



Episode 757: DEBATE: Is Fractional Reserve Banking Economically Benign?

Guest: Jeff Herbener and John Tamny

WOODS: I'm so glad, John, that you agreed to do this, because I just thought of it spontaneously while I was talking to Jeff, and here you are doing it. I'll tell you – and I say this – everybody knows that you and I have a disagreement on this. I'm giving you credit for doing it, because I think most people would have just refused. I really do. I think most people would have refused, whereas you jumped at the chance. So I thought that's great; we're going to have some fun doing this. So we're going to do this in the same in format which I've done other exchanges on the show, so I'll give each of you an opportunity to have an opening statement. And it doesn't have to be anything formal that you planned out, but just summarize what your position is on fractional-reserve banking. And then we'll go into responses to what each of you have said and so on.

Now, I never heard back: were you comfortable with the resolution that – it's kind of a ham-handed resolution, but I had to come up with something – "Austrian critiques of fractional-reserve banking, which is a benign institution, are based on confusions and misconceptions." Are you both comfortable with that as the resolution, with John arguing in the affirmative and Jeff arguing in the negative?

TAMNY: Yes.

HERBENER: Sure, that's fine.

WOODS: Okay, that's good. And then secondly, just for the sake of – I'm sure there will be people listening who are not actually sure what fractional-reserve banking is, or maybe as John might say, what it's alleged to be or whatever. Can the two of you maybe try to define it in a way that you're both comfortable with? John, do you want to try to explain what it is that we're talking about, and then I'll see what Jeff says?

TAMNY: Sure, it's based on what von Mises says: banks borrow money in order to lend it. And so banks take in to pay for deposits and then lend it out, knowing that their depositors won't all run on the bank at the same time, and so they lend out the money that depositors could come in and take back at any one time if they wanted to. To me it's benign.

WOODS: Okay, so Jeff, in terms of just strict definition, what do you want to say before we jump in?

HERBENER: Okay, a fractional-reserve bank is a bank that keeps against their demand deposit accounts only a fractional reserve for redemption.

WOODS: Okay, so that is to say, as John said, that if everybody were to come in demanding their deposits, they're demanding their money back simultaneously, because it's not all being held in the vault, so to speak, the bank would not be able to comply with that.

TAMNY: No, I'm not saying that. A bank could easily comply with it; I'm just saying that they don't keep it all in —

WOODS: Ah, okay, yeah, no, I see what you mean. I know how you would say a bank — right. But the point is that strictly speaking, the amount of money that everybody would be asking for would not just be sitting there lying idle in the vault. Can we agree on that?

TAMNY: Yes.

WOODS: Yeah, okay. Okay, well, John, since given the wording of the resolution you actually are arguing in the affirmative, then why don't you go first? And I'm not going to run a strict clock here. We're all adults here. So just say your peace, and then I'll give Jeff a chance.

TAMNY: Well, yeah, let me first of all say how glad I am to do this, Tom. I'm a big fan of yours going back a long time, and Jeff for years too, and obviously I'm a huge fan of Ludwig von Mises. His books never leave me. They're always nearby, so what fun to have this discussion.

I guess I'll begin by saying what an odd discussion it is. I can't believe smart people are questioning what is like questioning whether the sun sets in the west. Of course banks take in deposits and lend them out. As von Mises himself put it on page 295 of *The Theory of Money and Credit*, banks borrow money in order to lend it. That's what they do. That's why they're banks. What I don't understand is this odd Austrian supposition that banks for being banks have some sort of magical power that allows them to multiply away this money. By that definition, I suppose I can multiply money.

Tom, I've got \$1,000. I want to lend it to you, and I'm not going to police you on where you go with it. Maybe you lend it to Jeff. Do we suddenly have \$3,000? No, we've still got \$1,000, and as a saver and a lender I give up use of that money. Tom, I've got an apartment that I live in in Washington, DC, but I think it'd fetch several thousand dollars a month in rent. I'd like to rent it to you for \$500 a month. My guess is if I do that, since you luckily don't live in DC, is that you'll rent it to someone else at a higher price and bank the profit. Have we multiplied apartments? No, there's still only one to speak of. NetJets has thousands of customers, but it's got 700-800 planes. The interesting thing about that is all of those customers can demand access to a plane at any time. Is NetJets multiplying planes? No, like banks it just realizes that not everyone's going to have a need for a plane at any one time, but if there is a run on planes NetJets can of course borrow from other fractional jet companies; it can go to jet companies themselves to make up for the shortfall.

