Taking Money Back

by Murray N. Rothbard

Money is a crucial command post of any economy, and therefore of any society. Society rests upon a network of voluntary exchanges, also known as the "free-market economy"; these exchanges imply a division of labor in society, in which producers of eggs, nails, horses, lumber, and immaterial services such as teaching, medical care, and concerts, exchange their goods for the goods of others. At each step of the way, every participant in exchange benefits immeasurably, for if everyone were forced to be self-sufficient, those few who managed to survive would be reduced to a pitiful standard of living.

Direct exchange of goods and services, also known as "barter," is hopelessly unproductive beyond the most primitive level, and indeed every "primitive" tribe soon found its way to the discovery of the tremendous benefits of arriving, on the market, at one particularly marketable commodity, one in general demand, to use as a "medium" of "indirect exchange." If a particular commodity is in widespread use as a medium in a society, then that general medium of exchange is called "money."

The money-commodity becomes one term in every single one of the innumerable exchanges in the market economy. I sell my services as a teacher for money; I use that money to buy groceries, typewriters, or travel accommodations; and these producers in turn use the money to pay their workers, to buy equipment and inventory, and pay rent for their buildings. Hence the ever-present temptation for one or more groups to seize control of the vital money-supply function.

Many useful goods have been chosen as moneys in human societies. Salt in Africa, sugar in the Caribbean, fish in colonial New England, tobacco in the colonial Chesapeake Bay region, cowrie shells, iron hoes, and many other commodities have been used as moneys. Not only do these moneys serve as media of exchange; they enable individuals and business firms to engage in the "calculation" necessary to any advanced economy. Moneys are traded and reckoned in terms of a currency unit, almost always units of weight. Tobacco, for example, was reckoned in pound weights. Prices of other goods and services could be figured in terms of pounds of tobacco; a certain horse might be worth 80 pounds on the market. A business firm could then calculate its profit or loss for the previous month; it could figure that its income for the past month was 1,000 pounds and its expenditures 800 pounds, netting it a 200 pound profit.

Gold or Government Paper

Throughout history, two commodities have been able to outcompete all other goods and be chosen on the market as money; two precious metals, gold and silver (with copper coming in when one of the other precious metals was not available). Gold and silver abounded in what we can call "moneyable" qualities, qualities that rendered them superior to all other commodities. They are in rare enough supply that their value will be stable, and of high value per unit weight; hence pieces of gold or silver will be easily portable, and usable in day-to-day transactions; they are rare enough too, so that there is little likelihood of sudden discoveries or increases in supply. They are durable so that they can last virtually forever, and so they provide a sage "store of value" for the future. And gold and silver are divisible, so that they can be divided into small pieces without losing their value; unlike diamonds, for example, they are homogeneous, so that one ounce of gold will be of equal value to any other.

The universal and ancient use of gold and silver as moneys was pointed out by the first great monetary theorist, the eminent fourteenth-century French scholastic Jean Buridan, and then in all discussions of money down to money and banking textbooks until the Western governments abolished the gold standard in the early 1930s. Franklin D. Roosevelt joined in this deed by taking the United States off gold in 1933.

There is no aspect of the free-market economy that has suffered more scorn and contempt from "modern" economists, whether frankly statist Keynesians or allegedly "free market" Chicagoites, than has gold. Gold, not long ago hailed as the basic staple and groundwork of any sound monetary system, is now regularly denounced as a "fetish" or, as in the case of Keynes, as a "barbarous relic." Well, gold is indeed a "relic" of barbarism in one sense; no "barbarian" worth his salt would ever have accepted the phony paper and bank credit that we modern sophisticates have been bamboozled into using as money.

But "gold bugs" are not fetishists; we don't fit the standard image of misers running their fingers through their hoard of gold coins while cackling in sinister fashion. The great thing about gold is that it, and only it, is money supplied by the free market, by the people at work. For the stark choice before us always is: gold (or silver), or government. Gold is market money, a commodity which must be supplied by being dug out of the ground and then processed; but government, on the contrary, supplies virtually costless paper money or bank checks out of thin air.

We know, in the first place, that all government operation is wasteful, inefficient, and serves the bureaucrat rather than the consumer. Would we prefer to have shoes produced by competitive private firms on the free market, or by a giant monopoly of the federal government? The function of supplying money could be handled no better by government. But the situation in money is far worse than for shoes or any other commodity. If the government produces shoes, at least they might be worn, even though they might be high-priced, fit badly, and not satisfy consumer wants.

Money is different from all other commodities: other things being equal, more shoes, or more discoveries of oil or copper benefit society, since they help alleviate natural scarcity. But once a commodity is established as a money on the market, no more money at all is needed. Since the only use of money is for exchange and reckoning, more dollars or pounds or marks in circulation cannot confer a social benefit: they will simply dilute the exchange value of every existing dollar or pound or mark. So it is a great boon that gold or silver are scarce and are costly to increase in supply.

