A Roadmap For Reopening The Sequestered U.S. Economy

By L. Carlos Lara

This Lara-Murphy Report (LMR) article was reprinted with permission. This and many more articles related to IBC and Austrian Economics are published monthly in the LMR. Subscriptions are available at www.usatrustonline.com

Experts estimate that we will not have a COVID-19 vaccine until 2021 at the earliest. For the foreseeable future, living with COVID-19 is our new “normal” and one of the main reasons why all businesses in our cities, except those considered essential (groceries, pharmacies, federal and state offices, etc.), have been ordered to close their locations.

In the city in which I reside, Nashville Tennessee, the “safer at home order” began on March 22, 2020 and it was on that very same day that our city mayor, under the auspices of the Governor of Tennessee, released a preliminary ROADMAP FOR REOPENING NASHVILLE. Even so, the quarantine would remain in place until May 11.

The most significant aspect of this “Roadmap” is to recognize that reopening Nashville businesses will be done in very closely monitored “phases” that must sustain declining trends in new COVID-19 cases for at least 14 days before it will be allowed to go to the next “phase.” Failure to reach the 14 days with the desired results will extend the lockdown provisions of “phase one.” There are a total of 4 “phases.”

Phase one officially began May 11th and shopping traffic on the streets has been dismal. Fear of the virus pandemic continues to keep people away from the downtown area shops, restaurants, hotels, and night-life attractions. Furthermore, phase one does not allow for critical ambiance activities such as “live music” at any of the downtown area stores, and all of the virus social distancing rules are strictly enforced. Even if “phase one” is executed perfectly for the first 14 days required, getting to “phase 4” which removes all the business restrictions, and if executed perfectly for its entire 14-day requirement, will take 56 days or until July, 2020.
In effect, what is generally recognized as Nashville’s primary tourist and selling season has ended suddenly and abruptly in a matter of two months. Many of the businesses in the downtown area of Nashville have filed for bankruptcy and abandoned their highly expensive leased locations. Other high travel destinations such as Hawaii and Las Vegas, have also experienced similar financial problems to those of Nashville and have especially spiked in the month of May, and will most likely do so again in June and July. With now 33 million Americans having filed unemployment claims and the airline industry in serious trouble, 2020 is quickly stacking up as a year for national catastrophic losses.

**Downsizing Business Has Become The New Normal**

Nashville is also the home of one of my oldest business clients as well as dearest friends, Ed and Karen Smith. Of course, neither of us can believe what has happened to Nashville in the last two months, much less the rest of the entire world since the Corona virus pandemic. We became acquainted with each other 22 years ago under similar unusual circumstances. As a workout specialist and “trustee,” I was introduced to the Smith’s by their top five major creditors for purposes of establishing a “Merchandise Trust Agreement” between us in order to resolve their, and the Smith’s, financial difficulties and indebtedness.

Please keep in mind that these agreements were signed and executed during a period of financial instability. In fact, during this period of 1989, the entire western and apparel industry of which they were all a part, was also in financial turmoil. Over this 22-year period of time the Smiths have become very successful Nashville business owners and all of their suppliers have been paid in full. They now own most of the real estate in which they operate their businesses. Financially, Ed and Karen Smith’s enterprise is currently profitable and sound.

Nevertheless, due to Nashville’s ensuing circumstances, the Smiths plan to downsize their entire operation to one or two stores beginning immediately, but will continue to remain open and operational. Due to their business acumen, I am confident they will continue to remain a successful enterprise. The Merchandise Trust Agreements, on the other hand, have fully completed their future need and will disband.

I only wish I could relay the same type of happy news to the millions of many national businesses that have already filed for bankruptcy with no hope of recovery. Unfortunately, this problem is only just beginning for countless others.

**Sudden Chaos of the Markets and Major Industries**

In the wake of the coronavirus pandemic, it’s as though all hell has broken loose. The sudden chaos of the stock market and the collapse of major industries have made it difficult to capture the impending results on the economy in real-time. Plus, people have been sequestered in their homes and have not been out to meet and talk with each other, consequently they have not realized how much their world has changed. Meanwhile the Federal Reserve has engaged in unprecedented actions, pumping $2.5 trillion into the financial system in just two months.

