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# The Voluntaryist

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*"If one takes care of the means, the end will take care of itself."*

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## "Free Banking and Fractional Reserves"

By Carl Watner

*[Editor's Note: The following article originally constituted an exchange of correspondence with Lawrence H. White. White revised his "Reply" to include responses to my original article as well as my "Commentary." I'd like to thank Larry for permission to print his "Reply." Subscribers' comments on this topic are encouraged.]*

In an otherwise exemplary essay on "Free Banking and the Gold Standard", (Llewellyn H. Rockwell, Jr. and Leland B. Yeager, eds., THE GOLD STANDARD: An Austrian Perspective, Lexington: Lexington Books, 1985) author Lawrence H. White notes that some gold standard advocates, such as Murray Rothbard, have argued for "100 percent reserve requirements against demand deposits and bank notes." White writes that:

Rothbard urges this position not as a paternalistic intervention into the market for inside money, but on the grounds that the holding of less than 100 percent reserves against demand liabilities is *per se* fraudulent. This argument is more jurisprudential than economic. He has recently written: "It should be clear that modern fractional reserve banking is a shell game, a Ponzi scheme, a fraud in which false warehouse receipts are issued and circulate as equivalent to the cash supposedly represented by the receipts." And in rebuttal to the argument that a banker hardly needs 100 percent reserves in order to meet all the redemption demands that will in fact confront him at any one time, he writes: "But holders of warehouse receipts to money emphatically do have...a claim, even in modern banking law, to their own property any time they choose to redeem it. But the legal claims issued by the bank must then be fraudulent, since the bank could not possibly meet them all." (p. 120)

White then goes on to ask why Rothbard would wish to prevent banks and their customers from making whatever sorts of contractual arrangements are mutually agreeable. He states that the court cases cited by Rothbard ("to the effect that bank notes do not contractually bind their issuers to holding 100 percent reserves") demonstrate that the inscription actually found on the face of a typical British bank note ("The Bank of XYZ promises to pay the bearer on demand one pound sterling") makes no promise about reserve holding behavior. As White puts it, "There is nothing to indicate that the note constitutes a warehouse receipt or establishes a bailment contract." (A bailment occurs when goods or commodities are transferred for a special purpose, such as storage, without transfer of ownership or title.) A few sentences later, White continues:

Nothing in a free banking system prevents an individual who desires 100 percent reserve banking from explicitly contracting for it. In historical fact safety deposit boxes have commonly been offered by banks for those who wish their money held as a bailment; who wish, in other words, to retain unconditional title to it. It would be silly to suggest that bank notes and demand deposits gained acceptance historically only when their holders were fraudulently misled by the

misrepresentation of bank demand liabilities as unconditional warehouse receipts.

White then argues that under a title-transfer view of contracts, "a bank note payable to the bearer on demand, with no stipulation of the reserves to be held, constitutes a conditional title to bank-held specie, conditional on presentation for redemption. In a title-transfer regime prevention of breach of contract by banks issuing such notes requires only that any obligation to redeem on demand be satisfied for all customers who actually present notes and deposits for redemption. Fractional reserves do not constitute a breach of contract." (White, pp. 120-121)

The purpose of this article is to examine the arguments for and against free banking and fractional reserves in an attempt to determine if fractional reserve banking is fraudulent and therefore would be excluded from the free market as part and parcel of the general prohibition against all forms of fraud. Let us first begin by listing the claims put forth by White:

1. "Rothbard's view that bank notes are the legal equivalent of warehouse receipts is based on what he thinks legal practice ought to be, not on the interpretation courts have actually made of the contractual obligations incurred by the issuers of bank notes."

2. "In historical fact safety deposit boxes have commonly been offered by banks for those who wish their money held as a bailment, who wish...to retain unconditional title to it."

3. "It would be silly to suggest that bank notes...gained acceptance historically only when their holders were fraudulently misled by the misrepresentation of bank and demand liabilities as unconditional warehouse receipts."

