How Central Banks Promote Money-Creation by Private Banks

Frank Shostak

Some commentators consider fractional reserve banking as a major vehicle for the expansion in the money supply growth rate. What is the nature of this vehicle?

Fractional reserve banking arises because banks legally are permitted to use money placed with them in demand deposits. Banks treat this type of money as if it was loaned to them. However, is this really the case?

When John places $100 in a safe deposit box with Bank One he does not relinquish his claim over the $100. He has an unlimited claim against his money. Likewise, when he places $100 in a demand deposit at Bank One he also does not relinquish his claim over the deposited $100. Also in this case John has an unlimited claim against his $100.

Now let’s assume that Bank One takes $50 out of John’s demand deposit without getting any consent from John in this regard and lends this to Mike. By lending Mike $50, the bank creates a deposit for $50 that Mike can now use.

Remember that John still has an unlimited claim against the $100 while Mike has now a claim against $50. What we have here that the Bank One has generated an extra spendable power to the tune of $50. We can also say that Bank One has $150 deposits that are Bank's One liabilities, which are supported by $100 cash, which are Bank One's reserves. Note that the reserves comprise 66.7% of Bank’s One deposit liabilities. This example indicates that Bank One is practicing fractional reserve banking.

Although the law allows for this type of practice, from an economic point of view, this results in money out of “thin air” which leads to consumption that is not supported by production, (i.e., to the dilution of the pool of real wealth).

According to Mises,

It is usual to reckon the acceptance of a deposit which can be drawn upon at any time by means of notes or checks as a type of credit transaction
and juristically this view is, of course, justified; but economically, the case is not one of a credit transaction. ... A depositor of a sum of money who acquires in exchange for it a claim convertible into money at any time which will perform exactly the same service for him as the sum it refers to, has exchanged no present good for a future good. The claim that he has acquired by his deposit is also a present good for him. The depositing of money in no way means that he has renounced immediate disposal over the utility that it commands.\(^1\)

Similarly, Rothbard argued,

In this sense, a demand deposit, while legally designated as credit, is actually a present good — a warehouse claim to a present good that is similar to a bailment transaction, in which the warehouse pledges to redeem the ticket at any time on demand.\(^2\)

**Why a Free Unhampered Market Would Limit Fractional-Reserve Banking**

In a truly free market economy, the likelihood that banks will practice fractional-reserve banking will tend to be significantly lower than in a system with a central bank.

In an unhampered market, if a particular bank tries to practice fractional-reserve banking it runs the risk of not being able to honor its checks.

For instance, if Bank One lends out $50 to Mike out of $100 deposited by John, it runs the risk of going bankrupt. Let us say that both John and Mike have decided to exercise their claims. Let us also assume that John buys $100 worth of goods from Tom while Mike buys goods for $50 from Jack. Both John and Mike pay for the goods with checks against their deposits with Bank One.

Now Tom and Jack deposit their received checks with their bank — Bank B, which is a competitor of Bank One. Bank B in turn presents these checks to Bank One and demands cash in return. However, Bank One has only $100 in cash — it is short $50. Consequently, Bank One is running the risk of going bankrupt unless it can quickly mobilize the cash by selling some of its assets or by borrowing.

The fact that banks must clear their checks will be a sufficient deterrent to the practice of fractional-reserve banking in a free market economy. Furthermore, it must be realized that the tendency of being “caught” practicing fractional-reserve banking, so to speak, rises when there are many competitive banks. As the number of banks rises, and the number of clients per bank declines, the chances that clients will spend money on goods from individuals that are banking with other banks will increase. This in turn will increase the risk of the bank not being able to honor its checks once the bank begins the practice of fractional-reserve banking.

Conversely, as the number of competitive banks diminishes, that is as the number of clients per bank rises, the likelihood of being “caught” practicing reserve banking is diminished. In the extreme case if there is only one bank it can practice fractional-reserve banking without any fear of being “caught,” so to speak.

Thus if Tom and Jack are also clients of Bank One, then once they deposit their received checks from John and Mike, the ownership of deposits will be now transferred from John and Mike to Tom and Jack. This transfer of ownership, however, will not cause any effect to Bank One.

We can then conclude that in a free market, if a particular bank tries to expand credit by practicing fractional-reserve banking, it runs the risk of being “caught.” Hence in a truly free market economy the threat of bankruptcy will bring to a minimum the practice of fractional-reserve banking.