But if government manages to establish paper tickets or bank credit as money, as equivalent to gold grams or ounces, then the government, as dominant money-supplier, becomes free to create money costlessly and at will. As a result, this "inflation" of the money supply destroys the value of the dollar or pound, drives up prices, cripples economic calculation, and hobbles and seriously damages the workings of the market economy.

The natural tendency of government, once in charge of money, is to inflate and to destroy the value of the currency. To understand this truth, we must examine the nature of government and of the creation of money. Throughout history, governments have been chronically short of revenue. The reason should be clear: unlike you and I, governments do not produce useful goods and services which they can sell on the market; governments, rather than producing and selling services, live parasitically off the market and off society. Unlike every other person and institution in society, government obtains its revenue from coercion, from taxation. In older and saner times, indeed, the King was able to obtain sufficient revenue from the products of his own private lands and forests, as well as through highway tolls. For the State to achieve regularized, peacetime taxation was a struggle of centuries. And even after taxation was established, the kings realized that they could not easily impose new taxes or higher rates on old levies; if they did so, revolution was very apt to break out.

Controlling the Money Supply

If taxation is permanently short of the style of expenditures desired by the State, how can it make up the difference? By getting control of the money supply, or, to put it bluntly, by counterfeiting. On the market economy, we can only obtain good money by selling a good or service in exchange for gold, or by receiving a gift; the only other way to get money is to engage in the costly process of digging gold out of the ground. The counterfeiter, on the other hand, is a thief who attempts to profit by forgery, e.g., by painting a piece of brass to look like a gold coin. If his counterfeit is detected immediately, he does no real harm, but to the extent his counterfeit goes undetected, the counterfeiter is able to steal not only from the producers whose goods he buys. For the counterfeiter, by introducing fake money into the economy, is able to steal from everyone by robbing every person of the value of his currency. By diluting the value of each ounce or dollar of genuine money, the counterfeiter's theft is more sinister and more truly subversive than that of the highwayman; for he robs everyone in society, and the robbery is stealthy and hidden, so that the cause-and-effect relation is camouflaged.

Recently, we saw the scare headline: "Iranian Government Tries to Destroy U.S. Economy by Counterfeiting $100 Bills." Whether the ayatollahs had such grandiose goals in mind is dubious; counterfeiters don't need a grand rationale for grabbing resources by printing money. But all counterfeiting is indeed subversive and destructive, as well as inflationary.

But in that case, what are we to say when the government seizes control of the money supply, abolishes gold as money, and establishes its own printed tickets as the only money? In other words, what are we to say when the government becomes the legalized, monopoly counterfeiter?

Not only has the counterfeit been detected, but the Grand Counterfeiter, in the United States the Federal Reserve System, instead of being reviled as a massive thief and destroyer, is hailed and celebrated as the wise manipulator and governor of our "macroeconomy," the agency on which we rely for keeping us out of recessions and inflations, and which we count on to determine interest rates, capital prices, and employment. Instead of being habitually pelted with tomatoes and rotten eggs, the Chairman of the Federal Reserve Board, whoever he may be, whether the imposing Paul Volcker or the owlish Alan Greenspan, is universally hailed as Mr. Indispensable to the economic and financial system.

Indeed, the best way to penetrate the mysteries of the modern monetary and banking system is to realize that the government and its central bank act precisely as would a Grand Counterfeiter, with very similar social and economic effects. Many years ago, the New Yorker magazine, in the days when its cartoons were still funny, published a cartoon of a group of counterfeiters looking eagerly at their printing press as the first $10 bill came rolling off the press. "Boy," said one of the team, "retail spending in the neighborhood is sure in for a shot in the arm."

And it was. As the counterfeiters print new money, spending goes up on whatever the counterfeiters wish to purchase: personal retail goods for themselves, as well as loans and other "general welfare" purposes in the case of the government. But the resulting "prosperity" is phony; all that happens is that more money bids away existing resources, so that prices rise. Furthermore, the counterfeiters and the early recipients of the new money bid away resources from the poor suckers who are down at the end of the line to receive the new money, or who never even receive it at all. New money injected into the economy has an inevitable ripple effect; early receivers of the new money spend more and bid up prices, while later receivers or those on fixed incomes find the prices of the goods they must buy unaccountably rising, while their own incomes lag behind or remain the same. Monetary inflation, in other words, not only raises prices and destroys the value of the currency unit; it also acts as a giant system of expropriation of the late receivers by the counterfeiters themselves and by the other early receivers. Monetary expansion is a massive scheme of hidden redistribution.

When the government is the counterfeiter, the counterfeiting process not only can be "detected"; it proclaims itself openly as monetary statesmanship for the public weal. Monetary expansion then becomes a giant scheme of hidden taxation, the tax falling on fixed income groups, on those groups remote from government spending and subsidy, and on thrifty savers who are naive enough and trusting enough to hold on to their money, to have faith in the value of the currency.

