Suppose you were given 100,000 dollars and buried it in your backyard. How much of the purchasing power of your 100,000 dollars would be stolen over the next 24 years by the Federal Reserve System?

Before we can answer this question we must look at the relative institutional setting the dollars are used in to see what affects the purchasing power of the monetary unit. In other words, we must look at the banking system that the dollars are used in. In the United States we have a banking system outfitted by a central bank, the Federal Reserve that uses fractional reserve banking and fiat money. We also need to look at how dollars work in the investment world.

This is how money works in the investment world; one of the tools investment analysts use to roughly and quickly calculate if the investment is worth undertaking or not is the Rule of 72. The Rule of 72 works like this, investors use the rule of 72 to roughly calculate how long it is going to take to get their capital or money to double. The reason this is so important is because investors should be concerned with how fast their investment is going to double in value compared to other investment strategies. The higher the annual rate of return is on a given investment portfolio, the shorter time it takes for the principal to double in a given time frame.

We are going to use the rule of 72 in reverse to figure out how fast it takes inflation to eat half of your money. If we assume an inflation rate of 3 percent, then in 24 years half of the purchasing power of your principal will be eaten up by inflation. In 24 years inflation will have eaten up half of your principal!

Inflation is discouraging to investors. Investors want to invest less and consume more current goods as inflation rates rise, this is because they feel their money is rapidly decreasing
in value and want to own something that is tangible and has value. The consequence of this is individuals’ time preference schedules become short sighted in times of inflation or as the money supply increases. This means people consume today instead of investing for tomorrow. This means capital markets have less capital to work with, which implies technological processes are hampered and discouraged. This means in the long run the rate at which standards of living are increased will be slowed because of the opportunity cost of consuming current goods rather than saving and investing in capital goods.

Saving and investing in capital goods is important because it lowers the cost of labor. It lowers the cost of labor by making individuals more productive via better technologies. Since individuals are more productive, they can now make more money. The individuals who make more money can now save more money. This process lowers the natural rate of interest by giving firms more money to work with in the process of research and development for new and cheaper ways to produce economic goods. This process increases standards of living by lowering the costs of living. Inflation does the opposite, inflation raises interest rates and makes people more present oriented, making them want to spend more today than save for tomorrow.¹ Dr. Hoppe refers to this process as decivilization.

What is inflation? Inflation is defined as an increase in the money supply. This is different than many contemporary definitions of inflation. An example of a contemporary definition of inflation would be something to the effect of: inflation is defined as a general rise in prices. A rise in the money supply is the cause for a general rise in prices. Without inflation (an increase in the money supply), there would be no general rise in prices. A general rise in prices is where the 3 percent of the purchasing power of your dollar went.

What causes inflation? As stated earlier inflation is an increase in the money supply; and who is responsible for the money supply? The Federal Reserve System is. It is the Federal Reserve System who takes the 3 percent of the purchasing power of your dollar each year. They do this through manipulating the money supply for whatever reason they feel is an adequate one. What they aren’t telling you is what they are doing when they increase the money supply is creating the boom and bust cycles they claim they are trying to prevent.

Special interest groups in the banking industry have long manipulated the banking system to their advantage. J.P. Morgan was the first in the early 1900’s to manipulate the United States banking system as we know it today.²

Prices can go up or down two ways. These two ways are the laws of supply and demand. What happens to a commodity when more of it is created holding all other things equal? The price of that commodity is driven down via the laws of supply and demand. When there is an abundant supply of a given commodity people can’t get as much as they could have if there were less of that commodity. People are willing to pay less for something when there is more of it. The converse is also true, if there isn’t a lot of that commodity, sellers can get a higher price for that commodity.