The fact that banks must clear their checks will be a sufficient deterrent in many cases to the practice of fractional-reserve banking in a free market economy. The practice will not be prevented in its entirety, but market competition will work to localize and limit its effects.

**Fractional Reserve Banking in the Presence of a Central Bank**

The presence of a central bank removes the free market deterrent from banks to generate money out
of thin air. By injecting monetary reserves to the banking system, the central bank can dictate the increase in money supply via the fractional reserve banking.

According to the popular way of thinking, if the Fed injects $1 billion into the economy and banks have to hold only 10% in reserves against their deposits, this will cause the first bank to lend 90% of this $1 billion. The $900 million in turn will end up with the second bank, which will lend 90% of the $900 million. The $810 million will end up with a third bank, which in turn will lend out 90% of $810 million and so on.

Consequently, the initial injection of $1 billion will become $10 billion (i.e., the money supply will expand by a multiple of 10).

Observe that banks respond to the initial injection of $1 billion by the Fed, which coupled with the legal reserve requirements of 10%, sets in motion the monetary expansion of $10 billion. In this framework, banks are responding to the injection of reserves by the central bank.

However, does all this make much sense given that the central banks in the world today do not target money supply but rather set targets for the overnight interest rate like the federal funds rate in the United States? Surely then the entire multiplier model must be suspect.

Indeed economists from the post-Keynesian school of economics (PK) have expressed doubt [6] about the validity of the popular framework. In the present monetary framework, it is held the job of the central bank is to ensure that the level of cash in the money market is in tune with the interest rate target.

For instance, if on a particular day the government intake of cash exceeds outlays, this leads to a deficiency of cash in the money market on that day. To prevent a scramble for cash in the money market and a subsequent increase in the overnight interest rate, the central bank must inject an appropriate amount of cash in order to keep the interest rate at the target. Note that the central bank here is performing a balancing act, or so it is held.

The PK school of thought maintains that, central banks do not actively pursue monetary pumping to influence various economic data in the economy; the central bank is just aiming at keeping the money market well balanced. (The exception to this is 2008 when the Fed aggressively pumped money to the economy to counter the economy sliding into a depression - the belief held by the then Federal Reserve Chairman Ben Bernanke).

In this way of thinking, it would appear that the central bank has nothing to do, at least directly, with an expansion in the money supply. The key source of money expansion, it is held, is commercial banks via an expansion in lending that set in motion an expansion in the money supply. (For PK economists, the demand for loans, plus the willingness of banks to lend, determines the quantity of loans and thus of deposits created).

The supply of loans, in this way of thinking, is never independent of demand — banks supply loans only because someone is willing to borrow. To conclude, then, according to this way of thinking, the driving force of bank-credit expansion — and thus money-supply expansion — is the increase in the demand for loans and not the central bank as the money multiplier model presents.

Central Banks Remain the Key Factor

Superficially, it does make sense to conclude that central bank policies are of a passive nature and central banks just aim at keeping the money market in balance. In reality, central banks are far from being passive. In fact, without central banks being active it would be impossible for banks to expand lending. Here is why.

Let us say that for whatever reason banks are experiencing an increase in demand for loans. Also, let us assume that the supply of loanable funds is unchanged. According to PK, bank loans will increase. The demand-deposit accounts of the new borrowers will now also increase. Obviously, the new deposits are likely to be employed in various
transactions. After some time elapses, banks will be required to clear their checks and this is where problems might occur. Some banks will find that to clear checks they are forced either to sell assets or to borrow the money from other banks (remember the pool of loanable funds remains unchanged).

Obviously, all this will put an upward pressure on money-market interest rates and in turn on the entire interest-rate structure. To prevent the rise in the overnight interest rate above the interest-rate target, the central bank will be forced to pump money. Therefore, the conceptual outcome as depicted by the multiplier model remains intact here. The only difference is that banks initiate the lending process, which is then accommodated by the central bank.

It follows then that the expansion of large amounts of credit out of "thin air" cannot emerge without the support from the central bank. The modern banking system can be seen as one huge monopoly bank which is guided and coordinated by the central bank. Banks in this framework can be regarded as branches of the central bank. For all intent and purposes the banking system can be seen as one bank. (Note that a monopoly bank can practice fractional-reserve banking without running the risk of being “caught”.)