That's what banks do all the time. If there is a run on cash, if they're solvent banks, they can go to myriad market institutions that will say, okay, show us what collateral you have, show us what you have in your books, we will lend you in the near term to make up for any cash shortfall. There's nothing to this. Banks borrow money in order to lend it. If they weren't doing this, they wouldn't be banks; they'd be money warehouses. And that's what interests me about all this. Austrians seem to have a problem with banks paying for deposits and lending them out. What are they supposed to do? They could be money warehouses, in which case people would pay banks I assume a negative interest rate to basically look at their money as it just sits there.

But what interests me about this is we're all fans of market signals. Why hasn't, if banks are so awful for the economy, if they're eviscerating the savings of the rest of us, why haven't banks as warehouses of capital become a very normal and prominent of finance? I just think that's interesting that they haven't.

I'll also point out that implicit in the Austrian view is that banks again are very powerful, that they can multiply money for being banks. But as Tom points out in his book, his very great book *Meltdown*, banks are shrinking as a source of total lending. As of 2008 – and this was one of Tom's many excellent reasons for not bailing out the banks – he pointed out that they represent a very small percent of total lending: 20% at the time of the book's publication. I've updated that of course for my book *Who Needs the Fed?* The number is now 15%. Banks' total market control – or what's the word? Banks account for 15% of total lending, and that number is in free fall. If banks were able to multiply money, if the Fed had rendered them accessibly powerful, their market share would be increasing, but in fact, it's in free fall. This kind of flies in the face of the Austrian view that banks are very, very powerful and are doing all this damage to the economy. In fact, they're dying before our eyes, and I say good riddance. We never needed them.

But I guess the other thing that I'll point out is that Austrians understandably and correctly believe in market signals. They believe in the message of the market generally. Okay, well, while banks aren't the total source of lending that they used to be, they're still 15%. And so I ask the question, is everyone else stupid in the Austrian circle? Why would people keep their money, their savings in banks that are going to eviscerate them through lending that multiplies those dollars into nothingness? Why would they do that if banks are doing all the awful things that Austrians seem to say they are, that this fractional lending does? You might also explain a quote from von Mises himself. As he once put it, "What is usually called plentifulness of money and scarcity of money is really plentifulness of capital and scarcity of capital." Von Mises' broad point is that where the rich are, where the productive are, money is abundant. There's lots of money in Beverly Hills. There's lots of Lake Forest, Illinois. There's lots of money on the Upper East Side of New York. If banks are eviscerating the value of money, why would the rich hold so much money, and why would they denominate their wealth in what is worthless? Do the Austrians know something that the rest of us fools, including the richest people in the world, don't know?

And then you can't get around the basic truth from von Mises once again, that he who tries to borrow money needs it solely for procuring other economic goods. Fairly explicit in the Austrian critique of banks is that they are multiplying money into nothingness. Okay, well then why would people (a) save in dollars if the money's going

to be multiplied into nothingness, but the better question is why would people borrow dollars if those dollars by the Austrian definition can't be exchanged for anything simply because they've been multiplied up to infinity since there's nothing to get in return for those dollars? It's never been explained.

And so my view has always been the Austrian critique of this, it's a stain on a great school. It's in fact a Keynesian argument. It's this belief that credit can be multiplied. But credit is what we create. Per von Mises again: you borrow money to get what you don't have, to get real economic resources. If banks were multiplying credit with the help of the Federal Reserve, no one would borrow dollars in the first place. Yet we know that's not the case. And so I'll leave it there.

WOODS: All right, Jeff, now you have some time of your own to argue in the negative.