Meanwhile the hemorrhaging has already started. Besides the stock market’s complete collapse, real-estate, which generally moves much slower, is already at a standstill. As always under these austere measures, the small wage earners, those individuals that basically live from paycheck to paycheck, have already lost their jobs in record numbers. These are the results of the mess this financial crash is spreading everywhere.

So too, the prestigious brick and mortar stores that have been virtually hanging on by their nails, like J.C. Penney, that should have died years ago, finally gave up the ghost and filed for Chapter-XI Bankruptcy. At this juncture it will be a quick process.

Also, the love of my life retailer, Neiman Marcus—I say that because I trained under Stanley Marcus as a college student—it too has filed for Chapter XI Bankruptcy. Lord & Taylor and J. Crew are also on the list as having filed. Nordstrom and Macy’s, while still alive and breathing for now, have shuttered hundreds of stores. And this is all just the beginning of more to
In a special 60 MINUTES news segment Scott Pelley of CBS news asked Jerome Powell, Chairman of the Federal Reserve an important question. Pelley asked, “When does the economy recover”? Powell said that it was “very difficult to answer because it really depends to a large degree, on what happens to the coronavirus. The sooner we get the virus under control, the sooner businesses can recover. And more important than that, the sooner people can become confident that they can resume certain kinds of activity. Going out, going to restaurants, traveling, flying on planes, those sorts of things. So that’s really going to tell us when the economy can recover.”

Again, Pelley asked, “What economic realities do the American people need to be prepared for?” Powell’s response was more realistic than even he realizes. “This is a time of great suffering and difficulty. And it’s come on us so quickly and with such force, that you really can’t put onto words the pain people are feeling and the uncertainty their realizing. And it’s going to take a while for us to get back...Twenty million people have lost their jobs...It’s women to an extraordinary extent, who were making less than $40,000 per year; almost 40% have lost their jobs in the last month or so. Extraordinary statistic. So that’s who’s really bearing the brunt of this.”

Although the Chairman of the Federal Reserve answered a lot of questions for Scott Pelley in this lengthy interview, he stayed clear of the coronavirus pandemic, except to blame it for the cause of the current financial crisis. He repeated several times to Pelley that the Federal Reserve had no oversight over it. He was however, quick to receive praise for what the Federal Reserve has done, and done quickly.

In response to a push notification that Pelley had just received on his phone: “Dow tanks more than 500 points in Wall Street sell-off, after Fed chair warns economic recovery will be prolonged and bumpy.” To which Pelley exclaimed to Powell, “You knew that was coming.” And Powell looking rather flattered, simply said: “I’ve been watching the markets.” What?

Table A. States with new series high unemployment rates, April 2020, seasonally adjusted (1)

<table>
<thead>
<tr>
<th>State</th>
<th>Rate (p)</th>
<th>State</th>
<th>Rate (p)</th>
<th>State</th>
<th>Rate (p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alaska</td>
<td>12.9</td>
<td>Maine</td>
<td>10.6</td>
<td>Oklahoma</td>
<td>13.7</td>
</tr>
<tr>
<td>Arizona</td>
<td>12.6</td>
<td>Maryland</td>
<td>9.9</td>
<td>Oregon</td>
<td>14.2</td>
</tr>
<tr>
<td>California</td>
<td>15.5</td>
<td>Massachusetts</td>
<td>15.1</td>
<td>Pennsylvania</td>
<td>15.1</td>
</tr>
<tr>
<td>Colorado</td>
<td>11.3</td>
<td>Michigan</td>
<td>22.7</td>
<td>Rhode Island</td>
<td>17.0</td>
</tr>
<tr>
<td>Delaware</td>
<td>14.3</td>
<td>Mississippi</td>
<td>15.4</td>
<td>South Carolina</td>
<td>12.1</td>
</tr>
<tr>
<td>Florida</td>
<td>12.9</td>
<td>Montana</td>
<td>11.3</td>
<td>South Dakota</td>
<td>10.2</td>
</tr>
<tr>
<td>Georgia</td>
<td>11.9</td>
<td>Nebraska</td>
<td>8.3</td>
<td>Tennessee</td>
<td>14.7</td>
</tr>
<tr>
<td>Hawaii</td>
<td>22.3</td>
<td>Nevada</td>
<td>28.2</td>
<td>Texas</td>
<td>12.8</td>
</tr>
<tr>
<td>Idaho</td>
<td>11.5</td>
<td>New Hampshire</td>
<td>16.3</td>
<td>Utah</td>
<td>9.7</td>
</tr>
<tr>
<td>Illinois</td>
<td>16.4</td>
<td>New Jersey</td>
<td>15.3</td>
<td>Vermont</td>
<td>15.6</td>
</tr>
<tr>
<td>Indiana</td>
<td>16.9</td>
<td>New Mexico</td>
<td>11.3</td>
<td>Virginia</td>
<td>10.6</td>
</tr>
<tr>
<td>Iowa</td>
<td>10.2</td>
<td>New York</td>
<td>14.5</td>
<td>Washington</td>
<td>15.4</td>
</tr>
<tr>
<td>Kansas</td>
<td>11.2</td>
<td>North Carolina</td>
<td>12.2</td>
<td>Wisconsin</td>
<td>14.1</td>
</tr>
<tr>
<td>Kentucky</td>
<td>15.4</td>
<td>North Dakota</td>
<td>8.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Louisiana</td>
<td>14.5</td>
<td>Ohio</td>
<td>16.8</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(1) All state series begin in 1976 | (p) = preliminary
I thought. You have been watching the markets? And, I couldn’t help but to laugh out loud.

