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The 1930s Chicago Plan and the 2005 American Monetary Act by Stephen Zarlenga, AMI Monetary Reform Conference, Chicago, October, 2005

(Notes: CP refers to *Chicago Plan* by Ronnie J. Phillips; EP refers to *Economic Policy for a Free Society* by Henry Simons)

Why is monetary reform so critically important?

Because the money power has more impact on citizens day to day lives than the Executive, Legislative and Judicial branches. It's really a fourth branch of government, and leaving it in private hands is dangerous and unacceptable – it negates the balancing of powers principle of our constitution and creates an aristocracy – a plutocracy – the rule by wealth.

A privately controlled money system can nullify hard-won reforms in other areas such as the environment, medical care, or peace initiatives because such concentration of wealth and power will eventually overwhelm and be used against the people to unwind whatever other gains we've achieved. Witness the attack on Roosevelt's social security reform. You can't secure real progress with the private control of society's money system behind your lines.

What does monetary reform really mean?

It means establishing a fair system that doesn't give special privileges to some and disadvantage to others – that doesn't concentrate wealth and power. It means helping the society create values for living well.

You are welcome to receive a draft of the latest version of the American Monetary Act. Comments are invited. If you think someone should see it, please ask me to forward a copy. We're seeking commitment to this now – we're writing what it would take to legally implement the three-part reform in Chapter 24 of *The Lost Science of Money* by Stephen Zarlenga (abbreviated as LSM hereon).

It's vitally important to be ready with a workable plan – **when not if** – the next financial meltdown occurs. No one knows when that will be, since there's tremendous power in the control over a money system, but warning signs have been there for years. It could be triggered by a couple of bad hurricanes!

The American Monetary Act is part of a long reform tradition going back to the Chicago Plan of the Great Depression (and that plan was close to one advanced independently by the great scientist Frederick Soddy in Britain in 1926).

Let's start in December 1932:

It's been only 20 years since the Federal Reserve was created by America's banking 'elite' (see LSM, Ch. 19). But in those brief 20 years, the Fed brought America to its knees:

- * Farms were wrecked with huge debt and falling land prices.
- * Factories were closed.
- * Exchanges were destroyed.
- * Banks were closing.
- * The economy collapsed – people couldn't find work and many were hungry.

From 1929 to 1932:

- * National income dropped 52%.
- * Industrial production fell 47%.
- * Wholesale prices fell 32%.
- * The real value of debt rose 140%.
- * Unemployment rose 329% from 3.5 to 15 million people, over a quarter of our workforce was unemployed.

All that destruction in less than 20 years!!

In that horrendous climate, many economists were aware that the banking system caused the problem and major changes were needed. One fear of bankers and economists was that all the banks would simply be nationalized, because People were angry. They feared violent revolution might be sparked.

In this atmosphere, the best economic minds in the country devised a reform plan:

Henry Simons from the University of Chicago created the proposal and prominent economists from other universities joined him in what became known as the “**Chicago Plan.**”

Economists like Paul Douglas of the University of Chicago; Frank Graham and Charles Whittlesey of Princeton; Irving Fisher of Yale; Earl Hamilton of Duke; and Wilford King of NYU, to name a few.

One version was sent to all the academic economists – about a thousand in total. Of those responding, 235 from 157 universities agreed with the proposal; another 40 approved it with reservations; and only 45 disapproved. So the plan had broad professional support.

Variants of the Chicago Plan usually started by condemning the banking structure as foolish and harmful: “If the purpose of money and credit were to discourage the exchange of goods and services, to destroy periodically the wealth produced, to frustrate and trip those who save, our present monetary system (does that) most effectively!”

They dispensed with the gold standard as not a real standard, because the value of gold had changed violently up and down against commodities. From 1914 to 1917 wholesale prices rose 65% and then increased another 55% to May 1920, so gold coins lost over 75% of their value against wholesale prices in the Fed's first six years. Then, by June 1921, wholesale prices fell 56% against gold. “Hard money” advocates who believe that gold money has been stable should study these facts.