4. "[A] bank note payable to bearer with no stipulation of the reserves to be held...constitutes a **conditional** title to bank-held specie, conditional on presentation for redemption."

### EXAMINATION OF WHITE'S CLAIMS

1. As Clem Johnson in a recent issue of THE VOLUNTARYIST put it, the average American wouldn't recognize a property right if it hit him in the head. There is little argument with White's assertion that the statist court systems have ruled that bank notes are generally considered debts and are not legally the equivalent of a warehouse receipt. These statist rulings are part and parcel of the State's attempt to manipulate the monetary system to its own benefit. More often than not, bankers and those who have controlled the monetary system in a given country have been in collusion with the State. In fact, getting favorable legal decisions or legislative rulings has been one of the primary means by which they have established their dominance and control. For example, the Supreme Court of the United States has almost never respected property rights (it upheld FDR's abrogation of the gold clause and confiscation of privately held gold during the New Deal era). Furthermore, a decision that bank notes and demand deposits were to be treated as bailments would have made it far more difficult for the State to have increased the supply of money. So is it any surprise that the courts, themselves creatures of the State, have ruled in favor of the State?

2. With respect to the claim that historically safety deposit boxes have commonly been offered by banks for those who wish their money held as a bailment, Raymond DeRoover, author of MONEY, BANKING AND CREDIT IN MEDIAEVAL BRUGES (Cambridge, Mediaeval Academy of America, 1948, pp. 249-250) has noted that "Banks today still perform the same function of safe-keeping (acting as depositaries or safe-keepers of monies and valuables) **but they do not keep a record in their ledgers of what customers put into their safety-deposit boxes** (emphasis added). Once the money-changers had extended their activity to deposit banking, it

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# The Voluntaryist

Editor: Carl Watner

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### From the Editor:

## What We Are For? - What Do We Believe?

Past editorials and articles have made it clear that THE VOLUNTARYIST is unique in that it is the only regularly published libertarian publication to advocate non-State, pro-free market attitudes coupled with an anti-electoral stance and a predilection for non-violent means. In fact, we could probably argue that THE VOLUNTARYIST is the only journal in the world that consistently upholds individualist anarchism (by which we mean self-government), rejection of electoral politics, and the advocacy of non-violent means to achieve social change. This after all is what we signify when we use the term 'voluntaryist'.

THE VOLUNTARYIST is seldom, if ever, concerned with personalities; but we are concerned with ideas. Our interest is in the enduring aspects of libertarianism. Among these ideas we would include the concept that taxation is theft; that the State is an inherently invasive institution, a coercive monopoly, that war is the health of the State; that power corrupts (especially State power); that there is no service demanded on the free market that cannot be provided by market methods; and that the delineation and implementation of property rights are the solution to many of our social and economic ills. Nor to be overlooked is our insistence on the congruence of means and ends; that it is means which determine ends, and not the end which justifies the means.

Voluntaryist thinking forms a link in the chain of ideas started many centuries ago. We have reviewed some of the significant sources of radical libertarian thought in Issue 25. Our roots are to be found in antiquity, when moral thinkers realized that character building, the building of morally strong individuals, was the essential basis of human happiness - as well as the prerequisite of a better society. Self-responsibility was inextricably linked to self-control. The ideas of personal integrity, honesty, productive work, fulfillment of one's promises and the practice of non-retaliation set the stage for social harmony and abundance, wherever and whenever these two attributes of social life were to surface in the world's civilizations.

These ideas helped set the stage for the voluntaryist outlook on means and ends. A person could never use evil means to attain good ends. For one thing, such an attempt would never work. It would be impractical and self-defeating. For another thing, it would be inconsistent with personal integrity. A person would not resort to lying and cheating, for example, even if he or she mistakenly thought such base means could result in good ends. Evil means, like these, would always be rejected by an honest person.