When the supply of money is increased, only one thing can happen, holding all other things equal, the value of money must go down. This is analogous to an increase in the production of wheat or corn or any other good, except with the commodity of money inflation is created. Money is different than other commodities in the sense that one of its main functions is as a medium of exchange. That is the defining characteristic of money, it functions as a medium of exchange. The commodity of money is at the foundation of an exchange-based economy. It is what economic goods and services are exchanged for. This is

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why it is important for the supply of money to be fixed (or as close to fixed as possible) once chosen by the market and this is one of the advantages commodity-backed currencies offers. The commodity chosen has a limited quantity and cannot be made out of thin air like fiat money can. When left to the hands of self-interested men, the money supply will always increase because the men who use the new money first benefit the most from the new creation. This can happen because money has the quality of being non-neutral, meaning the first individuals to use the money use it as a stronger, more potent dollar than those individuals who use it in later trades. Money is not delivered by a helicopter or by mail to everyone and instead is injected into an economic system at particular points and this distorts the purchasing power of the first recipients, who get to use the new money before it loses its purchasing power and the last recipients who reap no benefit of the new money and lose purchasing power. This leads to fluctuations in capital markets that otherwise would not be there, and this misallocates resources.

The United States banking system is based on case law from Great Britain. In the United Kingdom, the bankers organized and came up with a strategy to distinguish between bailment law and a good-faith debt. Rothbard states:\footnote{Rothbard, Case Against the Fed.  Page 42}:

Unfortunately, since bailment law undeveloped in the nineteenth century, the bankers’ counsel were able to swing the judicial decisions their way. The landmark decisions came in Britain in the first half of the nineteenth century, and these decisions were then taken over by the American courts. In the first important case, \textit{Carr v. Carr}, in 1811, the British judge, Sir William Grant, ruled that since the money paid into a bank deposit had been paid generally, and not earmarked in a sealed bag (i.e., as a “specific deposit”) that the transaction had become a loan rather than a bailment. Five years later, in the key follow up case of \textit{Devaynes v. Noble}, one of the counsel argued correctly that “a banker is rather a bailee of his customer’s fund than his debtor,… because the money in…[his] hands rather a deposit than a debt, and may
therefore be instantly demanded and taken up.” But the same Judge Grant again insisted that “money paid into a banker’s becomes immediately a part of his general assets; and he is merely a debtor for the amount.” In the final culminating case, Foley v. hill and Others, decided by the House of Lords in 1848, Lord Cottenham, repeating the reasoning of the previous cases, put it lucidly if astonishingly:

The Money placed in the custody of a banker is, to all intents and purposes, the money of the banker, to do with as he pleases; he is guilty of no breach of trust in employing it; he is not answerable to the principal if he puts it into jeopardy, if he engages in a hazardous speculation; he is not bound to keep it or deal with it as the property of his principal; but he is, of course, answerable for the amount, because he has contracted.

Money is a commodity; it should be treated as a commodity under bailment law. When someone deposits money in a bank, they expect to be able to get it out whenever they want to, they still command the money. The money is just in storage. They did not loan the money to the bank. This is exactly what the bankers in the United Kingdom convinced the legal system, that when someone deposits money at their bank it is not for storage, it is a loan. That is right. Depositors do not command their property anymore because by law it is considered a good-faith loan. Now banks do not have to give deposits back to depositors immediately and can do as they wish with the depositors’ money. When depositors demand their money and the bank does not have the commodity backing the notes issued, the bank can plea with its customers that it is in a financial crisis and will have to give the money back to its depositors at some later date that is more convenient for the bank. A tool of the free market used to keep bankers honest to their costumers is now lost. Banks can now dilute their notes and issue receipts for money that isn’t even in existence. After this ruling in England by Lord Cottenham in 1848, customers or depositors have no legal recourse against the crossbred
depository and lending institution There is no way to keep the banks’ incentives aligned with the depositors’ incentives. Depositors are at the mercy of fractional-reserve banks.

This passage from Rothbard explains why the Federal Reserve (the U.S. Central Bank) is an effective cartelizing agent.