HERBENER: Okay, so I think the first general point to make, and I'm sure that John and I both agree on this, is that the function of all private enterprise in the market economy is to use resources to satisfy consumer preferences, and so whether they're banks or manufacturing firms or retail firms and so on. So the first question to ask about the products that banks provide is what customer preferences are they satisfying with these products? And here again I'm following in my analysis also Ludwig von Mises, who makes a distinction between – the key distinction I think in this discussion especially – between money proper and money substitutes, which are claims for money. And so it might be that customers of banks go to banks in order to obtain claims to money, demand deposit accounts that they consider either safer than carrying around money proper or perhaps more convenient as a medium of exchange. And so the demand deposit is a redemption claim to money; it needs to be a redemption claim if it is to function as a money substitute for people at large, for merchants to take the customer's check and return it to the customer's bank and be able to claim those funds in the checking account for money itself.

Now, banks of course can function in providing this service by simply charging fees to customers who take out demand deposit accounts, and the customers pay fees for the benefit of having this safer and more convenient money substitute. This, by the way, is of course reflected in the way that monetary analysis is done. So if we look at calculations of the overall money stock in the economy, this distinction is always made in adding up all of the money proper, all of the Federal Reserve notes in our economy, and then adding up all of the redemption claims for money, the checkable deposits, to come up with money measure M1. So this distinction I think is of fundamental importance in our discussion.

And then second, banks might also provide services to customers in financial intermediation, in middleman services. So this is what John was talking about. It might be that a customer wishes to lend money to the bank as a saver, which is to lend the funds they have to a bank, who then goes through the list of borrowers to find credit-worthy borrowers. It assumes the risk of default and so on and so forth, providing middleman services. And for this, of course, the bank would earn an interest rate differential. They would pay interest to the saver in a time deposit and pay a wholesale interest rate and then earn the retail interest rate when they lend to the investors on the other end.

Now interestingly, Mises calls this kind of lending by the banks commodity credit, and some of the discussion that John and I are having is terminological, and so I'm going to stick with Mises' terms and call this commodity credit. What he's referring to here is that there are real commodities, real resources, that are being saved and diverted from consumption to the production of capital projects in this financial intermediation function. As we say in economics, this is satisfying people's time preferences for saving and earning a rate of interest, whereas the demand deposit is satisfying people's preferences for a more useful medium of exchange.

Now, fractional-reserve banks then do something different than this. Fractional-reserve banks create money substitutes or additional claims to money by issuing loans. And Mises calls this circulation credit. He calls this circulation credit, because there are no real resources here behind the additional claims to money that are created by banks when they make these loans. So they're just writing balances into customers' checking accounts when customers come in to borrow money. They're not intermediating this credit by borrowing it on contract for time and amount of loans like they do in time deposits, like certificates of deposit.

Now, the implications of this fractional-reserve issue are similar to the implications of fiat money issue. So when the Fed, if they just print up more money proper, more fiat paper money, then this of course doesn't create any real resources, but it does give the first obtainers of this new money command over real resources, so that they can purchase these real resources at the expense of other people who don't obtain this new money. So there's a diversion of real resources with the issue of fiat money, and this diversion is not part of the market, and so it diverts resources away from the efficient uses in society of resources to satisfy consumer preferences toward just the money producer.

So a similar thing is happening with the issue of claims to money. Claims to money that a bank creates by issuing loans don't create real resources. They're not saved funds in the sense of financial intermediation, where people are willing then to divert the use of resources away from consumption and towards investable projects; there are just more claims to money that the receivers of these claims can then use to obtain command over resources at the expense of people who don't obtain these claims. And so the fractional-reserve bank does something that fails to satisfy really either of the preferences of these two normal banking functions that we talked about: providing a money substitute and then financial intermediation.

Now, let me also then, having provided that as background, talk about the existence of fractional-reserve banks. So the existence of fractional-reserve banks of course in our existing economy, which is heavily interventionist, doesn't prove or disprove their viability in a market economy, in a pure market economy. The same, by the way, would be true of the existence of 100% reserve banks. So we can look in history and find cases of 100% reserve banks, for example in the 1600s in Amsterdam, but we would have to look at the details of what sort of laws existed and regulation and so on and so forth that may or may not have supported the existence of 100% reserve banks, just like we would do the same thing for fractional-reserve banks today. So the existence of something doesn't necessarily demonstrate the abstract claim that in a free enterprise system, fractional-reserve banks would be robust.