Spending and going into debt are encouraged; thrift and hard work discouraged and penalized. Not only that: the groups that benefit are the special interest groups who are politically close to the government and can exert pressure to have the new money spent on them so that their incomes can rise faster than the price inflation. Government contractors, politically connected businesses, unions, and other pressure groups will benefit at the expense of the unaware and unorganized public.

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We have already described one part of the contemporary flight from sound, free market money to statized and inflated money: the abolition of the gold standard by Franklin Roosevelt in 1933, and the substitution of fiat paper tickets by the Federal Reserve as our "monetary standard." Another crucial part of this process was the federal cartelization of the nation's banks through the creation of the Federal Reserve System in 1913.

Banking is a particularly arcane part of the economic system; one of the problems is that the word "bank" covers many different activities, with very different implications. During the Renaissance era, the Medicis in Italy and the Fuggers in Germany, were "bankers"; their banking, however, was not only private but also began at least as a legitimate, non-inflationary, and highly productive activity. Essentially, these were "merchant-bankers," who started as prominent merchants. In the course of their trade, the merchants began to extend credit to their customers, and in the case of these great banking families, the credit or "banking" part of their operations eventually overshadowed their mercantile activities. These firms lent money out of their own profits and savings, and earned interest from the loans. Hence, they were channels for the productive investment of their own savings.

To the extent that banks lend their own savings, or mobilize the savings of others, their activities are productive and unexceptionable. Even in our current commercial banking system, if I buy a $10,000 CD ("certificate of deposit") redeemable in six months, earning a certain fixed interest return, I am taking my savings and lending it to a bank, which in turn lends it out at a higher interest rate, the differential being the bank's earnings for the function of channeling savings into the hands of credit-worthy or productive borrowers. There is no problem with this process.

The same is even true of the great "investment banking" houses, which developed as industrial capitalism flowered in the nineteenth century. Investment bankers would take their own capital, or capital invested or loaned by others, to underwrite corporations gathering capital by selling securities to stockholders and creditors. The problem with the investment bankers is that one of their major fields of investment was the underwriting of government bonds, which plunged them hip-deep into politics, giving them a powerful incentive for pressuring and manipulating governments, so that taxes would be levied to pay off their and their clients' government bonds. Hence, the powerful and baleful political influence of investment bankers in the nineteenth and twentieth centuries: in particular, the Rothschilds in Western Europe, and Jay Cooke and the House of Morgan in the United States.

By the late nineteenth century, the Morgans took the lead in trying to pressure the U.S. government to cartelize industries they were interested in--first railroads and then manufacturing: to protect these industries from the winds of free competition, and to use the power of government to enable these industries to restrict production and raise prices.

In particular, the investment bankers acted as a ginger group to work for the cartelization of commercial banks. To some extent, commercial bankers lend out their own capital and money acquired by CDs. But most commercial banking is "deposit banking" based on a gigantic scam: the idea, which most depositors believe, that their money is down at the bank, ready to be redeemed in cash at any time. If Jim has a checking account of $1,000 at a local bank, Jim knows that this is a "demand deposit," that is, that the bank pledges to pay him $1,000 in cash, on demand, anytime he wishes to "get his money out." Naturally, the Jims of this world are convinced that their money is safely there, in the bank, for them to take out at any time. Hence, they think of their checking account as equivalent to a warehouse receipt. If they put a chair in a warehouse before going on a trip, they expect to get the chair back whenever they present the receipt. Unfortunately, while banks depend on the warehouse analogy, the depositors are systematically deluded. Their money ain't there.

An honest warehouse makes sure that the goods entrusted to its care are there, in its storeroom or vault. But banks operate very differently, at least since the days of such deposit banks as the Banks of Amsterdam and Hamburg in the seventeenth century, which indeed acted as warehouses and backed all of their receipts fully by the assets deposited, e.g., gold and silver. This honest deposit or "giro" banking is called "100 percent reserve" banking. Ever since, banks have habitually created warehouse receipts (originally bank notes and now deposits) out of thin air. Essentially, they are counterfeiters of fake warehouse-receipts to cash or standard money, which circulate as if they were genuine, fullybacked notes or checking accounts. Banks make money by literally creating money out of thin air, nowadays exclusively deposits rather than bank notes. This sort of swindling or counterfeiting is dignified by the term "fractional-reserve banking," which means that bank deposits are backed by only a small fraction of the cash they promise to have at hand and redeem. (Right now, in the United States, this minimum fraction is fixed by the Federal Reserve System at 10 percent.)

