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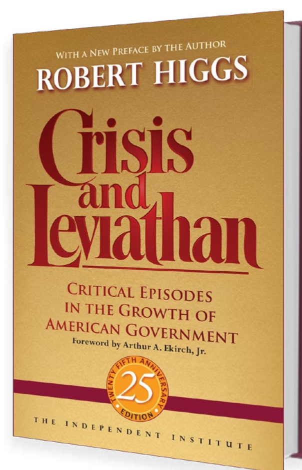

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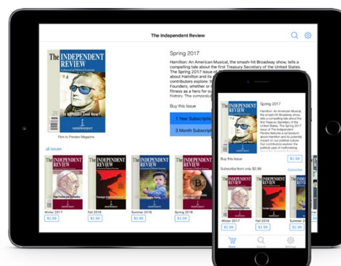

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Rothbard on Fractional Reserve Banking

A Critique

MICHAEL S. ROZEFF

Murray Rothbard, in *The Case for a 100 Percent Gold Dollar* (1974), maintains that fractional-reserve banking is fraudulent. Viewing it as coercive and unlawful, he argues that banks ought to be allowed to serve only as warehouses for money. He insists that all deposits become bailments, not debts or credits.[1] Money would always be an asset, never a liability. A proper bank would, in his view and by law, hold all deposits intact and become a 100 percent reserve-storage or safety-deposit bank, although to call such a business a bank under these conditions is something of a misnomer because such a so-called bank makes no loans.

Rothbard's firm belief that fractional-reserve banking constitutes fraud rules out fractional-reserve free banking even in a free market. This position, I argue, goes against basic ideas of liberty and the free market, both of which Rothbard champions. When he regards fractional-reserve banking as fraudulent and proposes its illegality, he introduces his own ethical judgment based on his own assessment of the merits of any and all exchange transactions that may occur between banker and depositor. He introduces his own idea of the appropriate property rights in a bank deposit, his own idea of what appropriate money must be, and his own idea of libertarian law. Although he is entitled to his opinions, the market participants in a condition of liberty in free

Michael S. Rozeff is a retired professor of finance now living in East Amherst, New York.

1. A *bailment* is property temporarily held in trust. The trustee (bailee) may not use the property. There is no exchange, and title remains with the bailor. A paper credit, by contrast, arises out of an exchange. It represents a right against a person, not against a specific thing or sum of money.

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markets decide all these matters for themselves, and their reasoning and valuations may differ from Rothbard's. They may not regard fractional-reserve banking as fraudulent, and they may want to transact via fractional-reserve banking arrangements. They may wish to circulate media of exchange that are someone else's liabilities.

Rothbard's position has since been espoused in books by both Jesús Huerta de Soto (2001) and Jörg Guido Hülsmann (2008) as well as in articles, such as one by Hans-Hermann Hoppe, Hülsmann, and Walter Block (1998) that argues against fiduciary media. These latter-day adherents to Rothbard's position show no diminution in the strength of their convictions, despite the criticisms presented by George Selgin and Lawrence H. White (1996), who have argued against Rothbard's position and supported free banking. For example, Hülsmann writes in his book, "There is no tenable economic, legal, moral, or spiritual rationale that could be adduced in justification of paper money and fractional-reserve banking" (2008, 238). This extraordinary statement boldly restates Rothbard's beliefs. If a community willingly and freely uses paper money, shall Hülsmann maintain that they have no rationale? Moreover, it is not difficult to locate scholarship that provides viable economic reasons for paper money and fractional-reserve banking.[2] It is quite easy to find numerous real-world instances in which paper money, tokens, scrip, and credits arose spontaneously (see Timberlake 1987). I argue here that the Rothbardians have not proven, either on grounds of morality or on grounds of economics, that paper money or fractional-reserve banking evinces criminal behavior.