So if we look at the features of intervention by the state that support fractional-reserve banking, we find a couple of relevant ones. Probably the main thing is that banks are cartelized under banking regulation, and each bank is required then to accept the money substitutes of other banks, as checks of other banks, on demand to par. Again, this is similar to laws that support the circulation or use of fiat paper money, so the legal tender laws which give impetus to the use of fiat money over other kinds of money. And so again, we wouldn't say that the existence of fiat money in the economy demonstrates their superiority in a free enterprise system. Also, with fractional-reserve banks in our system, there are implied bailouts. This too then supports their extension, if you will.

And so if we follow Ludwig von Mises' argument that he makes through his books to try to get at this question of whether in free enterprise fractional-reserve banking would be robust, he points out that if we eliminate all the government intervention that supports fractional-reserve banks and we just have what he likes to call independent banks, each bank with its own reserve and its own money substitute issue, then he thinks that under conditions like that that fractional-reserve banking would not be very robust, that there might be some degree of fractional-reserve lending that takes place, but it wouldn't be extensive. It would be constricted.

And the reason for this again goes back to the nature of the money substitute claim. The money substitute, the demand deposit, the checking account balances of each bank, in order to be money substitutes and therefore demanded by customers, have to be accepted by merchants in general, and in addition to anybody, because they're a general medium of exchange, and so it's possible that the competition of banks in this independent banking system would lead to the restriction of the issue of fractional-reserve balances, because competing banks could accumulate checking account claims, money substitute claims of their competition, and then present them for redemption. And so it isn't clear at all that in a completely unhampered market economy we would get an extensive fractional-reserve banking system.

So as Mises points out, what would happen or what tends to happen even now with fractional-reserve banks is that because of the unique function that they perform, they tend to be fragile. The difference between a fractional-reserve bank that has an extensive issue of these unbacked loans is that their existence tends to depend upon a certain reputation that is at stake every day in the market. It can be lost instantly in the market. And so fractional-reserve banks tend to be fragile, whereas in an unhampered market economy with the fraction reduced to a negligible amount — that is to say the fraction of lending reduced to a negligible amount — they would not have this fragility.

And then the final point that I'd like to make if I have time, also following Ludwig von Mises, is that Mises argued that because the fractional-reserve bank is not intermediating credit — they're producing this circulation credit as opposed to commodity credit — this is what sets in motion in his theory the business cycle. And so if just claims that have no real resources behind them are issued, this gives command over resources to the people who obtained this borrowed money, and then the investable projects that are engaged in are diverted from what they would have been

otherwise, and this leads to an unsustainable pattern of malinvestments throughout the economy.

WOODS: All right, John, I'll give you, let's say, three to five minutes to respond to what Jeff has just said.

TAMNY: Okay, sure. The first thing is that thankfully Jeff's not saying that time loans are a bad thing; he's just expressing a problem with basically demand deposits. Well, the good news for him there – and this is per Tom's book *Meltdown*; it's also per my book *Who Needs the Fed?* – is that banks once again represent 20, according to Tom, and I think Tom would agree with my number, now 15% of total lending. Where it gets interesting is that of that total lending from banks – or demand deposits represent about 2% of that. So the idea that something that's 2% of what's small in the first place could have any sort of negative economic impact isn't something to worry about. If your fear is of demand deposits, they're very, very small in a sector that's shrinking before our eyes.

Jeff points out that the fact that the 1% reserve requirement doesn't exist, that those banks don't exist, doesn't mean that market economies don't demand them, but once again, as Tom has pointed out in *Meltdown* and I pointed out in *Who Needs the Fed?*, there are numerous non-bank sources of credit. There are numerous financial intermediaries and institutions. Isn't it odd, if there's such a great need for banks to warehouse money and basically for the depositors to pay a fee for banks to do so, that they don't exist en masse, because there's all sorts per Tom's book of other sources of non-bank credit. Why not this one? I think that's strange.