If the expansion of credit out of thin air requires the support of the central bank then one can infer that, in a free market without the central bank, the likelihood of such an expansion emerging is not very high.

Again, if a particular bank tries to expand credit without the backup from a genuine lender — i.e., practicing fractional-reserve banking — it runs the risk of not being able to honor its checks, which raises the risk of bankruptcy.

In a free market then, without the central bank, the fact that banks must clear their checks is likely to be a sufficient deterrent to the practice of fractional-reserve banking.

Finally, not only does fractional-reserve banking gives rise to monetary inflation it is also responsible for monetary deflation. Since banks by means of fractional-reserve banking generate money out of “thin air”, then whenever they do not renew their lending they in fact give rise to the disappearance of money.

This must be contrasted with lending of genuine money, which can never physically disappear unless it is physically destroyed. Thus when John lends his $50 via Bank One to Mike the $50 is transferred to Mike from John. On the day of the maturity of the loan Mike transfers to Bank One $50 plus interest. The bank in turn transfers the $50 plus interest adjusted for bank fees to John — no money has disappeared.

If however, Bank One practices fractional-reserve banking and lends the $50 to Mike out of “thin air,” then on the day of maturity when Mike repays the $50 the money goes back to the bank — the original creator of this empty money, i.e., money disappears from the economy, or it vanishes.

From this we can also conclude that the fractional reserve banking which is supported by the central bank is the key to the menace of the boom-bust cycle. We can also conclude that in a truly free market the likelihood for boom-bust cycle to emerge will tend to be low.


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

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3 Charts Showing Just How Boxed-in the Fed Is

by Robert P. Murphy

The Fed met market expectations by cutting its target for the fed funds rate by 25 basis points, down to the range of 1.75 - 2.00 percent. In this post I want to demonstrate just how boxed in the Fed has now become, with the help of 3 charts.

First, let's review just how low interest rates have been (and still are), in a long-term historical context:

As the chart shows, the (effective) fed funds rate was in this range back during the early 2000s, which helped spawn the housing bubble and bust (as I predicted in this Mises.org article [3] which ran 11 months before the financial crisis). Before then, we have to go all the way back to the early 1960s to see rates this low. And furthermore, to the extent that Mises was right, and artificially low interest rates lead to an unsustainable boom, then the seven years of virtually zero percent interest rates (from December 2008 - December 2015) have fostered a plethora of malinvestments.

Now here's the irony: In the midst of the Fed cutting rates, and injecting $75 billion in repo operations [4] on Tuesday to push down a spike in short-term rates, at least on paper we see that everything seems to be fine. Specifically, consumer price inflation [5] is a bit lower than the Fed's desired level but is still at a "healthy" 1.8% (year over year, as of August), while the official unemployment rate is still at a 50-year low:

Finally, despite the apparently healthy economy (vis-a-vis the Fed's "dual mandate"), there is still an extraordinary stockpile of excess reserves in the banking system, relative to the pre-crisis era:

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Medical metaphors for economics are never perfect, but we can certainly say this: Far from being in the midst of a robust "recovery," the patient—i.e. the US economy—is still incredibly weak, needing constant infusions of medicine to stave off a crisis in its circulation.

On the one hand, it's refreshing that Fed officials don't think the economy can be summed up in two numbers, namely the official unemployment and consumer price inflation rates. But on the other hand, the fact that the Fed is cutting rates now, in spite of the "healthy numbers," is an ominous indication of just how deep the rot goes in the economy's capital structure.

Unfortunately, the world may soon see exactly why 7 years of unprecedently loose monetary policy was a very foolish idea.

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**The Driving Force of Free Markets Is Empathy, Not Greed**

by Dr. Rainer Zitelmann

Both capitalists and anti-capitalists frequently accuse capitalism of being a system driven by selfishness and greed. Capitalism’s defenders sometimes say: “By nature, man is selfish, which is why socialism will never work. Capitalism better reflects the fundamental characteristics of human nature.” Anti-capitalists claim that capitalism promotes the worst characteristics in man, especially greed.

But are greed and unbridled selfishness really the driving forces of capitalism? Human self-interest is one—not the only—driving force of all human action. But this has nothing to do with a particular economic system. Rather, it is an anthropological constant. In capitalism, however, this self-interest is curbed by the fact that only the entrepreneur who prioritizes other people’s needs can be successful.