I am attempting not to minimize the dangers of the virus and the hundreds of thousands of people it has killed, however, in all honesty, Bob and I have been watching the markets for years and I have personally experienced several financial crises myself. But this particular financial crisis we knew was coming and we also knew that it would be bigger and more catastrophic than the 2008 crisis. In fact, we talked about it in detail in September 2016 in our live stream video presentation, “How to Weather the Coming Financial Storms.” Furthermore, we were very confident that it would happen this year. Keep in mind that all financial crises are ignited by some catalyst of one kind or another. What we did not know was that a virus pandemic would set this one off.

This is what knowledge of the business cycle teaches you, it’s what the Austrian School of Economics teaches you. Unfortunately, Keynesian Economics and the Federal Reserve don’t teach you anything no matter how often they watch the markets. They are always the culprits that cause all financial crisis. It’s our great hope that people will finally figure this out.

State Unemployment for April 2020

In this section I reproduce some state-based data from the Bureau of Labor Statistics (BLS). Readers can find it at: https://www.bls.gov/news.release/laus.nr0.htm

“Unemployment rates were higher in April in all 50 states and the District of Columbia, the U.S. Bureau of Labor Statistics reported today. Similarly, all 50 states and the District had jobless rate increases from a year earlier. The national unemployment rate rose by 10.3 percentage points over the month to 14.7 percent and was 11.1 points higher than in April 2019.” This was reported May 22, 2020 by an economic news release put out by the U.S. Bureau of Labor Statistics.

Nevada had the highest unemployment rate in April at 28.2 percent. Hawaii was at 22.3 percent. Nevada exceeded its high by 10.00. Connecticut had the lowest unemployment rate at 7.9 percent. As has been made clear already, these are high tourist cities that have been seriously affected by the coronavirus.

Once again, these are all statistics that have the latest available numbers and are depicting the effects of the virus pandemic. They will jump again next month and possibly once again the next month after that. If the coronavirus cases continue to climb it is highly unlikely that the fear of the virus can be relieved enough to stimulate the economy back to life. Too many people are still very afraid of what has happened.

Conclusion

Only recently have businesses been allowed to open their doors to the public. Each state has laid down their own rules for reopening. Nevertheless, each state is carefully monitoring its death tolls from the coronavirus. If the death toll does not subside a state could be forced into a lockdown closed condition once again. This becomes the kiss of death for the economy to recover. Once they collapsed the economy in the manner they did, it will become very difficult to go back to where we once were. Finding a vaccine quickly is the only definitive cure.

Unfortunately, experts estimate that we will not have a COVID-19 vaccine until next year at the earliest, and some warn that one may never come. For the foreseeable future, living with COVID-19 is our new “normal.” Readers need to adjust to this reality in all aspects of their lives. Regarding their finances, we urge more than ever to consider Nelson Nash’s Infinite Banking Concept (IBC) and to read more in Austrian economics, in order to make sense of the unfolding economic disaster.

This article was originally published in the Lara-Murphy Report.