Monetary Freedom

Instead of arguing, as Rothbard does, that monetary freedom necessarily requires 100-percent-reserve banking, let us ask what monetary freedom might look like. The institutions and practices that arise under freedom are impossible to know in advance. We can imagine many possibilities. People themselves decide what kinds of property rights they want and find acceptable in bank accounts. They hammer out what is fraudulent and what is not. Banks and their customers decide the details of their own exchanges. People decide what value standards (units of account) to use to establish prices and what media they want to use as money, whether commodity, paper, electronic, or something else. People may demand bank audits as they see fit, and they may become part of the market structure. Banks may issue their own banknotes. Perhaps banks arrange central clearing houses that issue notes. Retail establishments may become involved in issuing various clearing certificates. Local clearing systems may arise that use credit clearing. People trade and use banknotes as money if they wish. They depreciate those currencies that they believe are losing value, and they flock to the media that they think may appreciate or hold their value. If media are convertible, people decide on the appropriate media of redemption.

2. See Bhattacharya and Thakor 1993 for a review of banking theory. See also Selgin and White 1994.

People who make market exchanges decide more fundamentally what policies and practices they regard as fraudulent. With monetary freedom, none of us is in a legal position to decide a priori what kinds of monetary arrangements are fit for others. We can decide only what we find acceptable for ourselves and act accordingly. In this regard, people may turn to Rothbard's ethics and follow his advice or to the Holy Bible and seek its counsel or to any number of other sources in order to arrive at the ethics that form the basis of what they find acceptable in market arrangements. In the present state of human knowledge, ethics are contentious.

Although the Rothbard school can argue its ethical case based on the notion that a deposit is the property of the depositor, it cannot prove this case because a *deposit of assets* may well be freely exchanged for a *deposit account* whose property rights do not necessarily entail a warehouse receipt or the bank's legal obligation to segregate the deposit and hold it in storage for the depositor. Rothbardians are in no position to determine what form the property rights in a deposit account must take while simultaneously advocating liberty and a free market. If they stipulate the former, they abridge liberty and the market. If they choose the latter, the market participants stipulate the property rights.

The Main Proposition

I argue a simple proposition about free-market fractional-reserve banking. Suppose that in a free-market situation, depositors in a bank agree to make their deposits even knowing full well that the bank intends to lend out some of these deposits. Depositors may also know full well that they may lose some of their deposits. An analogous case involves making a risky loan even when knowing that the loan may not be fully repaid. Depositors may willingly accept a degree of risk in order to obtain other items of value to them, such as checking services and interest payments. Moreover, in a free market, insurance and risk-shifting services may arise for such credits.[3]

My proposition is that in this free market characterized by willing and voluntary behavior by both depositor and banker, with all actions being known and above board, the fractional-reserve banker's actions are not inherently criminal because what private parties agree to among themselves (without coercing innocent others) cannot be called criminal. Rothbardians may inform depositors that they are being robbed, but if the depositors prefer the arrangement, they have the final word. They have defined the property rights acceptable to them, and they must live by them. If this proposition is true, then, in this free-market scenario, vilifying the banker or

3. In the Bank of America "Deposit Agreement and Disclosures" dated June 30, 2008, appears this language: "This Agreement and the deposit relationship do not create a fiduciary, quasi-fiduciary or special relationship between us. We owe you only a duty of ordinary care. Our deposit relationship with you is that of debtor and creditor. Our internal policies and procedures are solely for our own purposes and do not impose on us a higher standard of care than otherwise would apply by law without such policies or procedures."

accusing him of embezzlement, legalized counterfeiting, or fraud or worrying that he is printing money out of thin air or creating two titles to the same property has no ethical weight. The Rothbardians express views on the ethics of arrangements that others are making, but they have no claim to being more ethically right than the others with regard to what the latter have agreed to.

Rights in Deposit Accounts

To understand how a deposit might be made in a bank and then loaned out nonfraudulently, we need only think of analogous cases for other kinds of firms. Every day billions of dollars are loaned to corporations doing all kinds of business, and the managers of these companies take the money and invest it as they see fit, usually under a variety of constraints that the lenders impose on them and that they accept. They do not hold the money in a warehouse ready to be returned to the lenders at a moment's notice. The loans are risky because payment at maturity is not assured, but this risk is compensated by a higher rate of return than the return on a safer loan. These loans are widely regarded, of course, as legitimate and moral. I know of no school of ethical thought that has proven they are not. I know of no reason to forbid them because of their inherent criminality.