Fractional Reserve Banking

Let's see how the fractional reserve process works, in the absence of a central bank. I set up a Rothbard Bank, and invest $1,000 of cash (whether gold or government paper does not matter here). Then I "lend out" $10,000 to someone, either for consumer spending or to invest in his business. How can I "lend out" far more than I have? Ahh, that's the magic of the "fraction" in the fractional reserve. I simply open up a checking account of $10,000 which I am happy to lend to Mr. Jones. Why does Jones borrow from me? Well, for one thing, I can charge a lower rate of interest than savers would. I don't have to save up the money myself, but simply can counterfeit it out of thin air. (In the nineteenth century, I would have been able to issue bank notes, but the Federal Reserve now monopolizes note issues.) Since demand deposits at the Rothbard Bank function as equivalent to cash, the nation's money supply has just, by magic, increased by $10,000. The inflationary, counterfeiting process is under way.

The nineteenth-century English economist Thomas Tooke correctly stated that "free trade in banking is tantamount to free trade in swindling." But under freedom, and without government support, there are some severe hitches in this counterfeiting process, or in what has been termed "free banking." First: why should anyone trust me? Why should anyone accept the checking deposits of the Rothbard Bank? But second, even if I were trusted, and I were able to con my way into the trust of the gullible, there is another severe problem, caused by the fact that the banking system is competitive, with free entry into the field. After all, the Rothbard Bank is limited in its clientele. After Jones borrows checking deposits from me, he is going to spend it. Why else pay money for a loan? Sooner or later, the money he spends, whether for a vacation, or for expanding his business, will be spent on the goods or services of clients of some other bank, say the Rockwell Bank. The Rockwell Bank is not particularly interested in holding checking accounts on my bank; it wants reserves so that it can pyramid its own counterfeiting on top of cash reserves. And so if, to make the case simple, the Rockwell Bank gets a $10,000 check on the Rothbard Bank, it is going to demand cash so that it can do some inflationary counterfeit-pyramiding of its own. But, I, of course, can't pay the $10,000, so I'm finished. Bankrupt. Found out. By rights, I should be in jail as an embezzler, but at least my phoney checking deposits and I are out of the game, and out of the money supply.

Hence, under free competition, and without government support and enforcement, there will only be limited scope for fractional-reserve counterfeiting. Banks could form cartels to prop each other up, but generally cartels on the market don't work well without government enforcement, without the government cracking down on competitors who insist on busting the cartel, in this case, forcing competing banks to pay up.

Central Banking

Hence the drive by the bankers themselves to get the government to cartelize their industry by means of a central bank. Central Banking began with the Bank of England in the 1690s, spread to the rest of the Western world in the eighteenth and nineteenth centuries, and finally was imposed upon the United States by banking cartelists via the Federal Reserve System of 1913. Particularly enthusiastic about the Central Bank were the investment bankers, such as the Morgans, who pioneered the cartel idea, and who by this time had expanded into commercial banking.

In modern central banking, the Central Bank is granted the monopoly of the issue of bank notes (originally written or printed warehouse receipts as opposed to the intangible receipts of bank deposits), which are now identical to the government's paper money and therefore the monetary "standard" in the country. People want to use physical cash as well as bank deposits. If, therefore, I wish to redeem $1,000 in cash from my checking bank, the bank has to go to the Federal Reserve, and draw down its own checking account with the Fed, "buying" $1,000 of Federal Reserve Notes (the cash in the United States today) from the Fed. The Fed, in other words, acts as a bankers' bank. Banks keep checking deposits at the Fed and these deposits constitute their reserves, on which they can and do pyramid ten times the amount in checkbook money.

Here's how the counterfeiting process works in today's world. Let's say that the Federal Reserve, as usual, decides that it wants to expand (i.e., inflate) the money supply. The Federal Reserve decides to go into the market (called the "open market") and purchase an asset. It doesn't really matter what asset it buys; the important point is that it writes out a check. The Fed could, if it wanted to, buy any asset it wished, including corporate stocks, buildings, or foreign currency. In practice, it almost always buys U.S. government securities.

Let's assume that the Fed buys $10,000,000 of U.S. Treasury bills from some "approved" government bond dealer (a small group), say Shearson, Lehman on Wall Street. The Fed writes out a check for $10,000,000, which it gives to Shearson, Lehman in exchange for $10,000,000 in U.S. securities. Where does the Fed get the $10,000,000 to pay Shearson, Lehman? It creates the money out of thin air. Shearson, Lehman can do only one thing with the check: deposit it in its checking account at a commercial bank, say Chase Manhattan. The "money supply" of the country has already increased by $10,000,000; no one else's checking account has decreased at all. There has been a net increase of $10,000,000.

But this is only the beginning of the inflationary, counterfeiting process. For Chase Manhattan is delighted to get a check on the Fed, and rushes down to deposit it in its own checking account at the Fed, which now increases by $10,000,000. But this checking account constitutes the "reserves" of the banks, which have now increased across the nation by $10,000,000. But this means that Chase Manhattan can create deposits based on these reserves, and that, as checks and reserves seep out to other banks (much as the Rothbard Bank deposits did), each one can add its inflationary mite, until the banking system as a whole has increased its demand deposits by $100,000,000, ten times the original purchase of assets by the Fed. The banking system is allowed to keep reserves amounting to 10 percent of its deposits, which means that the "money multiplier"--the amount of deposits the banks can expand on top of reserves--is 10. A purchase of assets of $10 million by the Fed has generated very quickly a tenfold, $100,000,000 increase in the money supply of the banking system as a whole.