Savings Are Critical to a Prosperous Economy

By Frank Shostak

It is held by most mainstream economists that spending is the heart of economic activity. Economic activity is depicted as a circular flow of money. Spending by one

4 www.infinitebanking.org  david@infinitebanking.org
individual becomes part of the earnings of another individual, and vice versa. In contrast saving is viewed negatively as it weakens the potential demand for goods and services.

If, however, people have become less confident about the future, it is held that they will cut back on their outlays and hoard more money. Therefore, once an individual spends less, this worsens the situation of some other individual, who in turn also cuts his spending.

A vicious cycle is set in motion. The decline in people’s confidence causes them to spend less and to hoard more money. This lowers economic activity further, thereby causing people to hoard more, etc.

The cure for this, it is argued, is for the central bank to pump money. By putting more cash in people's hands, consumer confidence will increase, people will then spend more, and the circular flow of money will reassert itself.

All this sounds very appealing. Indeed various surveys show that during a recession, businesses emphasize the lack of consumer demand as the major factor behind their poor performances.

Note that this approach ignores the production of goods and services. Are we to take such production for granted? Is it always there, with just the demand for that output being lacking?

In the real world, one has to become a producer first before one can demand goods and services. It is necessary to produce some useful goods that can be exchanged for other goods.

For instance, when a baker produces bread, not everything he produces is for his own consumption. In fact, most of the bread he produces is exchanged for the goods and services of other producers, implying that through the production of bread, the baker generates an effective demand for other goods. In this sense, his demand is fully backed by the bread that he has produced.

What limits the production of goods and services is the introduction of better tools and machinery (i.e., capital goods), which raises workers productivity.

Tools and machinery however are not readily available - they must be produced. In order to make them, people must allocate consumer goods that will sustain those individuals engaged in the production of tools and machinery.

This allocation of consumer goods is what savings is all about. Since saving enables the production of capital goods, saving is obviously at the heart of the economic growth that raises people's living standards.

Observe that the saved consumer goods support all the stages of production, from the producers of consumer goods to the producers of raw materials, the producers of tools and machinery, and all the other intermediate stages of production and services.

Also, note that individuals do not want various tools and machinery as such but rather consumer goods. In order to maintain their life and wellbeing people require access to consumer goods.

Introducing Money

The introduction of money does not alter the essence of saving. Money fulfills the role of the medium of exchange. It enables the output of one producer to be exchanged for the output of another producer. Note that while money serves as the medium of exchange, it does not produce goods and services.

According to Rothbard,

Money, per se, cannot be consumed and cannot be used directly as a producers' good in the productive process. Money per se is therefore unproductive; it is dead stock and produces nothing.1

Note also that, in the money economy, ultimate payment is made by exchanging real goods and services for other real goods and services, with this exchange simply being facilitated by money. Thus, a baker exchanges his bread for money and then employs that money to buy other goods and services, implying that he pays for other goods and services with his bread. Money only facilitates this payment.

Contrary to popular thinking, it does not follow that one can lift economic growth via the printing presses. When money is printed—that is, created "out of thin air" by the central bank or through fractional reserve
banking—it sets in motion an exchange of nothing for money and then money for something. This results in an exchange of nothing for something.

An exchange of nothing for something amounts to consumption that is not supported by production.

When money "out of thin air" gives rise to consumption that is not supported by preceding production, it lowers the amount of real savings that supports the production of goods of a wealth producer. This, in turn, undermines his production of goods, thereby weakening his effective demand for the goods of other wealth producers.

The other wealth producers are then forced to curtail their production of goods, thereby weakening their effective demand for the goods of yet other wealth producers. In this way, money "out of thin air" that destroys savings sets up the dynamics of the consequent shrinkage of the production flow.

Observe that what has weakened the demand for goods is not the sudden and capricious behavior of consumers, but the increase in money out of "thin air." Every dollar that was created this way amounts to a corresponding dissaving by that amount.

As long as the pool of real savings is expanding, the central bank and government officials can give the impression that loose monetary and fiscal policies drive the economy. This illusion is shattered once the pool becomes stagnant or starts declining.

What enables the expansion of the flow of production of goods and services is savings. It is through savings, which give rise to production, that demand for goods can be exercised. There can be no effective demand without prior production. If it were otherwise, poverty in the world would have been eradicated a long time ago.