Impure means must lead to an impure end since means always come before ends. The means are at hand, closest to us. They dictate what road we shall set out on and thus eventually determine our destination. Different means must inevitably lead to different destinations for the simple reason that they lead us down different paths. Thus it is that voluntaryists reject electoral politics as well as revolutionary violence. Neither of these methods could ever approximate voluntaryist goals - the ideal of a society of free individuals. Nor do either bring about a change or improvement in the moral tone of the people who comprise it.

Voluntaryists have a clear understanding of the nature of power - what we have labelled "the voluntaryist insight." We know that the

State, like all human institutions, depends on the consent and cooperation of its participants. We also know that we are self-controlling individuals, with ultimate responsibility for what we do. We cannot be compelled to do anything against our will, though we may suffer the consequences for a refusal to obey the State or any other gangster who holds a gun at us. The State may do what it pleases with our bodies, but it cannot force us to change our ideas. We may lose our liberty behind jail bars (liberty being the absence of coercion or physical restraints), but we cannot lose our freedom (freedom being the inner spirit or conscience) unless we give it up ourselves.

Voluntaryism offers a moral and practical way for advancing the cause of freedom. It rests on a belief in the efficacy of the free market and on a historic and philosophic antagonism to the State. It rests on an understanding of the inter-relatedness of means and ends, and on a belief that "if one takes care of the means, the end will take care of itself." We are pro-free market, anti-State, non-violent, and anti-electoral. This, in a few short phrases, is what we are for; what we believe.

## What Is Our Plan?

At a recent one day seminar at Freedom Country, the question was asked: "What can a person do to make this world a better place?" No single answer was articulated, but two different conceptual approaches were apparent. The responses of the participants could be categorized according to whether or not they believed

a. a better society depends on better individuals  
or

b. better individuals cannot be raised until we have a better society (where, for example, educational services are improved, child abuse no longer exists, etc.).

In other words, which comes first - the chicken or the egg? Better individuals or the better society?

Nineteenth century reformers, especially the non-resistants and abolitionists, grappled with this problem. How were they to advocate the abolition of slavery? Should they wait for Congress to abolish slavery or should they try to eliminate the vestiges of slavery from their daily lives? Should they be immediatists or gradualists? Should they use legislative means or moral suasion? Should they vote or hold office or should they denounce the U.S. Constitution as a tool of the slaveholders?

Those nineteenth century thinkers whom I would label voluntaryist (such as Henry David Thoreau, Charles Lane, William Lloyd Garrison, Henry Clarke Wright, and Edmund Quincy in pre-Civil War days, and Nathaniel Peabody Rogers) all believed that a better society only came about as the individuals within society improved themselves. They had no plan, other than a supreme faith that if one improved the components of society, societal improvement would come about automatically. As Charles Lane once put it, "Our reforms must begin within ourselves." Better men must be made to constitute society. For "society taken at large is never better or worse than the persons who compose it, for they in fact are it."

The Garrisonians, for example, were opposed to involvement in politics (whether it be office-holding or participating in political parties) because they did not want to sanction a government which permitted slavery. Their opposition to participation in government also stemmed from their concern with how slavery was to be abolished. To Garrison's way of thinking it was as bad to work for the abolition of slavery in the wrong way as it was to work openly for an evil cause. The end could not justify the means. The anti-electoral abolitionists never voted, even if they could have freed all the slaves by the electoral process. Garrison's field of action was that of moral suasion and not political action. He thought that men must first be convinced of the moral righteousness of the anti-slavery cause. Otherwise it would be impossible to change their opinions, even by the use of political force.

Given this approach, it seemed that the anti-electoral abolitionists had no real strategy. In rebutting this criticism, Nathaniel Peabody Rogers, in a September 6, 1844 editorial in the HERALD OF FREEDOM, spelled out his answer to the question: "What is your Plan?"

(To be without a plan is the true genius and glory of the anti-slavery enterprise. The mission of that move-

ment is to preach eternal truths, and to bear an everlasting testimony against the giant falsehoods which bewitch and enslave the land. It is no part of its business to map out its minutest course in all time to come, - to furnish a model for all the machinery that will ever be set in motion by the principle it is involving. The plan and the machinery will be easily developed and provided, as soon as the principle is sufficiently aroused in men's hearts to demand the relief of action.