**Successful Entrepreneurs Are Empathetic**

There is overwhelming evidence to suggest that empathy, rather than greed, is the true driving force of capitalism. Empathy is the ability to recognize and understand another person’s feelings and motives, and this is the most important characteristic of successful entrepreneurs.

Take Steve Jobs as an example. He came up with the iPhone and other products because he understood modern consumers’ needs and desires better than anyone else. Under capitalism, consumers can (and do) punish companies that behave selfishly and lose sight of the needs of their customers.

The same applies to Mark Zuckerberg, today one of the world’s richest people. He created Facebook because he knew better than other entrepreneurs what people wanted. Like all successful entrepreneurs, it was consumers who made Steve Jobs and Mark Zuckerberg so rich.

For many years, the Albrecht brothers were the richest people in Germany. They earned their fortunes from the food discounter Aldi, which was founded on the principle of offering good quality...
products at very reasonable prices. This was the same recipe for success followed by Sam Walton, the founder of Walmart, who was consistently one of the richest people in the United States.

Consumers’ purchasing decisions confirm that Jobs, Zuckerberg, the Albrecht brothers, and Sam Walton had correctly understood their customers’ desires, needs, and emotions.

The Market Punishes Self-Centered Entrepreneurs

Of course, under the capitalist system, there are also examples of companies that have acted selfishly and lost sight of the wants and needs of consumers.

One example is Deutsche Bank, which has faced thousands of lawsuits. Such companies are punished under capitalism, not only by the law but far more so by the market. Deutsche Bank lost its position as one of the world’s leading banks because it put the interests of its investment bankers above those of its customers and shareholders.

A company’s most important asset is its image, and companies that behave like Deutsche Bank end up incurring massive damage to their images and reputations; their customers lose confidence and flock to their competitors.

In socialist systems, on the other hand, consumers are powerless and at the mercy of state-owned companies. If a state enterprise acts with no regard for the needs of consumers, they have no alternative under socialism because there is no competition.

Under capitalism, consumers can (and do) punish companies that behave selfishly and lose sight of the needs of their customers. Every day, customers vote on the company with their wallets—by buying its products or not.

What About Monopolies?

Monopolies under capitalism are a temporary phenomenon. Even companies that appear omnipotent will eventually be ousted by new competitors as soon as they overreach their power and lose sight of their customers’ needs.

Ever since capitalism has existed, anti-capitalists have criticized the system’s inherent tendency to create monopolies. Lenin wrote over 100 years ago that imperialism and monopoly capitalism are the last stages of capitalism. But the monopolies he criticized at the time no longer exist. Even companies that appear omnipotent today, such as Google or Facebook, will not retain their power forever. Other companies and ambitious young entrepreneurs will seize the opportunity as soon as Google or Facebook starts to act too selfishly.

What is strange is that socialists who criticize capitalism for its tendency to form monopolies are in favor of state-owned companies. After all, the state is the most powerful monopolist of all, with the ability to brutally trample on the needs and wishes of its citizens through its means of coercion and because there are no alternatives for the customer.

In Summary

The fact that people and companies pursue their own interests is the same in every society. This is not a specific feature of capitalism.

Under capitalism, though, only those entrepreneurs and companies who prioritize their customers’ interests rather than their own self-interest will achieve success in the long-term. Companies that fail to understand and respect what consumers want will lose market share and may even disappear entirely as they are driven out by other companies that better meet their customers’ needs.

Empathy, the ability to recognize the desires and needs of others, is the true basis of capitalism—not unbridled greed and selfishness.

Dr. Rainer Zitelmann is a historian and sociologist. He is also a world-renowned author, successful businessman and real estate investor. His most recent book, The Power of Capitalism, was released in 2019.

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There's Nothing Natural About Socialism

by Allen Gindler

The socialist idea has many forms and flavors; however, one can observe three main paths toward socialism. They are the socialization of the means of production, wealth redistribution, and collectivization of consciousness. Different socialist movements use these three approaches to varying degrees.

Orthodox Marxists and Marxist-Leninists consider outright expropriation of private property as the primary way toward a socialist society. Italian Fascists and German National Socialists allowed de jure private property, but established de facto total control over all spheres of economic activities. The subjugation of the individual to the collective, which is collectivization of consciousness, and wealth redistribution were their preferred paths toward socialism. In all of these cases, though, we find totalitarianism is a common denominator, and the most odious regimes of the 20th century utilized collectivization of consciousness to the fullest degree.