Do People Save Money?

People do not save money. Rather they exchange it for goods and services. Once savings are exchanged for money, the holder of the money can employ it immediately in an exchange for other goods or can hold it temporarily.

Whether he uses it immediately in an exchange for other goods, puts it under the mattress, or keeps it in his pocket will not alter the existing pool of savings. How individuals decide to employ their money will only alter their demand for money. This, however, has nothing to do with savings, which are the production of consumer goods in excess of the consumption of these goods.

By lending money, individuals also in fact lower their demand for money. The act of lending does not alter the existing pool of savings, either. Likewise, if the owner of money decides to acquire a financial asset such as a bond or a stock, he simply transfers his money to the seller of that financial asset—no present savings are affected because of these transactions.

Conclusions

Contrary to popular thinking, monetary expansion cannot generate economic growth, but rather economic destruction. The heart of economic growth is the expanding pool of real savings. Monetary pumping destroys the flow of real savings and in turn undermines the prospects for economic growth. Any attempt to replace savings with money will end in an economic disaster.


Frank Shostak's consulting firm, Applied Austrian School Economics, provides in-depth assessments of financial markets and global economies.

This article was originally published on Mises.org.

The State: The Deadliest Virus
by Jesús Huerta de Soto

The deadliest virus is the institutionalized coercion which lies in the very DNA of the state and may even initially permit a government to deny the outbreak of a pandemic. Evidence has been suppressed, and heroic scientists and doctors have been harassed and silenced simply because they were the first to realize and expose the gravity of the problem. As a result, weeks and months have been lost, at an enormous
cost: hundreds of thousands of people have died due to the worldwide spread of an epidemic which, in the beginning, the shamefully manipulated official statistics made appear less dangerous than it actually was.

The deadliest virus is the existence of cumbersome bureaucracies and supranational organizations, which did not manage or wish to monitor in situ the reality of the situation, but instead endorsed the information received, while offering constant support and even praising—and thus becoming accessories to—all the coercive policies and measures adopted.

The deadliest virus is the notion that the state can guarantee our public health and universal welfare, when economic science has demonstrated the theoretical impossibility of the central planner’s giving a coherent and coordinating quality to the coercive commands it issues in its attempt to achieve its pompous objectives. This impossibility is due to the huge volume of information and knowledge which such a task would require and which the planning agency lacks. It is also, and primarily, due to the fact that the institutional coercion typical of the agency impacts the social body of human beings, who alone are capable of coordinating themselves (and do so spontaneously) and creating wealth. Such coercion prevents the emergence of precisely the firsthand knowledge the state needs to bring about coordination with its commands. This theorem is known as the impossibility of economic calculation under socialism. Mises and Hayek discovered the theorem in the 1920s, and the events of world history cannot be understood without it.

The deadliest virus is the dependency and complicity shown toward the state by countless scientists, experts, and intellectuals. When authorities are drunk with power, this symbiosis leaves a manipulated civil society unarmed and defenseless. For instance, the Spanish government itself urged citizens to take part in mass demonstrations of hundreds of thousands of people while the virus was already spreading exponentially. Then, just four days later, the decision was announced to declare a state of alarm and coercively confine the entire population to their homes.

The deadliest virus is the demonization of private initiative and of the agile and efficient self-regulation characteristic of it, combined with the deification of the public sector in every area: the family, education, pensions, employment, the financial sector, and the healthcare system (a particularly relevant point at present). Over 12 million Spanish people, including—quite significantly—almost 90 percent of the more than 2 million government employees (and among them a vice president of the Spanish government), have freely chosen private healthcare over public healthcare. The doctors and nurses of the public healthcare system work hard and selflessly, and their heroic efforts are never sufficiently recognized. However, the system cannot possibly do away with its internal contradictions, its waiting lists, or its proven incompetence in the matters of universal prevention and the protection of its own workers. But, by a double standard, any minor defect in the private sector is always immediately condemned, while far more serious and flagrant defects in the public sector are viewed as definitive proof of a need to spend more money and increase the size of the public sector even further.