Jeff points to the implied bailouts of fractional banks, and that's something that Austrians point to a lot. They say that, well, wait a second. Banks can make loans, and they're always backed up by the Federal Reserve. But that's quite simply not true. As anyone in banking will tell you, it's unheard of for a solvent bank to go to the Fed for a loan, and it is for the reasons that Tom's *Meltdown* make clear. There are countless market sources of credit willing to loan to solvent banks. So if you're a weak bank and insolvent, that's the only types that will go to the Fed, and that's an admission of bankruptcy, that all market sources of credit have shut you down. And that's why, contrary to the Austrian view that the Fed strengthens banks, in fact, the Fed is the worst thing that ever happened to banks, because it only exists to prop up the weakest ones that can't operate in the market economy.

Jeff points out that fractional banks set in motion what Mises described as the business cycle, but I think this is something Austrians in general have to revisit. I worship Mises, but I reject wholly the notion of the Austrian business cycle, and the reason I do is very simple, and it's based once again on Tom's book. Banks didn't need to be bailed out for lots of reasons, but the main reason is they don't factor into the real economy very much. They're shrinking as a total source of credit. And so we want to believe that the Fed's interactions with what is the least dynamic source of credit, what is shrinking before our eyes as a source of credit, could somehow influence an economy that doesn't rely on banks that much more? Does anyone on this podcast think that banks have anything to do with Silicon Valley's prosperity? And so the talk is that fractional-reserve banks are fragile. I say amen. I wish they were more fragile. I wish we would allow them to fail all the time. They would be better if so. Silicon

Valley is built on failure. Detroit used to be built on failure. The problem is we're not allowing the fragile to break. But I didn't hear a good argument there against fractional-reserve banks. They're just not very relevant. If you're bothered by them, they represent maybe 2%, demand deposits, of total savings in the US economy.

WOODS: All right, Jeff, your turn.

HERBENER: Okay, I'd like to return to this conceptual distinction and then maybe make a comment about what John just said in response. But anyway, John uses examples of other kinds of claims where there is just a reserve, like the NetJets example. But it's disanalogous for this reason: the issue of a money substitute by banks can be obtained indiscriminately by anyone, whereas the NetJets contract would be for particular people who want the service of particular things. To make it analogous, you'd have to say that these claims, these contracts that customers have with NetJets to use their jets on certain days and certain times would be salable, indiscriminately salable to anyone. But then we see in that case their competitors could simply buy up a bunch, present them for redemption all at once, and this would then destroy the business model of the company.

And John also mentioned this case of taking a given amount of money – that banks cannot create more money by engaging in fractional reserve. It's true that they don't create money proper. What they create are claims to money. So if we have a certain amount of money proper, like \$100, the banks don't of course by lending and engaging in this circulation credit, increase the amount of money proper; they increase the amount of checkable deposits by just writing loans into checking accounts. And they do this to the extent of the legal reserves, so if they have a 10% reserve and \$100 of money, what they're doing is actually increasing the claims, the on-demand, at par claims to that money balance.

Now on the question of implied bailouts, what I was thinking of in the implied bailouts was FDIC insurance, deposit insurance, and not the bailout of the bank failures. So I think that's a more important instance of the support to fractional reserves that the government provides this claim that they'll bailout the depositors. Otherwise the depositors would be much more attuned to the possibility that their on-demand redemption claims could not be honored by the bank.

WOODS: All right, at this point I'm going to give each of you an opportunity to ask the other one a question. Anything you want to ask go ahead and ask. So John, your turn.

TAMNY: Well, I guess my question to Jeff is, you know, you're a free market guy; I think we're all free market guys. What is the problem here? You're saying that banks can create multiply claims to money. Okay, but I can create multiple claims to money by lending 1,000 to Tom, who could then lend 1,000 to you, and then you could lend 1,000 to the person next to you. Where's the harm? If someone then comes and has a run on me on the Bank of John Tamny, if I've got good assets I can go out and borrow the money to make that person whole. I don't see the harm. I don't see why we're having this discussion. If it's demand deposits that bother you, why would something that's such a small portion of total bank lending bother you so much?

HERBENER: Yeah, okay. I think one the first point we're in complete agreement. I think my position would also be that if banks want to engage in fractional-reserve activity, that they're perfectly welcome to try this out, but that if we're going to have a free market economy they should only be able to do this within the structure of free enterprise. So they shouldn't have these legal protections or legal disabilities to other competition. Then sure, they should be able to try this out and succeed or fail based upon the results. So I don't see that – I think we're in agreement. We may disagree on the extent to which fractional reserves would be a robust part of banking activity. I think they would be very small; maybe you think it's an open question.