"Evolutionary" Socialists

Social democracy, or democratic socialism, as it has become known in the US, chose a middle path. Evolutionary socialists have not explicitly called for the expropriation of private property, nor they have advocated for the establishment of a totalitarian state. On the contrary, they have been supporting democratic institutions and private enterprises, especially while being in opposition. Their modus operandi is to gradually undermine capitalism from within and portray this process as a natural development of human society.

The world wars played a crucial role in establishing social democracy as the main force of the left in post-industrialized countries. Thus, fascism, national socialism, and communism had discredited themselves in the eyes of the majority of people. The former two were burned in the flames of WWII; the latter was suffocated during the Cold War. Thus, left had a clear winner: social democracy. Anarchists, syndicalists, and the residue of Marxists and fascists had not played a significant role in the political life of Europe and North America. Instead, they acted the part of a scarecrow which reminded everyone: “better me (mild socialism) than them.”

Morality and Equality

The philosophical basis of social democracy is the Kantian concept of the self-integrity of the human person from which — they claim — follows ethical justification for socialism. Democratic socialists call for economic equality as a moral principle and seek to gain it through the mechanism of wealth redistribution. Numerous social programs are fueled by wealth redistribution that society ought to support according to the highest moral standards. As soon as a new social-oriented idea finds its way into the law of the land, the next generation of people will consider it as a given and will not even suspect that it was possible to live without those rules. Moreover, it will become almost impossible to roll back some socialist-style laws. For example, the idea of the abolishing of the Social Security Act would be considered absurd by many.

The socialist doctrine based on superior morality has steadily penetrated governments, academia, media, and international institutions over the years. Socialism was being injected in small doses by invoking ethical arguments of the highest degree for the benefit of some groups or individuals or human society as a whole. The key to the success of evolutionary socialism has been its gradualism and steadiness. It has helped to mask socialist transformations as continuous improvements to human society due to the acceptance of ever-higher moral qualities and the defense of noble causes. For example, the contemporary left utilizes a desire to “save the planet" as a pretext to inject even more socialism into the body of free societies.

It's Not a Natural Evolution

The 20th century was the century of spending. All developed countries exhibited a steady growth of
social spending from virtually zero at the end of the 19th century up to a maximum of almost 32% GDP, as was the case in France, illustrated in Pic. 1.

Nonetheless, the notion of wealth redistribution is the central tenet of democratic socialism, so these socialists become more concerned about the centrally-planned redistribution of wealth rather than the production of wealth. And this illustrates the main difference between free economies and socialist-planned economies. Socialists want to redistribute wealth in a manner fitting to government planners. But advocates of free choices seek to allow free individuals to distribute resources through the marketplace — where wealth is built in proportion to how much one serves others. The democratic socialists are committed to breaking that naturally-occurring and proportional system through wealth redistribution which is in essence a latent and continuous expropriation of private property.

Consequently, democratic socialism is dangerous.
like other flavors of socialism and does not constitute a natural development of human society. On the contrary, it is an artificial construct that leads nations into an evolutionary dead end. All countries that practiced socialism of various flavors have never achieved economic equality but rather a sameness in their misery. The history of ex-Soviet republics shows that the only way out of poverty and moral decadence is embracing capitalism again.

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**Negative Interest Rates are the Price We Pay for De-Civilization**

by Jeff Deist

Do central bankers really think negative interest rates are rational?

"Calculation Error," which Bloomberg terminals sometimes display1, is an apt metaphor for the current state of central bank policy. Both Europe and Asia are now awash in $13 trillion worth of negative-yielding sovereign and corporate bonds, and Alan Greenspan suggests negative interest rates soon will arrive in the US. Despite claims by both Mr. Trump and Fed Chair Jerome Powell concerning the health of the American economy, the Fed's Open Market Committee moved closer to negative territory today — with another quarter-point cut in the Fed Funds rate, below even a measly 2%.

Negative interest rates are just the latest front in the post-2008 era of "extraordinary" monetary policy. They represent a Hail Mary pass from central bankers to stimulate more borrowing and more debt, though there is far more global debt [7]today than in 2007. Stimulus is the assumed goal of all economic policy, both fiscal and monetary. Demand-side stimulus is the mania bequeathed to us by Keynes, or more accurately by his followers. It is the absurd idea, that an economy prospers by consuming and borrowing instead of producing and saving. Negative interest rates turn everything we know about economics upside down.