Consider another case that is even closer to fractional-reserve banking. Stock brokers every day lend securities that have been left with them in margin accounts. The buyers of these securities have signed hypothecation agreements with their brokers that define a set of property rights. The property rights in the money deposited into the account are exchanged for the property rights in the account. The physical deposit is not identical to the account. These agreements allow the brokers to lend the securities. The securities are then carried in "street name," which means the buyers do not have title to them. The buyers instead have property rights defined by their account agreement. The account owner retains the right to sell these securities. The broker, called upon to sell a stock that he has loaned out, then obtains the stock elsewhere or from his reserves and sells it for his client. All of these arrangements are and have been regarded as legitimate and moral. No school of ethical thought has shown that they are immoral or fraudulent, although one can find those who, following Rothbardian logic, regard various forms of short selling as fraudulent.

It should be evident at this point that a bank in a free market may contract with depositors in much the same way that stockbrokers today contract with their customers. A bank depositor may give up property rights in money in exchange for an account with certain rights defined by an agreement between banker and depositor.

Persons may make loans or deposit their assets into accounts under many possible arrangements. In doing so, they exchange one set of property rights for another. The recipients of the wealth then use the proceeds in contractually controlled ways and do not merely store the depositors' wealth for them. In general, in these exchanges two or more parties come to agreements regarding the division of

future cash flows and assets. Their contracts express various divisions of these cash flows contingent on the various states of the world that may transpire in the future. A free-market bank might do much the same. One possible arrangement makes the depositor into a creditor and the banker into a borrower who takes possession of the title to the borrowed assets. But that form of contract is only one of many possibilities. The creditor might retain an option to call assets of similar value from the borrower, and such a call option can be modified in a great many ways. That arrangement is generally what happens in bank deposit accounts.

More specifically, you, with your wealth and in liberty, may conclude an arrangement with a business firm in which that firm agrees to hold and guard your wealth in your name, for you and only you, without disturbing that wealth, which is available to you at all times for withdrawal. You and that firm may agree to whatever stipulations you wish with regard to the disposition and storage of your wealth. You may instruct the firm to send you a monthly stipend. The firm may agree to unannounced audits or to daily or weekly audits. The number of possibilities is great. We may call the case being described, in which you and the firm agree that the firm may not lend your wealth, the "100-percent-reserve case."

By the same token, I, with my wealth and in liberty, may conclude an arrangement with a business firm in which the firm may lend my wealth. The range of possible stipulations is large. The bank may pass along part of the earnings on those loans in the form of other services to me, such as checking and clearing of transactions with others, or the bank may pay interest on my wealth. I may arrange to withdraw my wealth on demand, if and when the funds are available or in various money and nonmoney forms. The arrangement may or may not obligate the firm's owners to make good on this demand, perhaps after a delay. The firm's owners may or may not agree to place their personal wealth at my disposal to make good the return of my wealth. I may agree that the bank can create new demand deposits for borrowers. The number of possibilities is great. I call the case being described, in which the firm and I agree to the lending of my wealth through the firm's intermediation, the "fractional-reserve case."

Free Markets and Choice of Ethics

When we transact in these various ways in a free market, we do so in a condition called liberty. The term *free market* assumes that people entering exchanges have stipulated beforehand the rules of property they accept because in the market they are exchanging property that they own. The liberty aspect conditions the interactions in several ways. Liberty means that the exchanges are uncoerced. They are not forced on people by anyone else; people decide to make them of their own accord. But liberty also comes in even before a free market with exchanges because liberty cannot exist unless one willingly accepts rules of property for the property he may wish to exchange. There cannot be coercion in choosing the basic property rules one lives

under and adheres to in one's interactions with others because such coercion destroys liberty.

Each of us, in a state of liberty, decides for himself what arrangements to conclude with others who are also deciding in liberty. Because these arrangements are up to us—to be conducted, enforced, adjudicated, and dissolved as we see fit—no universal or absolute arrangements that hold for all (under liberty) can prevail unless everyone agrees to them. Choosing our rules of conduct ourselves, as persons in liberty, equivalently means deciding on our ethics and not having them decided for us by others—unless we choose to have them do so, which is still our choice made in liberty, but at one step removed. When we choose our governance, in liberty, we are choosing the rules by which we agree to interact with others socially. Thus, we are choosing our rules of conduct and agreeing to obey them. And because rules of conduct are ethics, we are choosing our ethics. If someone else has a different ethics and makes us obey the rules of conduct that their ethics stipulate, then we are not in liberty.