The Peel Act system insured that the Central Bank could act as a cartelizing device, and in particular to make sure that the severe free-market limits on the expansion of any one bank could be circumvented. In a free market, as we remember, if a Rothbard Bank expanded notes or deposit by itself, these warehouse receipts would quickly fall into the hands of clients of other banks, and these people or their banks would demand redemption of Rothbard warehouse receipts in gold. And since the whole point of fractional-reserve banking is not to have sufficient money to redeem the receipts, the Rothbard Bank would quickly go under. But if a Central Bank enjoys the monopoly of bank notes, and the commercial banks all pyramid expansion of their demand deposits on top of their “reserves,” or checking accounts at the Central Bank, then all the Bank need do to assure successful cartelization is to expand proportionately throughout the country so that all competing banks increase their reserves, and can expand together at the same rate. Then, if the Rothbard Bank, for example, prints warehouse receipts far beyond, say triple, its reserves in deposits at the Central Bank, it will not, on net, lose reserves if all the competing banks are expanding their credit at the same rate. In this way, the Central Bank acts as an effective cartelizing agent.

After the Central Bank has established itself as a successful or a strong financial institution, it increases its reserves in order to cartelize the banking industry, “…the most important way that a Central Bank can cartelize its banking system is by increasing the reserves of the bank, and the most important way to do that is simply by buying assets.” The Federal Reserve does this through what are called open market operations. The problem with this is the Federal Reserve is buying assets with money created out of thin air, the Federal Reserve writes a check or a warehouse receipt for fictitious money. The fake money that was given to

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4 Rothbard, Case Against the Fed. Page 63-64
5 Rothbard, Case Against the Fed. Page 64
whoever sold the asset to the Federal Reserve then deposits the check at his bank. His bank then deposits the money bank’s “reserves” account at the Federal Reserve. Now his bank can write warehouse receipts for money that is nonexistent.  

This pyramiding scheme will eventually collapse.

There are three axiomatic consequences of a centrally planned money supply and the expansion of credit and they are as follows: one is the consequential lowering of the purchasing power of the monetary unit, the second is the creation of a boom and bust cyclical economy, and the third is the redistribution of wealth. When the interest rate is any other rate other than the natural rate of interest individuals are mislead into either over or under investing. For example, when interest rates are held below the natural rate of interest individuals are deceived into over investing into capital adventures creating the boom, but once they realize the market didn’t actually want that much of whatever was produced a bust occurs when these capital adventures don’t yield the returns expected. Credit induced booms are followed by busts as businessmen liquidate malinvestments and reallocate capital in more economically productive directions. For example, the current craze is real estate; this could be looked at as an artificial boom due to interest rates held below the natural rate of interest. People are over investing in real estate causing unwarranted rise in prices in the real estate sector of the economy. Once individuals realize they have over invested and aren’t going to profit from their investment, a bubble will bust and the market will correct itself and put the resources wherever they are valued most. Real estate is a contemporary example, other sectors could be effected as well.

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6 This is an adaptation from an example Rothbard uses in The Case Against the Fed. Pages 65-67.
7 Rothbard, Murray. A Case Against the Fed.
8 Another example would be the railroad industry in the 19th Century or the Technology Sector of the United States Economy in the late 1990’s.
Another consequence is not immediate, but after the newly printed money has been absorbed by the economy and has had a chance to drive up the demand for all goods, a general rise in prices occurs.⁹