Under what scenario would anyone lend $1,000 to receive $900 in return at some point in the future? Only when the alternative is to receive $800 back instead, due to the predicted interventions of central banks and governments. Only then would locking in a set rate of capital loss make sense. By "capital loss" I mean just that; when there is no positive interest paid, the principal itself must be consumed. There is no "market" for negative rates. The future is uncertain, and there is always counterparty risk. The borrower might abscond, or default, or declare bankruptcy. Market conditions might change during the course of the loan, driving interest rates higher to the lender's detriment. Inflation could rise higher and faster than the agreed-upon nominal interest rate. The lender might even die prior to repayment.

Positive interest rates compensate lenders for all of this risk and uncertainty. Interest, like all economics, ultimately can be explained by human nature and human action.

If in fact negative interest rates can occur naturally, without central bank or state interventions, then economics textbooks need to be revised on the quick. Every theory of interest contemplates positive interest paid on borrowed capital. Classical economists and their "Real" theory say interest represents a "return" on capital, not a penalty. Capital available for lending, like any other good, is subject to real forces of supply and demand. But nobody would "sell" their capital by giving the buyer interest payments as well, they would simply hold onto it and avoid the risk of lending.
Marxists think interest payments represent exploitation by capital owners lending to needful workers. The amount of interest paid in addition to the capital returned was stolen from the debtor, because the lender did not work for it (ignoring, of course, the capitalist lender's risk). But how could a borrower be exploited by receiving interest payments for borrowing, i.e., repaying less than they borrowed? I suppose Marxists may in fact cheer the development of negative rates, and perversely see them as a transfer of wealth from lenders to borrowers (when, in fact, we know cheap money and credit overwhelmingly benefit wealthy elites, per the Cantillon Effect). So negative rates require Marxists to drastically rethink their theory of interest.

Austrians stress the time element of interest rates, comparing the lender's willingness to forgo present consumption against the borrower's desire to pay a premium for present consumption. In Austrian theory interest rates represent the price at which the relative time preferences of lenders and borrowers meet. But once again, negative interest rates cannot explain how or why anyone would ever defer consumption without payment — or in fact pay to do so!

It should be noted that rational purchasers of negative-yield bonds hope to sell them before maturity, i.e., they hope bond prices rise as interest rates drop even lower. They hope to sell their bonds to a greater fool and generate a capital gain. They are not "buying" the obligation to pay interest, but the chance of reselling for a profit. So purchasing a negative-yield bond might make sense as an investment (vs. institutional and central bank bond buyers, which frequently hold bonds to maturity and thereby literally pay to lend money). But if and when interest rates rise, the losses to those left holding those $13 trillion of bonds could be staggering.

In the meantime, a huge artificial market for at least nominally positive US Treasury debt grows, strengthening the dollar and suppressing interest rates here at home. Once again, the dollar represents the least dirty shirt in the laundry. Congress loves this, of course, because even 5% rates would blow the federal budget to smithereens. Rising rates would cause debt service to be the largest annual line item in that budget, ahead of Social Security, Medicare, and defense. So we might say Congress and the Fed are in a symbiotic relationship at this point. The rest of the world might call it America's "exorbitant privilege."

Negative interest rates are the price we pay for central banks. The destruction of capital, economic and otherwise, is contrary to every human impulse. Civilization requires accumulation and production; de-civilization happens when too many people in a society borrow, spend, and consume more than they produce. No society in human history previously entertained the idea of negative interest rates, so like central bankers we are all in uncharted territory now.

Our job, among many, is to bring the insights of Austrian economics on money and banking to widespread attention before something truly calamitous happens.

1. An earlier version of this article indicated that Bloomberg terminals were unable to calculate negative interest rates for callable bonds. This was not correct.

Jeff Deist is president of the Mises Institute. He previously worked as chief of staff to Congressman Ron Paul, and as an attorney for private equity clients.

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Sixth in a monthly series of Nelson Nash’s personally written Becoming Your Own Banker lessons. We will continue these lessons until we have gone through the entire book.