What is the course of action these abolitionists have pursued? How have they addressed themselves to their mighty work? ...They were not deterred by finding themselves alone facing a furious and innumerable host of enemies. They felt that the Right was on their side, and they went forward in the calm certainty of a final victory. They began, and as far as they have remained faithful, they continue to perform their mission by doing "the duty that lieth nearest to them." They soon discovered that Slavery is not a thing a thousand miles removed, but that it is intertwined with all the political, religious, social and commercial relations in the country. ...In obedience to the highest philosophy, though perhaps not knowing it to be such, they proceeded to discharge their own personal duties in this regard-to bear an emphatic and uncompromising testimony against Slavery, and to free their own souls from all participation in its blood-guiltiness. They laid no far-reaching plans....but obeyed that wisdom which told them that to do righteousness is the highest policy, and that to pursue such a straight-forward course would bring them soonest to the desired goal. Their question was not so much how shall we abolish Slavery? as, how shall we best discharge our duty?

Edmund Quincy in a February 24, 1841 editorial by the same title, in THE NON-RESISTANT, pointed out that social institutions are but the projection or external manifestation of the ideas and attitudes existing in people's minds. "Change the ideas, and the institutions instantly undergo a corresponding change." In words reminiscent of Bob LeFevre's emphasis on self-control, Quincy went on to write, that

There is a sense in which the kingdoms of the world are within us. All power, authority, consent, come from the invisible world of the mind....External revolutions, accomplished by fighting, have in general affected little but a change of masters....

We would try to bring about a mightier revolution by persuading men to be satisfied to govern themselves according to the divine laws of their natures, and to renounce the (attempt to govern others) by laws of their own devising. Whenever men shall have received these truths into sincere hearts, and set about the business of governing themselves, and cease to trouble themselves about governing others, then whatever is vicious and false in the existing institution will disappear, and its place be supplied by what is good and true.

We do not hold ourselves obliged to abandon the promulgation of what we believe to be truths because we cannot exactly foretell how the revolution which they are to work, will go on, or what will be the precise form of the new state which they bring about. ...A reformer can have no plan but faith in his principles. He cannot foresee wither they will lead him but he knows that they can never lead him astray. A plan implies limitations and confinement. Truth is illimitable and diffusive. We only know that Truth is a sure guide, and will take care of us and of herself, if we will but follow her.

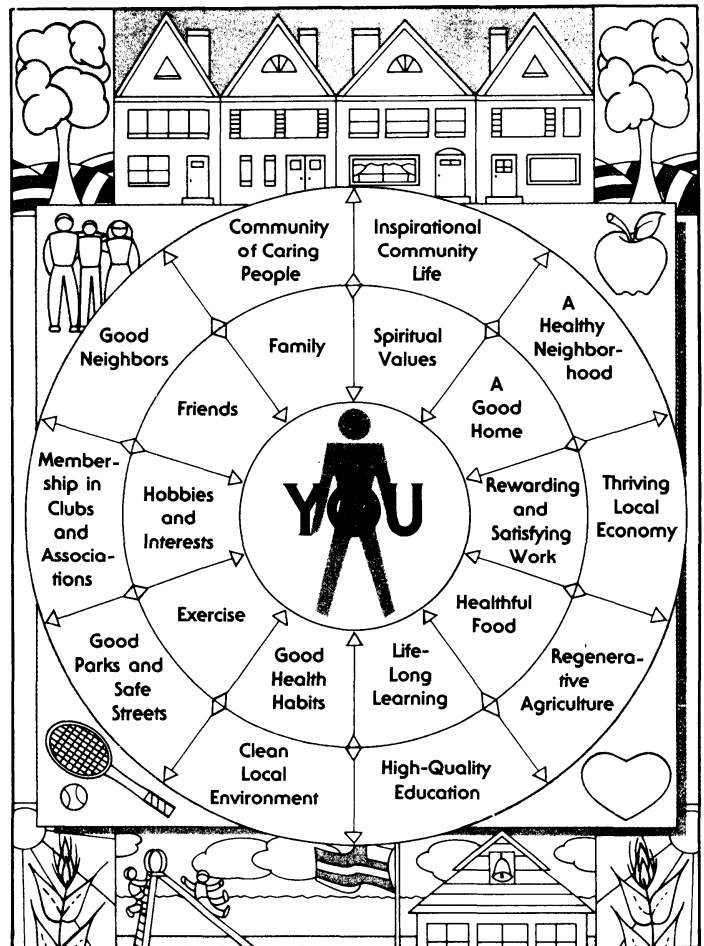
THE VOLUNTARYIST essentially upholds the same ideas as these nineteenth century thinkers. We advocate moral action, rather than politics and elections because moral suasion lays the axe at the root of the tree. We believe that moral action alone is sufficient to nullify State legislation. Legislation is not needed to abolish other legislation. Harmful and unjust political laws should simply be ignored and disobeyed. We do not need to use the State to