One version of the plan quoted Roosevelt's referring to gold as an “old fetish of so-called international bankers.”

The main features of the Chicago Plan:

First: Only the U.S. Government would create money. The Federal Reserve banks would be nationalized, but not the individual member banks. The power to create money was to be removed from private banks by abolishing fractional reserves – the mechanism through which the banking system creates money. So the plan called for 100% reserves on checking accounts, which simply meant banks would be warehousing and transferring the money and charging fees for their services.

Second: The Plan separated the loan-making function, which can belong in private banks, from the money-creation function, which belongs in government. Lending was still to be a private banking function, but lending deposited long-term savings money, not created credits. In this way, they'd restrict an unstable practice known as borrowing short and lending long – making long term loans with short term deposits. Some variations proposed this be done through mutual fund-like mechanisms, or by chartering entirely new types of banks.

Third: The proposal recognized the distinction between money and credit, which had been confused through fractional reserves and what was called the “real bills doctrine.” The confusion was seen as one of the causes of the depression, because when businesses reduced their borrowings on commercial bills, which occurs during any downturn, parts of the money supply had been automatically liquidated. The Chicago Plan saw the instability of this – that it aggravates a downturn.

**Simons made this grand observation of the problem, which still afflicts us today:
“The mistake ... lies in fearing money and trusting debt.”**

And: “Money itself is highly amenable to democratic, legislative control, for no community wants a markedly appreciating or depreciating currency ... but money is not easily manageable alongside a mass of private debt and private near-moneys ... or alongside a mountain of public debt.” (EP, p. 199)

Some variations of the plan had the U.S. Government lending banks all or part of newly printed cash needed to achieve 100% reserves. This was a crucial part of the plan, because depositors were going to the banks and withdrawing their accounts, deflating the system.

This loaning of reserves feature also elegantly converted all the previously monetized bank credits into real U.S. money, on which the banks paid interest to our government. It *post facto* made them intermediaries, earning some reasonable spread for their loaning work.

The best economic minds supported the Chicago Plan:

Paul Douglas wrote: “This proposal will of course be opposed by the bankers from whom it takes the lucrative privilege of creating purchasing power. It would however insure the safety of deposits, give large revenues to the government, provide complete social control over monetary matters and prevent abnormal fluctuations in the capital market. At the same time it would permit the allocation of productive resources...to remain primarily in private hands. All in all it seems the most promising program for the reform of our monetary and credit system...” (CP, p.141)

Frank Graham wrote it was self evident that the right of issuing money belongs in government, and that the banks seigniorage profits were a kind of tax on the community: “This privilege that the banks enjoy is in no way essential to the lending process.”

Marinner Eccles, who became Fed Chairman under Roosevelt, testified that the best course would be for the government to nationalize the Federal Reserve banks.

Congressman Jerry Voorhis made the case for 100% reserves and putting money into circulation by paying pensions and disabled persons. As late as 1945, Voorhis introduced legislation for a U.S. Monetary Authority as our sole creator of money. (CP, p.162)

James Angell, who disagreed with parts of it, still wrote that “it would go far toward making economic activity reasonably stable” (CP, p. 144)

Maurice Allais, the great French economist, backed the plan and published a book on it in 1948.

Irving Fisher of Yale wrote on it extensively and popularly well into the 1940s.

The young Milton Friedman was the best known advocate for the Chicago Plan in the postwar period, writing: “Henry Simons held the view...which I share - that the creation of fiat currency should be a government monopoly.” Friedman testified on this before Congress as late as 1975 and in 1985 wrote: “I have not given up advocacy of one-hundred percent reserves.” Friedman thought the transition to 100% reserves would not be difficult – “say 25% a year from now, 50% two years from now, etc.” (CP, p. 173, 181)

But turning the Chicago Plan into law proved elusive. When University of Chicago’s Chancellor Maynard Hutchins sent a copy of the plan to Senator Bronson Cutting in December 1933, Cutting asked him to draft a bill. Four months later he telegraphed Hutchins asking where it was, and Simons went to present the essentials of the plan to Cutting, who introduced it in the Senate on June 6th, 1934 (S. 3744). Wright Patman introduced it in the House (H.R. 9855).