In the case of liberty, a variety of banking arrangements may be concluded. If we all are living in liberty, Rothbardians cannot impose their arrangement for 100 percent reserves on others, and others cannot impose their arrangement for fractional-reserving on Rothbardians. Liberty requires tolerance if it is to be maintained. These arrangements and other arrangements can coexist, even if each faction looks down on the other's behavior or even thinks it criminal. As long as each side is not greatly affected by the other side's behavior, they can navigate their differences and interactions.

Two Titles to Same Property?

Rothbardians who hold to 100-percent-reserve banking while foreclosing fractional-reserve banking have a particular view of the bank deposit as property. They think that a bank deposit has to be property owned by the depositor, but, as shown earlier, depositors may exchange one set of rights for another. Because of their belief, Rothbardians regard bank loans as fraudulent creations of money out of thin air and as actions that create multiple titles to the same property. In fact, a new bank loan in a fractional-reserve bank historically has occurred more or less in the following way, and such a loan may occur in this way under monetary freedom. A bank locates a borrower who appears capable of repaying a loan with interest; to assure the loan's safety, the bank may require collateral. The bank provides the borrower with a credit, which is, say, a demand-deposit account. This credit is the so-called thin-air money that, it is supposed, fraudulently dilutes an original depositor's claim to his supposedly earmarked funds. However, another side to the exchange eliminates all the thin air: the borrower gives the bank a credit, which is his note or IOU to repay the loan. The economic nature of this exchange is thus an exchange of a credit (one IOU) for a credit (another IOU), as Henry Dunning MacLeod explained in detail as early as 1866. The deal may be viewed as involving the sale of the borrower's IOU to the

bank in exchange for the right to withdraw banknotes, which are the bank's IOUs. The original depositors are not defrauded if they have agreed to this arrangement, as they might have in order to obtain the benefits of a deposit account, such as returns generated by the bank's loans.

Furthermore, there are not necessarily two titles to the same property when a fractional-reserve bank makes a loan and creates a demand deposit because it obtains a new asset under property-right conditions not envisaged in Rothbard's story. It is true that two clear, uncontested or nonconflicting titles to the same property rights in a good cannot coexist. But it is not necessarily true, as Rothbard arbitrarily assumes, that a free-market bank deposit must be property owned by a depositor or that it must be property of a nearly safe kind, such as a warehoused and audited asset sitting in a safe-deposit box or a safe chamber. A bank depositor, like any creditor, may turn assets over to the bank and receive in return a new property title that defines his interests in ways much different from the warehouse receipt that the Rothbard school of thought envisages as the only legal and moral possibility. In particular, the bank may *pool* all sorts of assets and issue all sorts of claims against them.

The Rothbard school of thought seems to overlook that people can create property rights in physical objects, paper claims, and goods in general, including money, in many subtle ways. They can and do create sophisticated obligations and conditions on which they agree, and the outcomes of these arrangements are contingent on the occurrence of various states of the world. With this blind spot, the Rothbardians can see nothing but two claims to the same good. In short, the Rothbardians bypass the question of what property rights in bank deposits can be, ignore that such rights are created by people in liberty, and impose their own assumptions on the form that the property rights in a deposit account must take.

Henry Dunning MacLeod's Treatment

MacLeod (1902) provides an early, authoritative, and complete discussion of the major two banking possibilities, which are either that the banker is charged to hold money in safekeeping, in which case the property in the money remains with the depositor, or that the banker is allowed to lend the money, in which case the property in the money passes to the banker, who has made an exchange with the willing depositor, who now holds a credit.

After tracing banking's origins to Roman money changers, MacLeod distinguishes a bank that holds money in safekeeping and a bank that lends money it has received:

> It became the custom for private persons to place their Money with them for the mere purpose of security. In this case they [the money changers] acquired no Property in the Money: but they held it subject to the directions of the depositor—the Money itself was termed a **Depositum**.