On the other part, I would say that it does matter. We could say the same thing I suppose about money proper. You could say – that you're saying about demand deposits. So base money that the Fed creates is small relative to the whole economy, relative to bank lending, relative to shadow bank lending, relative to hedge funds and derivatives and so on. But it is part of a structure of asset claims that are generated by this process of expansion. And so one step in the pyramid, if you will, expanding one part of it leads to the expansion of the upper parts, the bigger parts. And so when the Fed expands bank reserves, this finds its way into an expansion of all sorts of other credit and asset prices and money substitutes and so on.

WOODS: Okay, Jeff, would you like to ask John a question?

HERBENER: Yeah, my question is this one: do you think – I made this analogy between fiat money issue and the issue of what Mises called circulation credit. Do you find this compelling, or do you think it's disanalogous, and if you think it's disanalogous, why?

TAMNY: I probably find it compelling. I can't stress enough how much Mises has just influenced me hugely. If the problems is with fiat money, I've always been for either a gold-defined dollar or some sort of private money, just because I think that JP Morgan would probably do a better job than the US Treasury would. I think we overrate the Fed's role in this. I think Austrians have too – and they're not alone. They keep blaming the Fed for everything. I'm against the Fed. I think it serves no useful purpose.

But you don't need a central bank to devalue a currency. You don't need a central bank to issue fiat money. If you look at the history of the dollar, the Fed was created in 1913, but the first devaluation of the dollar was in 1933. That had nothing to do with the Fed; it was FDR's decision. Fed Chairman Eugene Meyer resigned over what FDR did. The next major devaluation was 1971. Fed Chairman Arthur Burns begged Nixon; George Schultz and then the Milton Friedman crowd advised Nixon not to delink the dollar from gold. Burns was ignored. Presidents get the dollar they want, and so I guess what I'm saying is I think Austrians overrate the Fed's role in the dollar's evisceration, but I also think they overrate the Fed's role in the economy. Per Tom's book and per mine, banks are but a small and dying and non-dynamic source of total credit, so the idea that the Fed interacting with what is yesterday, with what is an anachronism, what is dying before our eyes could cause business cycles I think defies basic common sense.

WOODS: All right, let me ask each of you a quick question, and then we'll wrap up. Quick, like, try and keep your answers to a minute or two. So John, my question for

you is mostly a clarification question. If you're arguing that the money multiplier is a myth, how do you reconcile that with the existence of different monetary aggregates? Why don't we just have the monetary base and nothing else? How could M1 be larger than the monetary base, and M2 likewise larger, if there's only just money and it never multiplies?

TAMNY: Well, it's a great question, and my response is why would we have monetary aggregates? How very Keynesian or monetarist of us. What an obnoxious conceit, for us to presume to know how much the money supply should be or to presume to measure it. I again subscribe to the Mises point of view – I'm paraphrasing him, but no nation need ever worry about having too much or too little money. In Beverly Hills there's never a money supply problem. On the Upper East Side of Manhattan, the Fed couldn't keep money supply off of that on its best day. There's never a money supply problem in Palo Alto, California, but the Fed could not increase money supply in Baltimore or in Charleston, West Virginia on its best day. Any attempt to do that, any buying of bonds from banks to increase loanable funds, that money would flow out between breakfast and lunch. And so I am a free marketeer. I do not know why people would focus on monetary aggregates. I have zero interest.

WOODS: All right, now Jeff, I want to ask you – because I think this was implicitly raised by John – if the kind of banking system that you're describing is desirable, why do we not see it in the present context?

HERBENER: Well, I think in the present context we don't see it because of the legal disabilities I mentioned. But I should add that perhaps part of this movement that John has pointed out away from the use of banks and toward these alternative institutions, perhaps this is the means by which people are attempting to get around the restrictive nature – this kind of constraining nature of the banking system. So money market mutual funds for deposits and other forms of financial intermediation or direct investment and so on. So perhaps we are seeing this play out in a kind of indirect way.

