The Family Heritage Series

A weekly discussion of Americanist truths and traditions for those "heirs of all the ages" who will have to preserve that most important inheritance of all – freedom. Produced by the Movement To Restore Decency.

Volume II | Lesson Ninety-Seven

The Federal Reserve

LESSON IDEA

To show the dangers of a central banking system, particularly our Federal Reserve, and the consequences of runaway inflation.

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IN 1913, the same year the graduated income tax was fastened on the American middle class, the government muscled into the banking business of the nation. The legislation which accomplished this was the Federal Reserve Act, and it set up a central banking system, a banking system for bankers.

First, let's remember that a bank was originally nothing more than a warehouse for money. In earlier and saner times, when people used gold for buying and selling, wealthy men put the bulk of their gold in a bank for safekeeping, and the banker gave each a storage ticket, or an I.O.U., which the owner could use to reclaim his gold whenever he liked. The banker made his living by charging the gold owners a fee for his storage service.

Soon, however, the gold owners began to trade their storage tickets. It was simpler than taking gold out of the bank each time they bought something and putting gold in the bank whenever they sold something. And the bankers noticed that most of the gold in their vaults never moved from its assigned shelf. It must have seemed a shameful waste — especially when there were so many people who wanted to borrow gold and were willing to pay for the privilege. Why not issue new storage tickets to these would-be borrowers and thereby earn more money in fees, reasoned the bankers. The question was: How many tickets could safely be issued as claim checks for each ounce of gold actually stored? Four? Five? Six? Ten?

Issuing ten times as many storage tickets as could be made good in gold was good business for bankers, but it was also risky. If word got out that there was not enough gold to cover everyone's tickets, a run on the bank developed. (It was called a "a run" because people panicked and ran to the bank.) The bank opened its vault and handed out gold until there was none left; the people still standing in line when the doors closed were left holding worthless pieces of paper.

To keep this from happening and to keep bankers from being lynched by angry gold owners, central banks were set up to act like emergency rescue squads. The bankers who were members of the system put some of their gold into the central bank; then, if a run developed, the central bank rushed gold to the bank in trouble.

Notice that this central-bank rescue operation did not change the way the bankers did business, it merely tricked the gold owners into believing that the bank had as much gold in its vaults as there were storage tickets. Naturally, in return for providing this rescue service, the central bank wanted something: in many cases, the right to tell the bankers how to conduct their business.

This, of course, was not the story the American Congress heard when it was considering the central banking system called the Federal Reserve. The purpose of a central bank, said the promoters of the Fed (the Federal Reserve's nickname), was to keep local bank panics and "runs" from snowballing into national bank panics, called depressions, and to protect the public from being cheated of their savings by foolish and greedy bankers. Henceforth and forevermore, the governing board of the Fed would tell banks how much they could lend and how much they must keep in reserve — for the "good of the people," of course. It was not suggested that banks *stop issuing* more storage tickets than they had gold, but only that they *contain* their ticket issuing within the limits defined as safe by the Fed.

THERE WERE many things the Fed's promoters forgot to mention. One was that every time the central bank changed the amount of gold that the other banks had to keep in reserve, the number of storage tickets people could use to buy things also changed. Suppose, for example, the central bank says, "Okay, bankers, we told you before you had to keep half of the gold you owe to people on your 'untouchable' shelf, but now we are going to change that to one quarter. Take that extra quarter off your 'untouchable' shelf and put it on your 'lending' shelf, and start writing storage tickets. You can now issue to the people four times, instead of two times, as many tickets as you have gold in your bank." This gives more people more tickets to use to buy things. The amount of gold hasn't changed, and the number of things to buy hasn't changed; but overnight, the number of tickets being used by buyers and sellers has increased, and prices will go up. This will happen because the economy is like a giant auction; and if the buyers at an auction are suddenly given more money, they will normally offer more money for the goods being auctioned, thus "bidding up" the prices.

Suppose, on the other hand, the central bank says, "Okay, bankers, we told you before you had to keep one fourth of the gold you are storing on your 'untouchable' shelf, but now we are going to change that to one half. Take that extra quarter off your 'lending' shelf and put it on your 'untouchable' shelf and start calling the people who have borrowed storage tickets and tell them you must have the tickets back. You can now have only twice as many tickets out as you have gold in the bank. If the borrowers don't have the tickets, they will have to sell whatever they do have to get them."

Do you understand what will happen then? Suddenly, there are fewer tickets to be used for purchasing things, and fewer people who can buy things — even though the amount of gold hasn't changed and the number of things to buy hasn't changed overnight. Prices will go down. Do you see why? [*Use the auction example again. Fewer buyers with less money means fewer bids and lower prices.*]

ANOTHER THING the Fed's promoters neglected to mention when they were selling Congress on the glories of a central bank was that there was nothing to prevent the bankers' bank from acting like a crook instead of a guardian angel — and stealing on a big-time all-banks scale instead of a small-time one-bank scale.