The bill required 100% reserves on checking accounts, which it separated from savings accounts (which had to keep 5% reserves). It set up a Federal Monetary Authority to control the supply of currency and the buying and selling of government securities.

The American Monetary Act, a three-part reform to bring our money system under proper public control, agrees in its main features with the Chicago Plan:

First: It incorporates the Federal Reserve banks into the U.S. Treasury, where money will be created by the government as money, not as private interest-bearing debt; and will be spent into circulation to promote the general welfare, and be monitored to be neither inflationary nor deflationary.

Second: It removes the banks privilege to create purchasing media through the fractional reserve system. Fractional reserves are elegantly ended by the U.S. Government initially loaning banks enough money at interest to bring reserves to 100%, converting all the past monetized credit into U.S. government money. (Note: This feature is altered significantly in the latest version, where the banks automatically owe the U.S. Treasury the amount of their credit that has been turned into money.) Banks then act as intermediaries: accepting deposits and loaning them out to borrowers – what people think they do now.

Third: It Spends newly-created money into circulation on infrastructure, including education and health care needed for a growing society, starting with the \$2.2 trillion that the American Society of Civil Engineers estimate is needed for infrastructure repair, over the next 5 years; creating good jobs across our nation, re-invigorating local economies and re-funding all levels of government.

The false specter of inflation is always raised against such suggestions that our government fulfill its responsibility to furnish the nation’s money supply. But that knee-jerk reaction is the result of decades, even centuries, of propaganda against government. When one actually examines the monetary record, as *The Lost Science of Money* does, it becomes clear that government has a far superior record issuing and controlling money than bankers have.

So both plans envision taking over the Federal Reserve System and regional Federal Reserve banks. Both separate the money-creation and money-lending functions; placing the money-creation function in government and leaving the money-lending function in banks. Both set up national monetary authorities to control the money supply.

One difference between the plans is their greater awe of the “free market.” But the empirical nourishment we’ve received since they wrote calls for greater care in defining what’s meant by “free market” terminology. They strongly supported free markets, but their definition differed from the present conception.

For example, Henry Simons thought only stiff governmental regulation could create free market conditions. He wrote: “The presentation of *laissez faire* as a do nothing policy is misleading...it’s an obvious responsibility of the state...to maintain the legal and institutional framework within which competition can function effectively...the state (must have)...heavy responsibilities and large control functions” (EP, p.42-43)

Like the great 19th century reformer Henry George, Simons strongly believed that companies like railroads and utilities should all be government owned: “The state should face the necessity of actually taking over, owning and managing directly both the railroads and the utilities, and all other industries in which it is impossible to maintain effectively competitive conditions.”(EP, p. 50-51)

Greater attention to defining “free markets” might have avoided their current degeneration into mere forms of kleptocracy, falsely promoted under the banner of freedom. Better yet, instead of misusing the term *free*, the word *fair* is what people really have mind. Some groups equated free markets with no governmental regulation – just the opposite of what’s needed to have real “free markets.” Another difference was their preference for an automatic system with little discretion. We are not so worried about that.

The American Monetary Act goes beyond the Chicago plan in some important improvements derived from the lessons of history – experience with the Bank of England’s nationalization in 1946, and our American experience of the past 50 years:

First: The Act proposes that infrastructure expenditures, including education and health care and farming parity programs, be used as mechanisms to get newly created money spent into circulation to promote the general welfare. We’ve observed that the privately controlled money system can’t or won’t make the necessary infrastructure expenditures.

Second: The Act introduces considerations of fairness, sustainability, sound environmental practice and social cohesion as values in monetary decision making. In other words **moral considerations** are explicitly considered. I wish we were the first to do this, but Article Two of the treaty protocols establishing the European System of Central Banks and the Euro beat us to it, and it’s already operational in the Euro system. That Euro provision is quoted in Chapter 23 of the *The Lost Science of Money* book: “To promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.” (However, it says this is to be done “without prejudice to the objective of price stability,” by which they mean less than 2% inflation.)