The deadliest virus is the political propaganda channeled through state-owned media and also through private media outlets which, nonetheless, are dependent on the state as if it were a drug. As Goebbels taught, lies repeated often enough to the population can be turned into official truths. Here are a few: that the Spanish public healthcare system is the best in the world; that public spending has continued to decrease since the last crisis; that taxes are to be paid by “the rich” and they are not paying their fair share; that the minimum wage is not detrimental to employment; that maximum prices do not cause shortages; that a universal minimum income is the panacea of well-being; that the northern European countries are selfish and unsupportive, because they do not wish to mutualize the debt; that the number of deaths officially reported reflects the actual number of deaths; that only a few hundred thousand people have been infected; that we are performing more than
enough tests; that face masks are unnecessary, etc. Any moderately diligent citizen can easily verify that these are all lies.

The deadliest virus is the corrupt use of political terminology involving misleading metaphors to mesmerize the population and make people even more submissive and dependent on the state. We are told that we are fighting a “war,” and that once we win, we will need to begin the “reconstruction.” But we are not at war, nor is it necessary to reconstruct anything. Fortunately, all of our capital equipment, factories, and facilities are intact. They are there, waiting for us to devote all of our effort and entrepreneurial spirit to getting back to work, and when that happens, we will very quickly recover from this standstill. However, for this to occur, we must have an economic policy that favors less government and more entrepreneurial freedom, reduces taxes and regulations, balances public accounts and puts them on a sound footing, liberalizes the labor market, and provides legal certainty and bolsters confidence. While such a free market policy enabled the Germany of Adenauer and Erhard to recover from a far graver situation following World War II, Spain will be impoverished and doomed to move at idling speed if we insist on taking the opposite path of socialism.

The deadliest virus consists of the deification of human reason and the systematic use of coercion, which the state embodies. It appears before us in sheep’s clothing as the quintessence of a certain “do-goodism” that tempts us with the possibility of reaching nirvana here and now and of achieving “social justice” and ending inequality. However, it conceals the fact that the Leviathan thrives on envy and thus fuels hatred and social resentment. Hence, the future of humanity depends on our ability to immunize ourselves against the most deadly virus: the socialism which infects the human soul and has spread to all of us.

Jesús Huerta de Soto, professor of economics at King Juan Carlos University, is Spain’s leading Austrian economist, and a Senior Fellow of the Mises Institute. As an author, translator, publisher, and teacher, he also ranks among the world’s most active ambassadors for classical liberalism. He is the author of Money, Bank

Credit, and Economic Cycles, as well as Socialism, Economic Calculation and Entrepreneurship (Edward Elgar 2010), The Austrian School (Edward Elgar 2008) and The Theory of Dynamic Efficiency (Routledge 2009).

This article was originally published on Mises.org.

**Are Fractional Reserve Bank Deposits Money?**

By Robert Blumen

The issue of fractional versus 100 percent bank reserves has been much debated. One of major disputes is whether fractional reserve banking (FRB) is inherently fraudulent, or whether the mix of cash and other assets to be held against liabilities is a business decision, to be made by banks and customers? This article will show that attempts to construct a nonfraudulent FRB result in assets that are not money.

**Deposit Banks, Credit Banks, and Fractional Reserves**

The article starts from a world in which gold is the monetary commodity. One hundred percent reserve deposit banks accept gold in exchange for a bank deposit or banknotes. Credit banks are distinct from deposit banks. They are financial intermediaries that accept funds (not deposits) as loans, and then seek profits by lending the money out at a higher rate.

In his book on banking, Huerta de Soto argues that deposit banking is coherent from a legal standpoint when it is 100 percent reserve, and that before they became a standard feature of banking, fractional reserve banks were understood to be fraudulent by banks and customers alike.

**Nonfraudulent Fractional Reserve**

We shall try to construct a fractional reserve financial institution that overcomes the problem of consumer fraud. Starting with a credit bank, where the customers supply loans to the bank which are liabilities on its balance sheet, a fraction are loaned out. The bank agrees to meet requests for withdrawals on a best-
When loaning money to a fractional reserve financial institution, the customer must sign a disclosure in which they are fully informed that withdrawals are merely requests for the bank to consider and will be met only as long as there is enough cash on hand, at the discretion of the bank. Withdrawals may be denied if cash is not available, or even if the bank simply wishes to conserve equity to protect against loan losses or to purchase other assets.