Interestingly, all economists agree on the mechanics of this process even though they of course disagree sharply on the moral or economic evaluation of that process. But unfortunately, the general public, not inducted into the mysteries of banking, still persists in thinking that their money remains "in the bank."

Thus, the Federal Reserve and other central banking systems act as giant government creators and enforcers of a banking cartel; the Fed bails out banks in trouble, and it centralizes and coordinates the banking system so that all the banks, whether the Chase Manhattan, or the Rothbard or Rockwell banks, can inflate together. Under free banking, one bank expanding beyond its fellows was in danger of imminent bankruptcy. Now, under the Fed, all banks can expand together and proportionately.

"Deposit Insurance"

But even with the backing of the Fed, fractional reserve banking proved shaky, and so the New Deal, in 1933, added the lie of "bank deposit insurance," using the benign word "insurance" to mask an arrant hoax. When the savings and loan system went down the tubes in the late 1980s, the "deposit insurance" of the federal FSLIC [Federal Savings and Loan Insurance Corporation] was unmasked as sheer fraud. The "insurance" was simply the smoke-and-mirrors term for the unbacked name of the federal government. The poor taxpayers finally bailed out the S&Ls, but now we are left with the formerly sainted FDIC [Federal Deposit Insurance Corporation], for commercial banks, which is now increasingly seen to be shaky, since the FDIC itself has less than one percent of the huge number of deposits it "insures."

The very idea of "deposit insurance" is a swindle; how does one insure an institution (fractional reserve banking) that is inherently insolvent, and which will fall apart whenever the public finally understands the swindle? Suppose that, tomorrow, the American public suddenly became aware of the banking swindle, and went to the banks tomorrow morning, and, in unison, demanded cash. What would happen? The banks would be instantly insolvent, since they could only muster 10 percent of the cash they owe their befuddled customers. Neither would the enormous tax increase needed to bail everyone out be at all palatable. No: the only thing the Fed could do, and this would be in their power, would be to print enough money to pay off all the bank depositors. Unfortunately, in the present state of the banking system, the result would be an immediate plunge into the horrors of hyperinflation.

Let us suppose that total insured bank deposits are $1,600 billion. Technically, in the case of a run on the banks, the Fed could exercise emergency powers and print $1,600 billion in cash to give to the FDIC to pay off the bank depositors. The problem is that, emboldened at this massive bailout, the depositors would promptly redeposit the new $1,600 billion into the banks, increasing the total bank reserves by $1,600 billion, thus permitting an immediate expansion of the money supply by the banks by tenfold, increasing the total stock of bank money by $16 trillion. Runaway inflation and total destruction of the currency would quickly follow.

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To save our economy from destruction and from the eventual holocaust of run away inflation, we the people must take the money-supply function back from the government. Money is far too important to be left in the hands of bankers and of Establishment economists and financiers. To accomplish this goal, money must be returned to the market economy, with all monetary functions performed within the structure of the rights of private property and of the free-market economy.

It might be thought that the mix of government and money is too far gone, too pervasive in the economic system, too inextricably bound up in the economy, to be eliminated without economic destruction. Conservatives are accustomed to denouncing the "terrible simplifiers" who wreck everything by imposing simplistic and unworkable schemes. Our major problem, however, is precisely the opposite: mystification by the ruling elite of technocrats and intellectuals, who, whenever some public spokesman arises to call for large-scale tax cuts or deregulation, intone sarcastically about the dimwit masses who "seek simple solutions for complex problems." Well, in most cases, the solutions are indeed clear-cut and simple, but are deliberately obfuscated by people whom we might call "terrible complicators." In truth, taking back our money would be relatively simple and straightforward, much less difficult than the daunting task of denationalizing and decommunizing the Communist countries of Eastern Europe and the former Soviet Union.

Our goal may be summed up simply as the privatization of our monetary system, the separation of government from money and banking. The central means to accomplish this task is also straightforward: the abolition, the liquidation of the Federal Reserve System--the abolition of central banking. How could the Federal Reserve System possibly be abolished? Elementary: simply repeal its federal charter, the Federal Reserve Act of 1913. Moreover, Federal Reserve obligations (its notes and deposits) were originally redeemable in gold on demand. Since Franklin Roosevelt's monstrous actions in 1933, "dollars" issued by the Federal Reserve, and deposits by the Fed and its member banks, have no longer been redeemable in gold. Bank deposits are redeemable in Federal Reserve Notes, while Federal Reserve Notes are redeemable in nothing, or alternatively in other Federal Reserve Notes. Yet, these Notes are our money, our monetary "standard," and all creditors are obliged to accept payment in these fiat notes, no matter how depreciated they might be.