Third: The Act places more reasonable nationwide legal limits on the charging of interest, with an 8% cap – about what it was under most state laws until 1980/81. It’s obscene that people are being forced to pay over 30% p.a. interest.

Friends have told us that economists and bankers will strongly object to that, and to other parts of this proposal. But we didn’t expect them as allies in this fight – a fight we didn’t start, but are involuntary participants in. Remember billionaire speculator Warren Buffet’s warning remark: “If there is class war in the United States, my class is winning.”

He was being facetious – Buffet would never describe the purposeful destruction of our most vulnerable fellow citizens and their children, by the ‘most clever’, as “winning!” He’d probably join me in calling it cannibalism and agree that indigestion and worse is coming.

But finally, let's remember that Warren Buffet's role as a speculator is largely negative and certainly less creative economically than the average bricklayer.

Why didn't the Chicago Plan pass?

First: There was no understanding or support for the proposal among the electorate. Only Irving Fisher seems to have understood the necessity for popularizing the matter. Simons himself got cold feet and shied away from promoting the plan, desiring to remain on a level of professorial discussion. He even threw a wet towel on Fisher, who was promoting the reform, suggesting that Fisher avoid popularizing the idea! Simons was demanding perfection from his own proposal and was being overly cautious. The proper goal was not perfection, but should have simply been the substantial improvement that the Chicago Plan clearly represented over the existing system. Instead, Simons became obsessed with how banks would evade the reforms.

Second: The Plan was mishandled politically. Senator Cutting appears to have misunderstood his own bill, and incorrectly said in interviews that credit as well as money creation was also to be a sole function of government.

Third: The bill suffered a major setback when Cutting died in an airplane crash in May, 1935, while being forced to defend his election results in New Mexico by challenges from the Roosevelt Administration, which was then held responsible for his death.

The last attempt at 100% reserves was when Senator Nye of North Dakota tried to place it in part of the Administration's 1935 banking reform legislation, but his amendment was defeated.

The FDR administration had its own banking reform bill and remained ambiguous on the Chicago Plan, never commenting on it even though the political climate and professional support for the plan was sufficient to get it passed, had they made some effort. Instead, his Treasury Secretary Morgenthau was trying to make minor adjustments without fundamentally challenging the banking system.

The brilliant economist Lauchlin Currie had taken up the fight for hundred percent reserves from within the administration. Currie pointed out that economists had not really agreed on the nature of money and focused his attention to defining what is money in our system. But he made 2 political errors:

First, he thought he could "sneak" 100% reserves through in the administration's 1935 banking legislation with a provision giving the Fed the power to raise reserves. He thought "we'll just get them raised to 100%." But Senator Carter Glass, representing banker interests, easily blocked this by putting in a provision in the conference committee limiting the reserve requirement to double what they were at that time, which was about 15%.

Second, Currie made the error of compromising in advance, writing: "An advisor in Washington is of limited usefulness unless he acquires some sense of what is feasible and how projects and policies should be presented to have the best chance of being adopted." (CP, p.128)

I completely disagree regarding this type of reform. Promoting the reform in terms of *morality* rather than mechanics and economics is the better approach. The only time that such major reforms become possible are when either enough people are educated on the matter, or during a crisis, when no-one cares what the economists and bankers want, and then compromise is both unnecessary and counterproductive.

Remember, we are promoting a reform that would be good for over 99% of the population. It is only deception that blocks it, and one need not compromise with deception. Perhaps if it had been more clearly stated, in terms of ending that special banker's privilege rather than solely in terms of technical considerations, there would have been greater public understanding and support.

We have to learn from the mistakes these fellows made.

Can we learn from what John Maynard Keynes was doing during all this?

He was squarely behind the bankers and against such real reform. Yet he knew that he had to break out of orthodox economics or the whole system was in danger of being overturned. Keynesianism was a way to allow banks not government to keep control over the money-creation process, and while the more narrow-minded economists fought Roosevelt's attempts to create money and jobs as inflationary, during the nation's worst deflation, Keynes knew better.