What happens if a withdrawal is denied? By construction, the bank is allowed to do this and is not in default. However, to get some idea of how this might be handled, we will walk through the history of how fraudulent banks have handled defaults.

When a fraudulent bank runs out of gold and cannot meet the next customer withdrawal, it is bankrupt. What happens then? The bank would go into bankruptcy court. The depositors, as creditors of the bank, would become equity holders in its assets. The settlement would distribute the bank’s remaining assets to all creditors, with those depositors receiving a share of the equity, perhaps in the form of stock. If a bank held a portfolio consisting of bonds, home mortgages, credit card receivables, and small business loans, dividing them up among thousands or millions of depositors into equal assets would be difficult. The bankruptcy court might sell off the assets to a pension fund, insurance company, or a different (solvent) bank and distribute the proceeds as cash to the creditors.

If one bank fails due to bad management, that will work. The systemic problem with fractional reserve banking is that banks have obligations to other banks through interbank clearing. A bank run on a single bank in an interdependent system creates a contagion through interbank liabilities, leading to a systemic banking failure.

A number of models have been proposed, or tried out in practice, to prevent the contagion from infecting other banks when the legal system does not want to accept the reality of a bankruptcy. These approaches treat the inability to redeem deposits for gold as a bug, not a feature. The bank was merely suffering a bit of bad luck when too many depositors tried to redeem all at once, at a time when illiquid assets could not easily be sold. This view sees the redemption failure as a temporary “liquidity problem, not a solvency problem,” rather than an inherent flaw in fractional reserve. Mass psychology, a bit of herding behavior, perhaps reinforced by internet bloggers, is to blame.

One strategy for postponing redemptions is the euphemistically named bank holiday. Banks are open for business, accept deposits, buy and sell assets, but suspend withdrawals until a government bailout or some other means of injecting more equity into the banking system can be arranged. Another strategy is social pressure to discourage withdrawals. Rothbard in his critical review of White’s work on free banking describes this practice. A third possibility is an option clause, which Dowd describes as a contract which allows an issuing bank to defer redemption under certain conditions. These conditions would normally specify a maximum period for which redemption could be deferred, and a compensation rate of interest that would be paid to noteholders whose demands for redemption were deferred.

A money market fund (MMF) serves a similar purpose. These funds invest in highly liquid short-term debt such as commercial paper or T-bills. The investor in an MMF holds an ownership stake in the fund’s portfolio. Unlike a bank deposit, a check written on an MMF instructs the fund to sell assets in its portfolio for cash in exactly the quantity needed to cover the liquidation and then to deposit the proceeds in a bank, when they can be transferred to the recipient of the check.

Shares in MMFs are issued at a nominal value of $1, however the value represents nothing other than a current quotation for the value of the fund’s loan portfolio. Although MMFs strive to maintain the value of the portfolio at or in excess of $1 per share, there is no guarantee that they will be able to do so under all conditions. Indeed, there have been cases where MMFs have broken the buck, but that is considered a
normal business risk, not a default.

To return to our preceding discussion of how fractional reserve banks and depositors may respond to the inevitable event of a liquidity failure, in our hypothetical bank one or more of these methods would be contracted up front with the customer. This avoids the possibilities of fraud or of the customer being surprised when they cannot redeem their deposit at par.

**Do Legit Fractional Reserve Accounts Contain Money?**

The question is now, Are the fully disclosed fractional reserve bank accounts money? A 100 percent reserve account can at all times be redeemed for the nominal value in gold. A fully disclosed FRB account not so much. FRB accounts are not holdings of gold; they are complex credit securities. Their value is analyzed first by looking at the ability of the debtor to cover interest payments and, failing that criteria, at the fraction of the principal value of the debt that could be covered by sales of the assets in bankruptcy.

The analysis of an individual bond or debt can become quite complex. A bank’s portfolio can contain thousands of distinct assets valued in aggregate at billions of dollars. A simple example makes this point. Consider an account with a fractional reserve bank offering an option clause in which redemptions can be suspended for up to thirty days on payment of a 10 percent penalty rate. What is the value of $1,000 deposited into this financial institution’s account? To answer that question requires knowledge or estimate of the interest rate paid, the probability of a suspension, the 10 percent penalty (valued at $100) discounted to the present value, the chance of the financial institution going into bankruptcy, and the haircut that would be applied to the account during the liquidation. Securities analysis does offer analytical tools for the valuation of options, which involve higher mathematics.