We see both a generalized rise in prices from the increase of the money supply by the Federal Reserve and we see inflation in specific sectors caused by the manipulation of the natural rate of interest or the prime rate of interest. These two types of inflation are different because they are caused by two different variables. A generalized rise in prices is only after the money has thoroughly worked its way through the economy pushing the demand for goods up. This is different then the kind of inflation caused by the manipulation of the prime rate of interest. The manipulation of the prime rate can cause an increase in prices in a specific sector of the economy if the prime rate is held below the natural rate of interest, this causes a higher demand and hence higher prices for certain goods, a possible example could be people will demand more loans and mortgages because the individuals feel they are getting the loans at a discount and hence have access to cheap money. This causes prices in the real estate sector to rise. Another example, which is mentioned above, is the technology stock bubble of the 1990’s, the Federal Reserve kept the prime rate too low and it eventually caught up to everyone. It does not matter where this money went or which sector was affected, they were malinvestments and a market correction was inevitable. Both kinds of inflation are bad for the economy. Entrepreneurs and individuals need reliable market indicators to know how much to invest, save and consume. Time preference is an individual’s preference of current goods to future goods. Interest rates are the closest economic indicator to an aggregate of individuals’ time preference. Time preference schedules are distorted when the natural rate of

interest is held above or below its market equilibrium. Individuals’ are misguided into over investing in contemporarily popular sectors of the economy due to government manipulation of the prime rate of interest, consequently inducing inflation, while entitlements are being created for a favored group in American society.

This is just like any other commodity, the people who get to use the commodity first, benefit from it first. Why is it ok for the federal government to print money? Assuming a rate of inflation of 3 percent, the Federal Reserve is stealing 3 percent a year from anyone holding United States currency and creating an entitlement for the people who use the money first. Shouldn’t Alan Greenspan and his cronies in the counterfeiting cartel be lead off in shackles?

Democracy and a legal system based on case law and legal president are to blame for this. The institutional structure created by both democracy and a legal system based on case law allows the power of self-interested individuals to be unchecked in the public sector of the economy. The power special-interest groups can yield from a democracy with a legal framework based on legal president are so powerful that. One of the best examples of this is the power J.P. Morgan channeled from the process of democracy. After Morgan tried to cartelize the railroad industry and failed because he was trumped by the market process, Morgan realized he would need to use a much more coercive tool, Morgan used the democratic process and the rules played by in the U.S. legal system in order to take over and cartelize the banking industry.\textsuperscript{10} Morgan along with another business tycoon, Rockefeller,

\textsuperscript{10} Rothbard, Murray. \textit{A History of Money and Banking} in the United States. Chapter titled, “The origin of the Federal Reserve”.

organized and came up with a plan where they could manipulate the banking system to their whims and form a cartel that could be enforced by themselves.¹¹

Imagine going on a road trip and a quarter of the way through the trip you make a left at the “Y” in the road instead of making a right. You keep going in the wrong direction and never make the correction to get back on track. You never go back to the “Y” in the road and make the right that you were supposed to make. This scenario deals with the fundamental problem of a legal system based on legal president; once the legal system makes a wrong turn, it is difficult to correct, the legal system is apt for failure and will be taken advantage of by special interest groups.

Distortions are short-term, and markets are self-adjusting if not hampered by government intervention. Regime change can ruin an economic system in the long run by making an institutional structure that discourages investment.¹² Individuals do not want to cooperate with one another in an economic system where their government can renege on its promises or it is easier to gain a government granted entitlement instead of cooperating with one another voluntarily in a free society. In respect to the U.S. Banking system, individuals either have to collude with someone to be one of the first to use the newly printed money and hence we have crony-capitalism, or individuals may have to bribe a government official in order to gain an occupational licensure in order to work in the industry that gets to use the money first. The examples are countless; the point is the fact that some are gaining entitlements at the expense of others unjustly and creating an economic system that is unstable and is apt to collapse. No one can have something for nothing, sooner or later the

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monetary ponzi-scheme will crash. “In the long run, inflation comes to an end with the breakdown of the currency; it comes to a catastrophe…”\textsuperscript{13}

How are we paying for the war in Iraq? We are paying for it through the printing of new money. We are paying for it now via inflation. People with fixed incomes and people who hold cash balances are left holding the bag while government contractors, officials and special interest groups willing to reap the unearned benefit of using the newly printed money first.