In the past, central banks have turned crook by directly or indirectly outlawing the ownership of gold, or silver, or anything that has a value of its own, and forcing the former owners to accept the storage tickets they have as money. Since this action is always made legal by government, and everyone is stripped of wealth at the same time and left in the same predicament, most people go along with the pretense that the paper they have is money. The problem is that there is no way to limit how much paper is printed; the more "paper money" is printed, the higher the prices go. Remember the auction principle.

PRINTED PAPER passed off as money, and the resulting higher prices, are two characteristics of a disease we call inflation. An advanced case might be called runaway inflation. Germany had this disease after World War I, and this is how Karl-Heinz Abshagen, a journalist who was in Germany at the time, described its effects on families:

"Summer, 1923. About 10 o'clock in the morning. Two dozen women gradually gather in front of a small factory in a suburb of Hamburg. They are wives, mothers, perhaps even sisters of men working in the factory . . . . They are waiting for the men's wages to be paid this morning at this hour as on every second workday. The company is now paying its wages three times a week . . . so that the workers can buy what they need without losing too much; the currency is depreciating too quickly to permit them to pocket their money for more than a few hours without suffering loss of value . . . . All the stores close at noon until the new exchange rate is published; when they open again in the afternoon all the prices . . . are usually higher . . . . The women wait at the factory gate until the men hand them the money.They then hurry to the stores to exchange their paper money for groceries . . . before noon.

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"The emergency [*printing*] presses have difficulty keeping up with the steadily depreciating value of the currency. The money for payment of two days wages for twenty or thirty workers must be carried in suitcases or laundry baskets . . . . Pay envelopes disappeared long ago; they could not hold the bundles of thousand mark notes which a simple worker receives for two days' work . . . ."

Can you imagine our family living like this? Prices are already high in our country because of inflation, but in Germany in the 1920's it was so bad that a man had to work nine or ten hours to earn enough money to buy a pound of margarine and several days to pay for a pound of butter. Can you guess what happened to the people, like your grandparents, who had saved money during all of their working years, had quit their jobs, and were trying to live on their savings? How many pounds of butter do you think they could buy when prices were rising so crazily?

THERE WAS ONLY one group of people that liked this inflation: the borrowers who owed large sums of money. Suppose for a minute that you were a German shoemaker who owed ten thousand marks (the German term for money like our dollars) and earned five thousand marks a year. Every year you planned to pay back at least a thousand marks on your loan plus the interest fee you were charged for the use of the money. How many years would it take to pay it all back? [*Ten, of course.*] But suppose your country was suddenly caught up in runaway inflation and your earnings jumped to two million marks a year. Yes, it's true that the price of butter and shoes and suits would also jump with your salary, but your debt would stay the same. You could probably pay it all off in two months — which would be a tremendous help to you in your business. In fact, you might even be able to make a fortune during this chaotic time, if you were quick enough to take advantage of other shoemakers' misfortunes.

Most families did not make a fortune, however. There were food riots, anarchy, and complete chaos. No one felt safe anywhere — in city or country, homes or streets. By 1933, most Germans were ready to follow any politician who promised them law, order, and sanity; and the politician who presented his case most persuasively was Adolf Hitler, a socialist and a dictator.

What happened in Germany between 1923 and 1933 is exactly what socialists and communists want to happen in every country — but especially in ours. The Manifesto of the Communist League, put together in 1848 by Karl Marx, said a central banking system was one of ten weapons that should be used to destroy a nation like ours. Do you remember one of the other nine from our lesson last week? [***Remind family members of the destructive effects of the progressive income tax on the middle class.***]

WHEN THE Communist Lenin seized power in Russia, one of the first things he did was ruin the currency. As Alan Stang summed it up in his article, *Money Talks*: "Every dictator wants only himself and his cronies at the very top, and millions of slaves at the very bottom. A large middle class would threaten his power. So Lenin told his followers to go to the printing presses and to print up as much paper currency as possible. The idea was to flood the country with paper rubles and thereby to destroy the currency, which would give the Communists the chance to confiscate the wealth of the middle class. And the scheme 'worked.' Prices soared abruptly. The currency collapsed. As in Germany only two years later, Russians in 1921 sold their homes and property for bread. In the fall of that year, a well-equipped farm sold for two or three *poods* of flour — between seventy-two and one hundred and eight American pounds. There was a famine. The weakened population fell easy prey to cholera and typhus."