1970s, prior to the deregulation and technological developments which created a financial economy that dwarfs the real economy. This is because the banking system would no longer be able to fund the speculation in derivative "products" that dominate the constructs and activities of the financial economy. Yet shrinking the size of the financial economy will be just as essential as transitioning to a currency that is not based on interest-bearing debt, in order to create a real economy that no longer drives indiscriminate growth and the accelerating concentration of wealth.

We're told that governments, i.e., politicians, cannot be trusted with the money supply. Yet the Fed as a public central bank would be just as independent as it is now. Moreover, it's become abundantly clear that power has become at least as corrupting of finance as it is of politics. The Fed as a public central bank would be far more able to prevent the kind of irresponsible and illegal conduct that's occurred in the private banking system. The private banking system has caused so much pain and suffering. It should instead be helping the real economy provide the goods and services that people need. Something must change!

Of course this will not happen as long as the current financial system remains in the driver's seat of our economics, politics, and propaganda. But as has sometimes been said, if things can't keep on going the way they are headed, they probably won't. Sooner or later the financial system will fail again, or the political climate will change, which may open the way for possibilities that currently don't seem to exist.

What can be done to increase the possibility that if a political opening occurs, the right people with the right ideas will be in the right place at the right time? If that is our goal, we can hope that our current predicament may have a positive outcome.

For references and more information

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