Citizens' Guide to Monetary Policy

Produced by Utahns for Liberty!

History of Money and Banks in General

Economies. People living alone must provide themselves with everything that they want. But, as people live together, they tend to specialize in producing certain goods and/or services—and to exchange these with each other. Thereby, each person becomes less self-sufficient but more prosperous on average. *Thus developed professions and trade and economies.*

Money & Coins. Trade is a contractual exchange of goods and/or services. Its simplest form is barter—one simple swap that gives each party what he/she wants. Barter is possible only if each party has something wanted by the other. If not, then a series of trades may be needed to satisfy all parties involved—for example, if you have apples but want oranges, and if your neighbor has oranges but wants bananas, then you would need to involve at least one additional party in order to trade, such as a third party who has bananas but wants apples. Although barter "chains" like these can easily grow overly complex, people discovered that certain goods (usually not bananas) are especially well-suited as mediums of exchange—and they began to use them as such. *Thus developed money.* In limited places and/or times, objects from shells to grains to cigarettes have served as money; but, usually, rare metals (especially gold and silver) have done so. Such metals have proven remarkably adept at holding their value long-term—for example, one ounce of gold in Roman times could buy a quality toga and belt and sandals, whereas this same ounce of gold in modern times could buy their modern equivalents. Mints, both public and private, developed to produce standardized units of rare-metal money—and to certify their value by stamping them with indicative designs. *Thus developed mints and coins.*

Banks & Notes. Some people found it useful to pay specialists to keep their coins safe in vaults. *Thus developed banks.* Bankers found it useful to print receipts, which they would give to those depositing coins and take from those withdrawing coins. *Thus developed bank notes.* And many people discovered that it was often handier to use bank notes than metal coins in transactions—so, these notes circulated in commerce while most coins remained in bank vaults, whose contents rarely varied much from day to day.

Fractional Reserves. Some dishonest bankers innovated a form of fraud to exploit this fact—while falsely assuring depositors that their coins would be stored safely and could be withdrawn at any time, they actually kept only a small fraction of these coins in reserve and secretly loaned the rest to others at interest. Since many loans were immediately re-deposited, they could even re-loan a single coin multiple times without its owner's knowledge or consent, thereby giving multiple note-holders equal claim to it. In this way, a banker reserving 10% of each deposit and loaning 90%, for example, would generate not one but ten notes for every coin in his/her vault. *Thus developed fractional-reserve banking*, which became standard banking practice. Because such practice generated many times more notes than coins, whenever coin withdrawal rates rose too much higher than average, banks with insufficient reserves would fail in breach of contract due to empty vaults, leaving all of their remaining customers holding worthless notes for coins already claimed by others. *Thus developed bank "runs" and bank failures.*

Central Banks. Some bankers gradually realized that governments could help them to practice fractional-reserve fraud with less risk and/or more profit. So, they began to coax their politicians to charter special banking institutions, insulated from competition, for this end. *Thus developed central banking.* Each central bank has usually served both as its government's bank, providing its government with accounts and loans and other services, and as a bankers' bank, providing its fellow banks with a degree of supervision and regulation, as well as salvaging failing banks via loans and bailouts. In such ways, central banks have tended to socialize bankers' risks, lowering odds of individual bank failures while raising odds of collective bank failure.

Business Cycles. Some governments empowered their central banks to impose uniform reserve rates upon all banks. Such a central bank could then, simply by readjusting this rate, change the total number of notes placed in circulation without changing the total number of coins stored in banks—or, in other words, it could centrally control its nation's money supply. *Thus developed inflation and deflation.* Since money, like every other commodity, is subject to the fundamental economic law of supply-and-demand, doubling its supply of units (if all else remains unchanged) will halve each unit's value and, therefore, double all prices (and vice-versa). But not instantly, since complex economies require time to adjust to such disruptions to their equilibria, booming while overly-low prices rise in response to inflation, and busting while overly-high prices fall in response to deflation. *Thus developed "the business cycle"* of alternating booms and busts, with economic panics and stock-market crashes. Governmental meddling to stop prices from falling naturally has kept some busting economies "depressed" indefinitely.

Fiat Money. Central monetary planners, in macro-managing their economies, generally prefer more boom and lest bust, which requires more inflation than deflation, which is impossible if their paper bank notes remain tethered to rare-metal coins. So, all central banks have eventually divorced notes from coins entirely, maintaining these notes' value solely by government edict. *Thus developed fiat money*—at least, as a central planner's tool. Fiat money's history is actually far older than this; and its performance, unlike that of rare-metal coins, is not spotless but spotty, from the boon of England's tally sticks to the curse of America's "Continentals." It can benefit socialistic politicians by enabling them to maintain both low taxes and high expenditures, since any budget deficits can be alleviated via a limitless supply of new fiat notes. It can also benefit central (fractional-reserve) bankers by replacing a risk of systemic bank failure with fiat money's inherent risk of hyperinflation and collapse. And it can benefit bankers by providing them with great opportunities for profit in a perpetually-overstimulated economy fueled by persistent mild inflation (which, due to imperfect control, is inherently uneven and invariably allows occasional recessions). Such economies suffer long-term from ever-growing malinvestments, though, and harm the public by devaluing savings, discouraging self-sufficiency, encouraging indebtedness and dependency, and thus subtly transferring wealth from people to their bankers.

America's Monetary System: Problems and Solutions

Our government has never prohibited fractional-reserve fraud. And, without any Constitutional power to do so, it created (and abolished) central banks twice before its present Federal Reserve System, which was designed by bankers for bankers in 1910 at a secret meeting on Jekyll Island. Since 1913, it has gradually expanded the Fed's power, including by implementing a fiat dollar that the Fed has slowly inflated, reducing its current value to only a few percent of its initial one. As a result, Americans today have never been deeper in bondage. We should have better heeded warnings from statesmen like Thomas Jefferson, who wrote: "I believe that banking institutions are more dangerous to our liberties than standing armies. Already they have raised up a monied aristocracy that has set the government at defiance. The issuing power should be taken away from the banks and restored to the people to whom it properly belongs."

Our government could restore a proper monetary system by means like: (1) issuing U. S. Notes to repay our national debt while slowly raising bank reserve ratios, such that our money supply remains static—and, once all debt is repaid and all reserves are full, prosecuting any fractional-reserve fraud; (2) defining a fixed amount of gold as a new unit of money, issuing U.S. Treasury Certificates for every such unit of gold in its hoard, and replacing all U.S./Fed Notes with these certificates at an appropriate exchange rate, thereby restoring true money; (3) resuming its mint's public service of minting people's gold into coins for a fee; (4) repealing both legal-tender laws and bank regulations to restore both free-market competition and innovation in these fields; and (5) abolishing the Fed, letting free markets assume the Fed's few remaining functions.

For a more thorough education on these matters, please read G. Edward Griffin's excellent book, *The Creature from Jekyll Island*, which was first published in 1994.