Keynes approach was direct to the public:

The New York Times, in December, 1933, working with Felix Frankfurter (who later became a Supreme Court Justice), got Keynes to write an open letter to Roosevelt, which they published. Keynes wisely advised Roosevelt that: "Only the expenditures of public authority" could turn the tide of depression. Well, that was obvious enough!

However, Keynes inappropriately warned Roosevelt not to create the money for this, but only to borrow it, and wrongly advised him that there was already enough money in circulation, and that: "increasing the quantity of money...is like trying to get fat by buying a larger belt."

Several times his letter attempted to influence Roosevelt to drop his program of necessary reforms, and to concentrate on short range actions: "...even wise and necessary reform may, in some respects impede recovery...N.I.R.A. [National Industrial Recovery Act of June, 1933] which is essentially reform and impedes recovery..." (see LSM, Ch. 20)

Keynes was therefore not "revolutionary" except in relation to the utter backwardness of the financial establishment. He didn't come close to a real solution, but essentially protected his class.

The real question has always been whether the nation's money should be created under law, by government, or under the private caprice of bankers.

What were the Austrian economists up to?

Friedrich Hayek was arguing against national currencies – arguing for an international control over all economies through the gold system, incredibly writing: "There is no rational basis for the separate regulation of the quantity of money in a national area that remains part of a wider economic system;" arguing that independent national currencies cannot insulate a country from foreign shocks; and that fluctuating exchange rates would be bad.

Hayek tried to twist 100% reserves to covering them 100% with gold – a deflationist. This is the position supporting the creditors and usury and plutocracy; the normal outcome of Austrian economics. They talk a freedom game, but promote serfdom. Psychologically, they remind me of those middle ages cults that used to whip their own backs with chains.

Always remember, had we followed the ideas of the Austrian School, there would have never been a United States of America. If we follow their ideas now, there will soon not be a United States of America. Unfortunately, the present administration has made this seem like a worthy goal to many of the world's oppressed peoples.

Roosevelt's 1935 bank legislation, though an improvement over what had existed, wasn't considered the final word in banking reform – additional laws were expected. Over and over we see the better economists calling for

an end to fractional reserves – ending the bankers’ privilege to create money. Such was the effect of the horrendous experience with banking.

Most of the efforts to enact Chicago Plan reforms ended with World War II, as the country went onto a war footing.

How the American Monetary Act can get enacted into law

From the experience with the Chicago Plan we learn the importance of:

First – having an informed body of people among the electorate to promote and intelligently echo such proposals in their own cities, in meetings, with lawmakers and with media.

Second – being ready with an intelligently thought out program.

Third – staying on message and not shying away from the politics of it.

Fourth – not being afraid of not having all the answers. Some of it requires Aristotle’s method: we learn by doing – but we learn.

Fifth – not compromising in advance, or trying to sneak through important provisions.

The great reformer Henry George wrote in the late 1890s that there are many ways to argue the principles of political economy, but his preference was to examine it from a moral viewpoint. This is one reason we are still reading and hearing about Henry George today.

This is one of the best ways to proceed today – showing the unfairness – that is the immorality – of granting special privileges within our society. Who is going to dare argue for special treatment in principle? For what justification? There is none. Their position is untenable. Their focus on mechanics and ill-defined, and therefore confusing, concepts can be viewed as a diversion. They are happy to argue over those things forever, so long as they are holding the special privilege – the money power – in the meantime.

In terms of facts, the under-funding of American infrastructure by \$2.2 trillion remains an unanswerable indictment of our present money system. It has been unable or unwilling to fulfill this crucial responsibility. It must be cast aside. It is a danger and an insult to our country, and to humanity – even to the planet earth.

Back in the 1930s there was the thought that the Chicago Plan represented an ideal system of control, and as such represented a goal for future evolution.

Well folks, the AMI is presenting the American Monetary Act as that future evolution.

Thank you.

Special note: Attached are the Chicago Plan bills introduced in Congress in June 1934; H. R. 9855 in the House, and in the Senate S. 3744. Please copy them here at the end of the essay (or copy the Senate bill – they are exactly the same, except a page is missing from the House bill).