In addition to cancelling the redemption of dollars into gold, Roosevelt in 1933 committed another criminal act: literally confiscating all gold and bullion held by Americans, exchanging them for arbitrarily valued "dollars." It is curious that, even though the Fed and the government establishment continually proclaim the obsolescence and worthlessness of gold as a monetary metal, the Fed (as well as all other central banks) clings to its gold for dear life. Our confiscated gold is still owned by the Federal Reserve, which keeps it on deposit with the Treasury at Fort Knox and other gold depositaries. Indeed, from 1933 until the 1970s, it continued to be illegal for any Americans to own monetary gold of any kind, whether coin or bullion or even in safe deposit boxes at home or abroad. All these measures, supposedly drafted for the Depression emergency, have continued as part of the great heritage of the New Deal ever since. For four decades, any gold flowing into private American hands had to be deposited in the banks, which in turn had to deposit it at the Fed. Gold for "legitimate" non-monetary purposes, such as dental fillings, industrial drills, or jewelry, was carefully rationed for such purposes by the Treasury Department.

Fortunately, due to the heroic efforts of Congressman Ron Paul it is now legal for Americans to own gold, whether coin or bullion. But the ill-gotten gold confiscated and sequestered by the Fed remains in Federal Reserve hands. How to get the gold out from the Fed? How privatize the Fed's stock of gold?

Privatizing Federal Gold

The answer is revealed by the fact that the Fed, which had promised to redeem its liabilities in gold, has been in default of that promise since Roosevelt's repudiation of the gold standard in 1933. The Federal Reserve System, being in default, should be liquidated, and the way to liquidate it is the way any insolvent business firm is liquidated: its assets are parceled out, pro rata, to its creditors. The Federal Reserve's gold assets are listed, as of October 30, 1991, at $11.1 billion. The Federal Reserve's liabilities as of that date consist of $295.5 billion in Federal Reserve Notes in circulation, and $24.4 billion in deposits owed to member banks of the Federal Reserve System, for a total of $319.9 billion. Of the assets of the Fed, other than gold, the bulk are securities of the U.S. government, which amounted to $262.5 billion. These should be written off posthaste, since they are worse than an accounting fiction: the taxpayers are forced to pay interest and principle on debt which the Federal Government owes to its own creature, the Federal Reserve. The largest remaining asset is Treasury Currency, $21.0 billion, which should also be written off, plus $10 billion in SDRs, which are mere paper creatures of international central banks, and which should be abolished as well. We are left (apart from various buildings and fixtures and other assets owned by the Fed, and amounting to some $35 billion) with $11.1 billion of assets needed to pay off liabilities totalling $319.9 billion.

Fortunately, the situation is not as dire as it seems, for the $11.1 billion of Fed gold is a purely phoney evaluation; indeed it is one of the most bizarre aspects of our fraudulent monetary system. The Fed's gold stock consists of 262.9 million ounces of gold; the dollar valuation of $11.1 billion is the result of the government's artificially evaluating its own stock of gold at $42.22 an ounce. Since the market price of gold is now about $350 an ounce, this already presents a glaring anomaly in the system.

Definitions and Debasement

Where did the $42.22 come from?

The essence of a gold standard is that the monetary unit (the "dollar," "franc," "mark," etc.) is defined as a certain weight of gold. Under the gold standard, the dollar or franc is not a thing-in-itself, a mere name or the name of a paper ticket issued by the State or a central bank; it is the name of a unit of weight of gold. It is every bit as much a unit of weight as the more general "ounce," "grain," or "gram." For a century before 1933, the "dollar" was defined as being equal to 23.22 grains of gold; since there are 480 grains to the ounce, this meant that the dollar was also defined as .048 gold ounce. Put another way, the gold ounce was defined as equal to $20.67.

In addition to taking us off the gold standard domestically, Franklin Roosevelt's New Deal "debased" the dollar by redefining it, or "lightening its weight," as equal to 13.714 grains of gold, which also defined the gold ounce as equal to $35. The dollar was still redeemable in gold to foreign central banks and governments at the lighter $35 weight; so that the United States stayed on a hybrid form of international gold standard until August 1971, when President Nixon completed the job of scuttling the gold standard altogether. Since 1971, the United States has been on a totally fiat paper standard; not coincidentally, it has suffered an unprecedented degree of peace-time inflation since that date. Since 1971, the dollar has no longer been tied to gold at a fixed weight, and so it has become a commodity separate from gold, free to fluctuate on world markets.

When the dollar and gold were set loose from each other, we saw the closest thing to a laboratory experiment we can get in human affairs. All Establishment economists--from Keynesians to Chicagoite monetarists--insisted that gold had long lost its value as a money, that gold had only reached its exalted value of $35 an ounce because its value was "fixed" at that amount by the government. The dollar allegedly conferred value upon gold rather than the other way round, and if gold and the dollar were ever cut loose, we would see the price of gold sink rapidly to its estimated non-monetary value (for jewelry, dental fillings, etc.) of approximately $6 an ounce. In contrast to this unanimous Establishment prediction, the followers of Ludwig von Mises and other "gold bugs" insisted that gold was undervalued at 35 debased dollars, and claimed that the price of gold would rise far higher, perhaps as high as $70.