A bank has two general functions. The first is that as a depository institution. This is a warehouse for money. This is where you store your gold or other commodity. The second and completely separate function of a bank is that as a lending institution. This is where you go to get your loan in gold or whatever medium of exchange that is acceptable on the free-market at that time.

The two functions of banking are not to be commingled. When a bank is allowed to commingle the monies for both depositing and lending, it is known as committing fraud. Why aren’t other warehouses that store commodities allowed to loan out more than one receipt for the same item? Why for instance couldn’t we have a fractional commodity system where there would be fractional reserve grain elevators? The answer is because it is fraudulent to sell more than one receipt for the same piece of property. What bankers have done, specifically J.P. Morgan and his fellow cronies in the early twentieth century, is create a banking cartel that is enforced by the Federal Reserve Banking System. The Federal Reserve System is just a government granted cartel.\textsuperscript{14} The Federal Reserve System it is an institution


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Imagine you are interested in the business of real estate and you sell a home as a vacation home. You sell this home to the Adams family. You know the Adams family will only be using the home 2 weeks out of the year. You then decide to sell the same exact house to the Smith Family. You also know that they are going to only use the house for 2 weeks a year. Your rationalization for doing this is the fact that you are betting on them not using the house the same two weeks out of the year. Five years go by and the Adams and Smith family have never used the house the same two weeks. The sixth year is different though, they both happen to want to go there the same week, what happens to you the real estate agent? You go to jail for fraud and embezzlement. Is there something fundamentally wrong with this scenario? This is what fractional reserve banking is, just on a larger scale. Banks issue more than one receipt for what used to able to be redeemed in gold. I say, ‘what used to be redeemed for gold’ because special interest groups have obfuscated the monetary system even more by making fiat money. What they have done, is swipe the gold for useless pieces of paper. This paper is called legal tender, and by law or coercion has to be used as a medium of exchange. This is not the commodity of money that comes about spontaneously in a free society. This is an example of government intervention.
Do you eat fiat Pop-tarts and fiat Twinkies? This strikes at the fundamental fallacy of fiat money. Fiat money is not real money. It is not what is called hard money; it is soft money if it is anything at all. Fiat money is the banker’s answer to runs on the bank. Instead of having the federal government lift the responsibility from banks to pay in specie in times of financial trouble bankers now don’t have to come up with the asset backing the note at all with fiat money. If you go to a bank today and ask for the asset or specie backing your dollar, they will either look at you like you are mad or they will just exchange your dollar for another dollar. By legal tender law, the paper we call dollars is a medium of exchange. This is not what the commodity of money is supposed to be. Money, in the absence of government intervention, is some commodity picked by individuals that is easily divisible, stores its value (does not depreciate in value like the current fiat money does) and is easily transportable. Fiat money lacks the characteristic of being some commodity. There is no commodity backing it. Another important differentiation between fiat currency and commodity-backed currency is that with commodity backed currency, the value of the currency is somewhat predictable and the social norms that arise from this predictability breed confidence in the monetary system for entrepreneurs, this is very different from fiat money, which is controlled by boards headed by self-interested men. When monetary policy is in the hands of self-interested men, nothing good for the group comes out of the planning. Centrally planned monetary policy misallocates resources because it is impossible for the men in charge to ever figure out what the money supply should be or what individuals’ time preference schedules aggregate to. This is another reason centrally planned monetary commissions are not an adequate solution for monetary policy. Commodity backed currencies are self-regulating in this respect. Individuals know their own preferences, they are the only one’s who have knowledge to their own time
What is used as a medium of exchange, the demand and supply of money and rates of interest come about spontaneously via institutions of human action not of human design.

What has happened in the past is that banks get in trouble loaning too many receipts for the same piece of gold and bankers run to the government and ask for mercy from the deposit or note holders. As Rothbard stated, “government has finally refused to pay all debts, and has virtually absolved the banking system from that onerous duty.”¹⁵ In other words, the government and the bankers have formed a coalition to steal from the deposit holders via fiat money.