> The Banker paid no interest on this Deposit because he was not allowed to trade with it. . . . In process of time they added to these the species of business which in modern language is technically termed "Banking": they received Money as a personal Loan to themselves: and they paid interest for it. The Money, therefore, necessarily became their own Property to trade with as they pleased: as modern Bankers do.
>
> Hence, the person who paid Money in this way into his Banker's acquired a mere Right of Action, or **Credit**, in his books. The earliest notice we have of these Banks, or *Argentariæ* is in Livy. . . . [T] the comedies of Plautus (B.C. 284–184) contain several allusions to Bankers and their business.
>
> To give a customer Credit was termed *scribere*. Thus Leonida says in the *Asinaria* of Plautus—"Abducit domum ultro et scribit nummos" *"Of his own accord he takes him home and gives him a Credit for the money." Perscribere* or *rescribere* was to give a cheque on one's account, or to transfer a Credit for one account to another. (MacLeod 1902, 161–62, emphasis and bold in original)

MacLeod later provides a more extensive treatment, in which, after surveying some banking history dating from the 1300s onward, he writes

> The essential feature of all these **Banks** was this: the subscribers advanced the Money as a Loan, or **Mutuum**: and thus it became the absolute property of the borrowers: and in exchange for their money they received a **Credit**: *i.e.,* a certificate, or Promise to pay interest; and the very essence of "**Banking"** is to receive money as a **Mutuum**: and to give in exchange for it Credits, Debts, Promises to pay, or Rights of action to demand an equal sum back again when they please. (1902, 318)[4]
>
> A **Banker** *is a Trader whose business is to* **buy Money** *and* **Debts** *by* **creating** *other* **Debts.** (1902, 321)

The dominant kind of bank on the European continent became a bank in which deposits became credits, not bailments. MacLeod discusses the case of England, for example:

> It was during the great civil war, as we have explained elsewhere, that the goldsmiths of London first began to receive the cash of the merchants and

4. A *mutuum* is a loan in which the thing lent cannot be used or enjoyed without consuming it, destroying it, or alienating it. Money lent to another person is generally enjoyed by that person's using it, in which case the money loan is a mutuum. In such a case, MacLeod informs us that "the lender cedes the Property in the thing lent to the borrower: and he acquires the Right to demand back an *equivalent* amount of the things lent: but not the *identical* things. In all such cases a **New Property** is called into existence: and a **Contract** or **Obligation** is created between the 'lender' and the 'borrower'" (1902, 91, bold in original).

> country gentlemen for safe custody, on condition of repaying an equal sum on demand.
>
> Now this money was not placed in their hands to be locked away idle in their cellars, as plate and jewelry are often given to the care of a banker as a **Depositum**, and to be restored *in specie* [in its own form.] The money was sold to the banker as a **Mutuum:** to be restored only *in genere* [in general form]. And they [the bankers] agreed not only to repay it on demand, but to pay six percent interest for it: consequently, they were obliged to trade with it in order to make a profit. (1902, 324)

Then we come to an important passage in a section headed "*On a* **Common Error** *respecting* **Deposits**":

> We must now notice a very common error respecting the meaning of the word **Deposit**: which will show how necessary it is to understand the changes of meaning which some words, which have been adopted from Roman Law, have undergone in modern business.
>
> A **Depositum**, in Roman Law, means anything which is placed in the charge or custody of a person for the mere purpose of safe keeping: without the Property in it passing to him; or his being allowed to use it for his own advantage.[5]
>
> It is very often supposed that when a customer pays in money to his account, that money is a **Deposit.** This is the first error on the subject: because the money so paid is not a **Depositum**: it is a **Mutuum**. The money is in reality sold to the banker: and it has become his actual property to deal with as he pleases.
>
> In the next place, it is not the cash which, is paid in which, in banking language, is termed the **Deposit**: but the **Credit**, or **Right of action**, which is created in exchange for it. So, when a banker discounts a Bill of Exchange he buys a Right of action, by creating and giving a Credit, or Right of action in exchange for it: and the Credit is also called a **Deposit**. The Money, or Bill of Exchange, sold to the banker, are [*sic*] his **Assets**. *And the* **Deposits** *are his* **Liabilities**: *or the* **Price** *he pays for his* **Assets**. (1902, 327)

Here MacLeod uses the example of a bank that discounts a bill of exchange (buys a credit) and simultaneously creates a deposit (and credit) in order to illustrate that a

5. MacLeod earlier makes clear that a depositum is a bailment when in describing solicitors he observes that they "do not acquire any Property in the money which passes through their hands. They receive it merely as a **Depositum**, or **Bailment**: they are only the Custodians, or Trustees of the money: and it is only entrusted to their custody for the express purpose of being applied in a certain way" (1902, 319, bold in original).

deposit is not an influx of cash to a bank as a depositum, but rather part of a credit transaction.