Suffice it to say that the gold price never fell below $35, and in fact vaulted upward, at one point reaching $850 an ounce, in recent years settling at somewhere around $350 an ounce. And yet since 1973, the Treasury and Fed have persistently evaluated their gold stock, not at the old and obsolete $35, to be sure, but only slightly higher, at $42.22 an ounce. In other words, if the U.S. government only made the simple adjustment that accounting requires of everyone--evaluating one's assets at their market price--the value of the Fed's gold stock would immediately rise from $11.1 to $92.0 billion.

From 1933 to 1971, the once very large but later dwindling number of economists championing a return to the gold standard mainly urged a return to $35 an ounce. Mises and his followers advocated a higher gold "price," inasmuch as the $35 rate no longer applied to Americans. But the majority did have a point: that any measure or definition, once adopted, should be adhered to from then on. But since 1971, with the death of the once-sacred $35 an ounce, all bets are off. While definitions once adopted should be maintained permanently, there is nothing sacred about any initial definition, which should be selected at its most useful point. If we wish to restore the gold standard, we are free to select whatever definition of the dollar is most useful; there are no longer any obligations to the obsolete definitions of $20.67 or $35 an ounce.

Abolishing the Fed

In particular, if we wish to liquidate the Federal Reserve System, we can select a new definition of the "dollar" sufficient to pay off all Federal Reserve liabilities at 100 cents to the dollar. In the case of our example above, we can now redefine "the dollar" as equivalent to 0.394 grains of gold, or as 1 ounce of gold equalling $1,217. With such redefinition, the entire Federal Reserve stock of gold could be minted by the Treasury into gold coins that would replace the Federal Reserve Notes in circulation, and also constitute gold coin reserves of $24.4 billion at the various commercial banks. The Federal Reserve System would be abolished, gold coins would now be in circulation replacing Federal Reserve Notes, gold would be the circulating medium, and gold dollars the unit of account and reckoning, at the new rate of $1,217 per ounce. Two great desiderata--the return of the gold standard, and the abolition of the Federal Reserve--would both be accomplished at one stroke.

A corollary step, of course, would be the abolition of the already bankrupt Federal Deposit Insurance Corporation. The very concept of "deposit insurance" is fraudulent; how can you "insure" an entire industry that is inherently insolvent? It would be like insuring the Titanic after it hit the iceberg. Some free-market economists advocate "privatizing" deposit insurance by encouraging private firms, or the banks themselves, to "insure" each others' deposits. But that would return us to the unsavory days of Florentine bank cartels, in which every bank tried to shore up each other's liabilities. It won't work; let us not forget that the first S&Ls to collapse in the 1980s were those in Ohio and in Maryland, which enjoyed the dubious benefits of "private" deposit insurance.

This issue points up an important error often made by libertarians and free-market economists who believe that all government activities should be privatized; or as a corollary, hold that any actions, so long as they are private, are legitimate. But, on the contrary, activities such as fraud, embezzlement, or counterfeiting should not be "privatized"; they should be abolished.

This would leave the commercial banks still in a state of fractional reserve, and, in the past, I have advocated going straight to 100 percent, nonfraudulent banking by raising the gold price enough to constitute 100 percent of bank demand liabilities. After that, of course, 100 percent banking would be legally required. At current estimates, establishing 100 percent to all commercial bank demand deposit accounts would require going back to gold at $2,000 an ounce; to include all checkable deposits would require establishing gold at $3,350 an ounce, and to establish 100 percent banking for all checking and savings deposits (which are treated by everyone as redeemable on demand) would require a gold standard at $7,500 an ounce.

But there are problems with such a solution. A minor problem is that the higher the newly established gold value over the current market price, the greater the consequent increase in gold production. This increase would cause an admittedly modest and one-shot price inflation. A more important problem is the moral one: do banks deserve what amounts to a free gift, in which the Fed, before liquidating, would bring every bank's gold assets high enough to be 100 percent of its liabilities? Clearly, the banks scarcely deserve such benign treatment, even in the name of smoothing the transition to sound money; bankers should consider themselves lucky they are not tried for embezzlement. Furthermore, it would be difficult to enforce and police 100 percent banking on an administrative basis. It would be easier, and more libertarian, to go through the courts. Before the Civil War, the notes of unsound fractional reserve banks in the United States, if geographically far from home base, were bought up at a discount by professional "money brokers," who would then travel to the banks' home base and demand massive redemption of these notes in gold.