Domestic inflation and domestic business cycles are caused by the central bank of the United States. The Federal Reserve Bank is the cause of the dramatic booms and busts in our economy. The Federal Reserve muddles with the institutions that arise out of voluntary human action, namely the commodity of money and individuals’ time preference schedules.

Ludwig von Mises in a lecture to German industrialists in 1931 stated:

According to the Circulation Credit Theory (Monetary Theory of the Trade Cycle), cyclical changes in business conditions stem from attempts to reduce artificially the interest rates on loans through measures of banking policy—expansion of bank credit by the issue or creation of additional fiduciary media (that is banknotes and/or checking deposits [p. 182] not covered 100% by gold). On a market, which is not disturbed by the interference of such an “inflationist” banking policy, interest rates develop at which the means are available to carry out all the plans and enterprises that are initiated. Such unhampered market interest rates are known as “natural” or “static” interest rates. If these interest rates were adhered to, then economic development would proceed without interruption—except for the influence of natural cataclysms or political acts such as war, revolution, and the like. The fact that economic development follows a wavy pattern must

¹⁵ Rothbard, Murray. What has Government Done to our Money”. Page 80
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be attributed to the intervention of the banks through their interest rate policy\textsuperscript{16}

It cannot be stressed enough that the causes of the business cycle and inflation are rooted in government intervention in financial and capital markets. In the absence of government intervention there would be no inflation, busts would not hamper economic progress. Entrepreneurs and individuals would not be led into either over or under investing by following the prime rate, the natural rate of interest which comes about spontaneously would be the indicator used by individuals and truly private banks to know if they are over or under investing.

Murray Rothbard makes a point that after a government has replaced the gold standard for a system of fiat currency, there is only one thing that can happen, and that is inflation of the money supply. After individuals realize the name of the game, that the government is pro-inflation and their dollars aren’t worth anything because the paper they thought were dollars is essentially toilet paper, hyper-inflation occurs, “Hyper inflation occurs when the public realizes that the government is bent on inflation, and decides to evade the inflationary tax on its resources by spending money as fast as possible while it still remains at some value.”\textsuperscript{17}

Fiat money, sooner or later becomes valueless due to this process.

Finally back to the question of what would the purchasing power of 100,000 dollars be after 24 years? If inflation is roughly 3 percent per year and by using the rule of 72 in reverse we know that inflation will consume half of the principal amount of money every 24 years. This means in 24 years, the money buried in your backyard would have the purchasing power of 50,000 dollars! After another 24 years, a total of 48 years, all other things held constant,

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\textsuperscript{17} Rothbard, Murray. \textit{What has Government Done to our Money}. Page 84
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the purchasing power of your 100,000 dollars would be that of only 25,000 dollars. After the
next 24 years, a total of 72 years, your 100,000 could only purchase 12,500 dollars worth of
goods. That’s right, in 72 years your 100,000 dollars buried in your back yard has the
purchasing power of only 12,500 dollars. How long will it take the public to realize that this
is happening as we speak? What is going to happen to our fiat currency? We already know
the answer, the U.S. dollar is going to collapse sometime in the future, specifically when the
mass public puts it together that their fiat currency has no or little value.

The type of regime that is first willing to allow bankers to commit fraud employing
fractional reserve banking and then allowing these special interest groups to swipe the gold
backing the deposit notes is a regime that is destined to fall or collapse. This is the same type
of regime that does not respect private property rights and where private property rights are ill
defined resources are misallocated.

Despite this trickery caused by the federal government, democracy and special interest
groups, humanity and justice will survive. What won’t survive is the regime with all of its
smoke and mirrors and lies. This type of regime will lose its credibility in the long-run and
sooner or later the people of the regime will realize they have been lied to and stolen from.
The Free-market will trump Statism, Utilitarianism and all of its’ cronies.
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