This is the reason that accounts that are fractionally reserved are not money. It is inherent that money is one good, everywhere one and the same thing within the market where it is accepted. Money is the most marketable good in the economy:

*Money is a medium of exchange. It is the most marketable good which people acquire because they want to offer it in later acts of interpersonal exchange. Money is the thing which serves as the generally accepted and commonly used medium of exchange. This is its only function.*

Money prices must all be expressed in the same unit. Fractional reserve accounts are not uniform. They are complex financial instruments. Each one is a special snowflake which can only be fully understood in relation to the assets and liabilities of the fractional reserve bank where they are held. This analysis requires access to information that may not be disclosed, and it requires special skills. To accept fractionally reserved bank notes or checks in payment, sellers would have to have some idea of the discount to apply for each bank. The discount factor could possibly be provided by ratings agencies, but the further we go in that direction, the further away we go from a universal medium of exchange toward a complex barter system in which nonconvertible assets are traded at calculated values that require a specialist to obtain market value pricing. Imagine if you were selling a car and someone offered 2 percent of his assets consisting of some rental properties, shares of stocks, and mutual funds. How would you evaluate the offer compared to an all-cash offer? What if you ended up owning 1 percent of the buyer’s rental property?

Compare this to the simplicity of the 100 percent reserve banking system. With 100 percent reserves, money is everywhere the same thing, deposits are valued at par, banks function as warehouses, and deposits as baiiments are the property of the depositor, not the property of the bank.1


This article was originally published on Mises.org.
Part 1 Lesson 15: Basic Understandings

Content: Page 26 Becoming Your Own Banker Fifth Edition

You “finance” everything you buy. You either pay interest to someone else or you give up interest you could have earned.

Create an entity—A plan— which you control and it makes money on your loans. One such entity can be a life insurance plan. Life insurance companies hire actuaries who design plans of insurance and then market those plans through agents. When someone buys one of these plans, the contract is very specific to point out who owns the plan (or policy). It is not the insurance company! The company is simply the administrator of the plan and must collect premiums—and must lend money out or make investments of one kind or another in order to be able to pay the death claims promised. Money is lent to any number of places and types of borrowers, including the owner of the policy if the owner so desires. The amount of money available to the owner is the entire equity in the policy at the time. In the hierarchy of places where money is lent, the owner ranks first. That is absolute control!

At the end of the year, the Life Insurance company makes an accounting of the experience that year of the death claims paid, the earnings on premiums collected, and the expenses of running the company. A dividend is declared which is actually a return to the policy owner of surplus premium that was collected. Hence, it is not an earning and, therefore, is not taxable. When that dividend is then used to buy additional paid-up insurance at cost, then the result is continuous compounding of an ever-increasing base.

It looks like this diagram:

![Diagram](Image)
The following financial professionals joined or renewed their membership to our Authorized Infinite Banking Concepts Practitioners team this month:

- Mike Everett - Lawrence, Kansas
- Anthony Faso - Las Vegas, Nevada
- Monica Felton - Scottsdale, Arizona
- John Hasche - Lake Preston, South Dakota
- Steve Hasche - Lake Preston, South Dakota
- William Hassler - Ocala & Sarasota, Florida
- W. Douglas Jones - Dalton, Georgia
- Peter Lount - Toronto, Ontario
- Vance Lowe - Arlington, Texas
- Frank Lupu - Boise, Idaho
- John Moriarty - Saint Louis, Missouri
- Joey Mure - Birmingham, Alabama
- Joseph Myers - Jacksonville, Florida
- Thomas O’Connell - Rockaway, New Jersey
- Ryan Ranuio - Ventura, California
- Carl Rogers - Charlotte, North Carolina

You can view the entire practitioner listing on our website using the Practitioner Finder.

IBC Practitioner’s have completed the IBC Practitioner’s Program and have passed the program exam to ensure that they possess a solid foundation in the theory and implementation of IBC, as well as an understanding of Austrian economics and its unique insights into our monetary and banking institutions. The IBC Practitioner has a broad base of knowledge to ensure a minimal level of competency in all of the areas a financial professional needs, in order to adequately discuss IBC with his or her clients.