Public Understanding and Acceptance of Bank Deposits

Other textbook treatments of banking that date from the early 1900s support MacLeod and the notion that the nature of a bank account was, if not wholly understood, at least known and accepted by the general public. At a minimum, the public no doubt understood the difference between a safety deposit and a demand deposit. I quote Joseph French Johnson:

> *Special and general deposits.* —There are two kinds of deposits, special and general. A special deposit may consist of anything of value left with the bank for safekeeping. The relation between the bank and depositor in such a case is that of bailee and bailor. The title to the deposit does not pass to the bank, but rests in the depositor. The bank is held to use ordinary care in protecting it, and if it is stolen without negligence on the part of the bank, the owner must bear the loss. The banker must return to the depositor the identical thing deposited. If the bank accepts a consideration for keeping the deposit, it is held by law to exercise greater care. Safety deposit business does not present any perplexing problems to the student who views banking as a whole.
>
> General deposits are obligations of the bank to pay money. They may be payable on demand or at a stated time in the future. The great bulk of commercial bank deposits are payable on demand. They create between the bank and the customer the relation of debtor and creditor, the title to the deposit passing to the bank, while the depositor acquires a right to receive a stated sum of money. The bank may satisfy a depositor by the payment of legal tender, no matter by what form of money or credit instrument the deposit was created or how much the legal tender may have depreciated. The legal tender greenback issues during the Civil War permitted the banks to pay their depositors depreciated paper money even though gold had been deposited. At the time, it was customary to make special contracts wherein gold payment was specifically agreed upon. (1911, 117)

Charles F. Dunbar writes:

> It happens every day that the merchant, having cash in hand, prefers not to hold it in his possession until it is required for use, but to "deposit" it with the bank where he usually transacts his business, until he needs to use it. In this case, when he makes his deposit, the property in the money or substitutes for money actually handed in by him passes to the bank, and he receives

> in exchange the right to demand and receive at pleasure, not that which he paid in, but an equivalent amount. Here then, as in the former case, the transaction is in effect a sale, although the use of the word "deposit" seems at first to suggest an entirely different idea of its character. (1922, 14–15)

Another indication that depositors have understood the nature of a deposit account and accepted it is the bank run. Bank runs occur when depositors doubt the safety or worth of the assets that stand behind the bank's liabilities, including their own deposits. If they were to think that their accounts are available on demand by everyone instantaneously because, for example, the bank is a 100-percent-reserve institution, a bank run would have no rationale. The fact that bank runs occur suggests that depositors know that their funds are not perfectly safe and that the bank may make too many loans, some of which go bad, and that the bank does not have backup lines of credit or ready assets that it can liquidate to meet deposit outflows. Bank runs suggest that depositors understand the nature of the exchange they are making with banks. To some extent, this observation undercuts the notion that banks have always been engaged in deceptive fraud, unbeknownst to depositors. This inference or judgment has to be tempered by the recognition that there have not historically been free markets in banks and money, so that the bank deposit is not entirely a freely accepted good or a market-created good, but instead is, to a varying extent that depends on the era and the laws of that era, a forced product.

Critical Misesian Errors

Rothbard (1974, 20) builds his case on a passage from Ludwig von Mises's *Theory of Money and Credit*. This critical passage argues that a demand deposit is not, economically speaking, a credit or an IOU:

> It is usual to reckon the acceptance of a deposit which can be drawn upon at any time by means of notes or cheques 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. If *credit* in the economic sense means the exchange of a present good or a present service against a future good or a future service, then it is hardly possible to include the transactions in question under the conception of credit. 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 the money in no way means that he has renounced immediate disposal over the utility that it commands. (1971, 268, emphasis in original)

In this passage, the analysis that is most critical *and* most erroneous begins with the following sentence: "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." In this sentence, Mises radically departs from treating the depositor as someone who makes subjective valuations of the goods under his control, which is the theory he elsewhere upholds strongly and which economists have widely adopted. Mises provides instead his own presumptions, which need not necessarily be true. He presumes that the good acquired by the depositor is for money at any time. This condition need not be the case; the depositor cannot obtain money at any time. The bank may be closed during certain hours. Depositors know that they are not placing the funds in a safety-deposit box. The depositor more substantively knows or may think that the bank may not be able to make good on all claims simultaneously or that it may provide funds only with a delay. Most persons know that they themselves do not intend immediately to withdraw what they have just deposited. They know that banks pay interest on deposits; they know that banks make loans.