abolish the State, any more than we need to embrace war to fight for peace. Such methodology is self-contradictory, self-defeating, and inconsistent.

Difficult as it is to totally divorce ourselves from the State, each of us must draw the line for him or herself as to how and to what extent we will deal with statism, whether it be driving on government roads, paying federal income taxes, using government "funny" money, or the post office. Several things are imperative, though. We must support ourselves on the free market, never taking up government employment. We must also remain uninvolved in politics, refusing to vote or run for public office. We must never accept a government handout or government funds (even when justified on the pretext that the money was stolen from you or that you were forced to contribute to a government program. No one is forcing you to accept money which the government has stolen.)

In short, what we are advocating is that every one take care of him or herself and care for the members of his or her family, when they need help. If this were done, there would be no justification for any statist legislation. Competent individuals and strong families, particularly the three generation living unit, are some of the strongest bulwarks against the State. (And it should be remembered that families need not be limited by blood lines. Love, which brings outsiders into the family, is often more important than blood ties.)

If people would only realize that it is the individual and only the individual that directs the use and control of human energy, the world would change as individuals change themselves. The chart which we display here is described by PREVENTION magazine (April 1987) as a prescription for regenerative living. Change starts with you and me! This means good family, friends, healthy living habits, lifelong learning, and rewarding and satisfying work; which in turn lead to good neighbors, a good community, a thriving economy, and a natural environment. That pretty much sums it up. What is our plan? - a better world begins with a better you!



## "Free Banking"

*Continued from page 1*

ceased to be true that funds were deposited with them primarily for reasons of safe-keeping. ...As the public did not have money on deposit with the money-changers either for reasons of safe-keeping or for the sake of return, we must look for some other motive which explains why people were willing to part with their pennies and to run the risk of losing them in the failure of a bank. This motive is fortunately not hard to find. It is for reasons of convenience that people of today often prefer to have money in the bank rather than in their till, their purse, or their strongbox. In many circumstances it is easier and more convenient to pay by check than to pay with cash."

White's statement that "nothing in a free banking system prevents an individual who desires 100 percent reserve banking from explicitly contracting for it" ignores the fact that a non-State banking system has never existed. The fact that safety-deposit box services are offered for those who wish to retain unconditional title to their money is totally beside the point. The safe deposit box does not perform the same service that a 100% reserve bank offers. As DeRoover points out, one who chooses a safety deposit box loses the convenience of transmitting and accepting money payments via a bank.