The same could be done today, and more efficiently, using advanced electronic technology, as professional money brokers try to make profits by detecting unsound banks and bringing them to heel. A particular favorite of mine is the concept of ideological Anti-Bank Vigilante Leagues, who would keep tabs on banks, spot the errant ones, and go on television to proclaim that banks are unsound, and urge note and deposit holders to call upon them for redemption without delay. If the Vigilante Leagues could whip up hysteria and consequent bank runs, in which noteholders and depositors scramble to get their money out before the bank goes under, then so much the better: for then, the people themselves, and not simply the government, would ride herd on fractional reserve banks. The important point, it must be emphasized, is that at the very first sign of a bank's failing to redeem its notes or deposits on demand, the police and courts must put them out of business. Instant justice, period, with no mercy and no bailouts.

Under such a regime, it should not take long for the banks to go under, or else to contract their notes and deposits until they are down to 100 percent banking. Such monetary deflation, while leading to various adjustments, would be clearly one-shot, and would obviously have to stop permanently when the total of bank liabilities contracted down to 100 percent of gold assets. One crucial difference between inflation and deflation, is that inflation can escalate up to an infinity of money supply and prices, whereas the money supply can only deflate as far as the total amount of standard money, under the gold standard the supply of gold money. Gold constitutes an absolute floor against further deflation.

If this proposal seems harsh on the banks, we have to realize that the banking system is headed for a mighty crash in any case. As a result of the S&L collapse, the terribly shaky nature of our banking system is at last being realized. People are openly talking of the FDIC being insolvent, and of the entire banking structure crashing to the ground. And if the people ever get to realize this in their bones, they will precipitate a mighty "bank run" by trying to get their money out of the banks and into their own pockets. And the banks would then come tumbling down, because the people's money isn't there. The only thing that could save the banks in such a mighty bank run is if the Federal Reserve prints the $1.6 trillion in cash and gives it to the banks--igniting an immediate and devastating runaway inflation and destruction of the dollar.

Liberals are fond of blaming our economic crisis on the "greed of the 1980s." And yet "greed" was no more intense in the 1980s than it was in the 1970s or previous decades or than it will be in the future. What happened in the 1980s was a virulent episode of government deficits and of Federal Reserve-inspired credit expansion by the banks. As the Fed purchased assets and pumped in reserves to the banking system, the banks happily multiplied bank credit and created new money on top of those reserves.

There has been a lot of focus on poor quality bank loans: on loans to bankrupt Third World countries or to bloated and, in retrospect, unsound real estate schemes and shopping malls in the middle of nowhere. But poor quality loans and investments are always the consequence of central bank and bank-credit expansion. The all-too-familiar cycle of boom and bust, euphoria and crash, prosperity and depression, did not begin in the 1980s. Nor is it a creature of civilization or the market economy. The boom-bust cycle began in the eighteenth century with the beginnings of central banking, and has spread and intensified ever since, as central banking spread and took control of the economic systems of the Western world. Only the abolition of the Federal Reserve System and a return to the gold standard can put an end to cyclical booms and busts, and finally eliminate chronic and accelerating inflation.

Inflation, credit expansion, business cycles, heavy government debt, and high taxes are not, as Establishment historians claim, inevitable attributes of capitalism or of "modernization." On the contrary, these are profoundly anti-capitalist and parasitic excrescences grafted onto the system by the interventionist State, which rewards its banker and insider clients with hidden special privileges at the expense of everyone else.

Crucial to free enterprise and capitalism is a system of firm rights of private property, with everyone secure in the property that he earns. Also crucial to capitalism is an ethic that encourages and rewards savings, thrift, hard work, and productive enterprise, and that discourages profligacy and cracks down sternly on any invasion of property rights. And yet, as we have seen, cheap money and credit expansion gnaw away at those rights and at those virtues. Inflation overturns and transvalues values by rewarding the spendthrift and the inside fixer and by making a mockery of the older "Victorian" virtues.

Restoring the Old Republic

The restoration of American liberty and of the Old Republic is a multi-faceted task. It requires excising the cancer of the Leviathan State from our midst. It requires removing Washington, D.C., as the power center of the country. It requires restoring the ethics and virtues of the nineteenth century, the taking back of our culture from nihilism and victimology, and restoring that culture to health and sanity. In the long run, politics, culture, and the economy are indivisible. The restoration of the Old Republic requires an economic system built solidly on the inviolable rights of private property, on the right of every person to keep what he earns, and to exchange the products of his labor. To accomplish that task, we must once again have money that is produced on the market, that is gold rather than paper, with the monetary unit a weight of gold rather than the name of a paper ticket issued ad lib by the government. We must have investment determined by voluntary savings on the market, and not by counterfeit money and credit issued by a knavish and State-privileged banking system. In short, we must abolish central banking, and force the banks to meet their obligations as promptly as anyone else. Money and banking have been made to appear as mysterious and arcane processes that must be guided and operated by a technocratic elite. They are nothing of the sort. In money, even more than the rest of our affairs, we have been tricked by a malignant Wizard of Oz. In money, as in other areas of our lives, restoring common sense and the Old Republic go hand in hand.