Mises presumes that the *only economic service* of an account is money storage because he views the account solely as a means of converting "money now" into "money later." This presumption need not be true. The depositor makes a demand or time deposit, as opposed to a safety deposit, for reasons of his own. He may wish to use or to receive other bank services. He may wish to receive interest rather than to pay for storage. He may wish to hold, use, and transport paper in preference to specie. Mises presumes that the money to be received later will perform "exactly the same service" as money deposited now. This equivalence need not be the case because the money need not have the same utility to the depositor both now and later. Finally, Mises argues that no credit transaction occurs because the "claim that [the depositor] has acquired by his deposit is also a present good for him. The depositing of the money in no way means that he has renounced immediate disposal over the utility that it commands." This argument merely asserts what it claims to prove—namely, that a deposit claim is a present good, by which Mises means that it can immediately be converted back into cash or specie and can be spent. This claim is not a proof, and, in any event, it is not the case. Checks, for example, are not accepted everywhere or at all times. Furthermore, one may request redemption from a bank, but in a free market it is a request that is and may be subject to uncertain fulfillment. It is not and need not be a guarantee.

Only by making these presumptions, which are not necessarily true, can Mises claim that no exchange of a present good (the deposit) for a future good takes place. Mises, in fact, is making two incorrect claims. The first is that there is no exchange of a present for a future good because money at both times performs the same services. However, the claim held by the depositor does have futurity; once the depositor makes a deposit, his return obviously can occur only in the future. Equally critical

are the facts that the return is clearly subject to various risks and, furthermore, that it may take the form of various banking services, including interest.

Consider a parallel instance. A lender also gives up current dollars for future dollars, but Mises does not conclude in this case that because a dollar is a dollar and performs the same services at both times, no credit transaction is possible. Indeed, he concludes the opposite, that the exchange is a credit transaction.

Mises's second incorrect claim is that "[t]he depositing of the money in no way means that [the depositor] has renounced immediate disposal over the utility that it commands." Because the depositor cannot be sure of getting his money back and because he is exchanging it for a different good with different utility, which is why he makes the deposit in the first place, he obviously has renounced any utility that arises from immediately spending the deposit. He has exchanged it for utility arising from a deferred claim to funds plus whatever else in the rearrangement provides him with utility, such as checking services, storage, and interest.

Clarifying Observations and Conclusions

To those who may believe that banknotes issued in a free market result from counterfeiting or are ipso facto inflationary, I note that in the fractional-reserve case, no third parties are obligated to accept banknotes that the bank may produce when it makes loans to borrowers. In a free market, no legal-tender laws or forced currencies exist. If a third party accepts a banknote, he does so willingly, as in any free-market exchange.

Other than citing MacLeod at length, I have not considered here what may or may not have occurred historically, as Huerta de Soto and Hülsmann do in their treatments. I have not considered whether a fractional-reserve bank can or will survive in a free market. I have asked no questions about central banking or the received laws on demand-deposit accounts. My goal here is strictly limited. I argue primarily that fractional-reserve banking is not inherently immoral or unethical in a free-market setting and secondarily that the economic ground on which Rothbard (relying on Mises) builds his case is erroneous. Banks today obviously do not operate in a free-market setting, and my thoughts on this current situation are distinct from the analysis presented here.

My argument muzzles no one. Anyone may wish to object to the ethics of those engaging in fractional-reserve banking. Anyone has the freedom to tell others that their banking firms are criminal or that banks are embezzling wealth and engaging in theft. Anyone may insist that depositors are being wronged. Those so arguing may ardently desire to protect depositors. They may tell depositors that their characterization of fractional-reserve transactions as theft is what libertarian law implies or what natural-law ethics implies. They may advocate outlawing the arrangements others have with their bank, inform others that their banking arrangements are inconsistent with a free market, or disseminate their belief that firms should not be allowed to lend wealth in this way and that such lending is immoral and fraudulent.