WOODS: All right, now I'd like to give each of you an opportunity just to sum up – and in fact, you don't even have to use it to sum up. If there's anything that's lingering that you feel like there's a misconception the other one has, you use this time however you like, but take a few minutes to wrap up. We'll start with John.

TAMNY: Well, thanks once again. I can't stress enough that I am humbled by the people I'm doing this with. Tom, I've been worshipping you for years. Jeff, much the same. And then I positively genuflect or whatever that word is before von Mises, so this is really great for me.

What I guess I'd like to clear up is that, Jeff, I'm with you 100% about the FDIC. I've always argued that we the depositor are the moral hazard. I keep my money at Citibank. Citibank's been bailed out five times in the last 25 years, and so I can do that because I know that the FDIC protects me. So my perfect world is we'd abolish it on a Friday, and by Monday insurance companies would be calling up bank depositors, and they'd say, Mr. Tamny, you're at Citi; they make a lot of dumb mistakes. It's going to cost you this much to keep your money there to insure your deposit. If you keep it at Georgetown Bank, which doesn't have a history of failure, it's going to cost you that

much less. I think we could solve that bailout problem in a heartbeat, and I'm with you 100%.

I would like to clarify the main thing is there's this view that banks are unique for their ability to multiply money. I reject the notion of money multiplication in the first place, and I think we can prove it by if I lend 1,000 to Tom, who then lends it to Jeff, there's still 1,000. Austrians have historically made the argument, well, wait a second, banks have the access to the Fed. They can engage in excess lending. That is quite simply not true. That's a myth. Well run banks never go to the Fed. To go to the Fed is an admission of bankruptcy, so to say that banks have an easier time lending money because they're backed by the Fed, that's defied by basic business realities. That doesn't happen.

After that, I guess I'd like to say that I think we probably agree far more than we disagree on this. I think Austrians overrate the role of banks, I think they overrate the power of the Fed, and I think they forget what makes Austrian school thinking so great, is it's this spontaneous order of things where things happen, where entrepreneurs pursue things. I look at Silicon Valley in 2001 and 2000, and I think that was beautiful. I look at Detroit 100 years before, and that was beautiful. 2,000 carmakers created; most of them died. Just about every startup in 2016 will die in 2017. That's not a sign of an excessive Fed. Banks have nothing to do with Silicon Valley; it's a sign of abundant investment. I want more of it. I want more failure, including banks, and I'll leave it at that.

WOODS: All right, Jeff, you have the last word.

HERBENER: Okay, I too would like to say that I'm glad that John and I are largely in agreement on things and that we've sort of discovered the nub of disagreement. And so I would just like to reiterate then Ludwig von Mises' position on the role of circulation credit on the business cycle. So here he's not saying that we always get humongous booms and busts from any expansion of circulation credit. There would be some rough proportion perhaps that would exist, so we might in fact see circulation credit being less important in some expansion and more important in others. But I think the main thing is that circulation credit and the base money, which is even smaller in amount, would be part of an extension of financial claims that is put in motion by this holding of fractional reserve against the issue of this leveraging asset. And so even from numerically fairly small changes in the first step of bank reserves or of circulation credit, we get really large expansions at the sort of top of the structure of finance.

And finally I'd like to suggest an article to read on Ludwig von Mises' position. I think this would be beneficial to everyone. This is Joe Salerno's article, called "Ludwig von Mises as Currency School Free Banker." This is in Guido Hulsmann's edited book, *Theory of Money and Fiduciary Media*. It's an excellent recitation of Mises' views on this, and I think it would maybe help clarify some of these points of debate.

WOODS: Well, I'll link to that and any other resources you gentlemen would like linked to at TomWoods.com/757, which is the show notes page for today. Well, how about this? I am just having — I've now had several debates. I even had a debate on the legitimacy from a libertarian point of view of the modern creation of Israel, and I had

a libertarian saying it was perfectly in line with libertarian principles, and I had one say it wasn't, and it was perfectly civil and amazing, but even beyond that now, we even just had a civil debate on fractional-reserve banking. Is there no limit to what we can accomplish here on the show? Well, gentlemen, thanks so much for your time. I appreciate it very much.

TAMNY: Thanks for having me, Tom. Thanks, Jeff.

HERBENER: Thanks very much, Tom. Thanks, John.