PART 1 Lesson 6 The Grocery Store (continued)

Content: Page 16, Becoming Your Own Banker Fifth Edition

Now we are going to face the complications at your grocery store. Let’s assume that you are a male, married, with children – where is your spouse going
to shop – your store or somewhere else? Your store, of course! She comes in and fills her cart with groceries. Here comes the complicated part, so pay close attention. This point is critical and requires complete honesty. Out of which door does she want to take the groceries – front or back?

When asked this hypothetical question, an amazing number of people will admit that “she will probably want to go out the back door, avoiding the cashier at the front door.” This is a polite description of theft! More retail businesses have been destroyed or severely limited by this factor than any other. It is a feeling among owners and those related to them that “this is our business and I can do anything I want to!” Unless this feeling is overcome the business is doomed. Remembering from lesson 5 the small markup on the can of peas – this means that if your spouse steals one can of peas, you must sell 20 to make up for it.

Furthermore, can she go out the back door with groceries, over a period of time, without the employees witnessing her act? And what will they do? Right! They will do the same! I’m trying to paint the picture of how devastating theft is to a retail business. I’m told that 85% of theft in a retail business is by employees.

There is another factor that makes owners want to go out the back door with goods. All businesses have a “silent partner” – the IRS. If your spouse goes past the cashier at the front door and pays retail for the peas, it means that your store will make more money than if she went out the back door. And the IRS posture is – “the more you make, the more we take.”

Imagine a situation where there is no income tax on the sale of groceries. Now we have eliminated one of the reasons to go out the back door. The only problem that remains is the urge to use the back-door privilege. This must be overcome – your business is at stake.

In addition, you and your family (plus maybe some others) are “captive customers.” You are not going somewhere else to buy groceries. If you charge these captive customers wholesale prices you will make no profit and you have defeated the entire reason for being in business. If you charge them retail prices you are assured of profit. But these are “captive customers” – why not charge these folks 62 cents for the can of peas? Instead of making 3 cents you are now making 5 cents. Your have increased your profit margin significantly! The extra 2 cents will go directly to additional capital and it will enable you to buy more peas to sell to other customers – and there is an unlimited demand for peas! Hopefully, you can see what continued use of this practice can do to the profitability of your business. Do this over a long period of time and your record books will show a superior profit picture.

When you sell your business many years later, you are in competition with others that have not obeyed these principles. He and his family members took goods out the back door. His record books will never look as good as yours. In fact, he will probably have gone out of business some years ago.

Even if he is still around, can you guess which business will bring the better price? Yours!

With the proceeds from the sale you can buy a huge annuity and have income deposited monthly directly to your bank account at retirement time.

I hope that you have learned this little lesson well because we will re-visit the grocery store many times in this course of study. If you understand the grocery store, the rest of learning how to be your own banker is a “piece of cake.”

Grocery stores are in the business of moving groceries to customers. When you sell something, you must replace the item to sell again. If you own the store don’t steal the peas.

Banks are in the business of “renting money” to customers. When they lend money, they must get it back, with interest. If you own the bank don’t steal the money!

Pretty simple, isn’t it?
Authorized IBC Practitioners
https://www.infinitebanking.org/finder/

The following financial professionals joined or renewed their membership to our Authorized Infinite Banking Concepts Practitioners team this month:

- Joseph Pantozzi - Las Vegas, Nevada
- Winnie Lau - Edmonton, Alberta
- Wade Borth - Fargo, North Dakota
- Timothy Yurek - Wilkes-Barre, Pennsylvania
- Clayton Campbell - Houston, Texas
- Thomas Laune - Franklin, Tennessee
- George Roth - Edmonton, Alberta
- Sarbloh Gill - Edmonton, Alberta
- Harold McGee - Austin, Texas
- Grant Thompson - Amarillo, Texas
- Darryl Ho - New Westminster, British Columbia
- Donald Turnbull - Pickering, Ontario
- Dan Allen - Lloydminster, Alberta
- Tony Chamblee - Middletown, Delaware
- Christopher Spencer - Gothenburg, Nebraska
- John Hasche - Lake Preston, South Dakota
- Steve Hasche - Lake Preston, South Dakota
- Richard Gane - Barrie, Ontario
- Dapo Orukotan - Sunrise, Florida
- Joseph Salloum - Montreal, Quebec

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.

Save the Date!
IBC Practitioner Think Tank
February 5-6, 2020
Birmingham, Alabama
https://infinitebanking.org/think-tank-symposium/