None of this gainsays the proposition provided earlier that in a free market characterized by willing and voluntary behavior by both depositor and banker, with all actions being known and not coercing innocent others, the actions of the fractional-reserve banker are not inherently criminal. Statements in opposition to this claim that people may make about others' banking arrangements express merely alternative ethical views or economic analysis, but, as I have shown, they are not ethically consistent with a free market and not derivable on economic grounds. Furthermore, the material explicated by MacLeod and others suggests that people have long distinguished safety deposits from general bank deposits and have not regarded the latter as fraudulent or criminal exchanges.

I suspect that the Rothbardians, in their ardor to mitigate what they regard as deep institutional evils, are throwing out the baby of liberty with the perceived bath water of fractional-reserve banking. They are sacrificing real monetary freedom on the altar of gold as sound money, or 100-percent-reserve banking. I believe that libertarianism, to be workable, may well require that people in various groups coalesce on certain ethical grounds, but also that libertarians cannot claim any particular ethic to be *the* libertarian ethic without coming into conflict with the principle of liberty. And when such claims are made, they deflect attention away from the central concern, which is liberty. They encourage a rivalry to produce systemwide revisions to be imposed on everyone or to hold for everyone rather than a condition of basic equal liberty that empowers everyone.

Rothbard says "my own policy goal is the establishment of the free market" (1974, 8). He goes on to say that a free market cannot have force and fraud. He tells us that "the proper remedy for any fraud is the general law in defense of property rights" (14). Further, "if fractional-reserve banking is fraudulent, then it could be outlawed not as a form of administrative government intervention in the monetary system, but rather as part of the general legal prohibition of force and fraud" (8).

A free market involves voluntary and uncoerced exchanges of property-right bundles in which involuntary force and fraud do not affect exchanges. Although this description sounds definite, it is not. If people are acting in liberty, all of these important matters and others (the free market, force and fraud, property rights, remedies, and law) are contingent on arrangements that people produce in their social interactions. They are *outcomes*. The liberty of persons logically precedes the arrangements that persons make in the realm of market exchanges. We cannot describe, much less prescribe, the goods and property rights that arise when a market operates in a condition of liberty. Furthermore, the free market is not static because free persons change their exchange arrangements. To speak of arrangements that *must* constitute or signify a free market is inconsistent with the concept of personal liberty and human action. Some of us may *prefer* certain arrangements, but other persons may prefer different arrangements. Therefore, we cannot say that a free market is consistent only with the use of gold as money, that a free market in money precludes the use of paper money, or that a free market is consistent only with 100-percent-reserve banking. Likewise, many other such statements cannot be viewed as

conclusive or necessary conditions of a free market. They must be viewed instead as the preferences of the person asserting them.

Many severe problems may be traced to the institutions of existing economies, including fractional-reserve banking. These problems and institutions are not my subject. I am here mainly concerned with the condemnation of fractional-reserve banking as immoral and with the repeated references to it as theft, counterfeiting, and fraud. That line of thought is apt to confuse the uninitiated and subtly undermine the case for liberty because it suggests that existing arrangements must be replaced by one safe or golden alternative known to the enlightened as the only proper banking method. Such stipulation is not what liberty is about or can be about in circumstances where people will differ, as they always have, about a welter of ethical, religious, and philosophical matters.

Let us appreciate that the particular institutional arrangements under which we now live have not arisen under a condition of liberty to make monetary choices. *We do not have monetary freedom*. What any believer in liberty wants necessarily includes monetary liberty, including the liberty to make any desired monetary arrangements he may want. *These arrangements may well include fractional-reserve banking*. They may include money that is not an asset, but a liability. The details of banking property rights under monetary freedom cannot be prejudged as necessities (gold, for example) or not necessities (paper, for example). Without indulging in a basic inconsistency with the concept of liberty, a believer in liberty cannot prejudge these details as inherently unethical, immoral, or criminal on the basis of preconceived ideas of the character of property in money and bank accounts. Liberty allows people to arrange and construct their property rights. The believer in liberty cannot possibly argue that fractional-reserve banking is immoral *for all* by some standard of morality or economics that says that a bank account has to be a bailment and not a credit.

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