It is interesting to note that 100% reserve banks existed in all the great banking centers of Europe (Amsterdam, Venice, and Hamburg) during the 17th and 18th Centuries. Due to the great number of worn and debased coins in circulation, a bank credit (based on the actual amount of gold or silver deposited in the form of various coins) was more certain, safe, and less cumbersome than transfer of the coins themselves. Deposits in these banks came to bear a premium over actual coin and payments were made by transfer of gold and silver credits on the books of the bank (from one customer to another). These banks never issued notes or credits for deposits in excess of actual specie received. Lending of specie on deposit was not undertaken. As Elgin Groseclose explains in *MONEY* (Norman: University of Oklahoma Press, 1934, p. 98) these banks "sought to make no profit from the use of its credit, and merely undertook to keep the money of the depositors in safety, and to pay it out or transfer it to others at the will of the owner. The profits of the bank were derived from fees for effecting transactions on its books, for the negotiation and discounting of bills of exchange, for notarial services..., and from the bank's services as money changer." So the existence of fractional reserve banks in Scotland during the 19th Century is not the sole historical indication of customer preference and accepted commercial practice.

3. White asserts that it is incorrect to suggest that purposeful misrepresentation has been behind efforts to get the public to accept bank notes and checks which were not backed by 100% reserves. I would maintain that such a claim is not as false as White would have us think. It should be clear that the primary reason for the acceptance of bank notes and checks was the convenience involved. But short of withdrawing his specie and losing the convenience of bank transfers, how could the consumer prevent his specie (on deposit or represented by the issuance of a bank note) from being used to expand the supply of bank notes and other forms of money via the fractional reserve banking? The statist legal system generally upheld the right of the banker and banking system to engage in fractional reserve practices.

4. What is a conditional title to bank-held specie? According to White, a bank note payable to bearer (with no stipulation of the reserve to be held) represents the bank's conditional ownership of the specie deposited or the specie which the note-holder may claim. Such ownership continues until such time as the bank note is presented for redemption, at which time ownership of the specie is transferred to the bearer of the bank note.

It seems to me, however, that this form of "conditional ownership" has no place in a title-transfer view. A title-transfer view of property ownership must be able to answer the question "Who owns it?", for any given moment there is an owner for any given piece of property. Is White trying to say that the bank owns the depositor's specie so long as the depositor does not demand it? While that is possible, I don't think that really explains anything. Perhaps the

following explanation of bailment sheds some light on the question of "conditions":

It is essential to the character of a bailment, that the title to the property should not pass to the bailee (the possessor). Therefore a sale is not a bailment, even if it is a conditional sale, for by a conditional sale title passes on performance of the condition. ...[I]f by contract or usage the identical thing is not to be returned, but only its equivalent, either in the same form or some other, or paid for in money, at the receiver's option; it is a sale or exchange, title passes on delivery, and the risk is upon the receiver. The same principle obtains in respect to the distinction between a bailment and a debt; as in the case of a deposit of money in a bank. (Irving Browne, *THE ELEMENTS OF THE LAW OF BAILMENTS AND COMMON CARRIERS*, Albany: Banks & Co., 1903, p. 3)

It is unclear to me whether White believes that "conditional ownership" is derived from a sale or bailment transaction. Does a contract in which no stipulation regarding 100 percent reserve or fractional reserve require that the banker treat the deposit of specie generally or specially? Where does the burden of proof lie?

I concede fractional reserves do not constitute a breach of contract when and where that practice is specified. The question remains, however, when fractional reserve practices are not specified, is the use of bank held specie by the banker a conversion of property? In the absence of any reference to this point in the contract, one of the parties to the contract must bear the burden of proof. It seems to me that the original owner should not have to bear the burden of proving the property is his, simply because it was his originally. The second party to the contract (the banker) thus should bear the burden of proving that he has the right to use the depositor's property when no stipulation has been made that he may do so. Another point to be considered is the rights of third parties who are not parties to the original contract. Is a person who accepts a banknote bound by the terms of the original contract, especially if that party is unaware of the custom of fractionalizing reserves?

DeRoover explains the importance of determining this question. "The decisive factor in the development of commercial banking systems seems rather to have been the change from regular to irregular deposits. Banking functions are unmistakably performed whenever cash reserves represent only a fraction of demand liabilities." This has the effect of creating additional purchasing power and thus makes the banks "manufacturers of money" (p. 311-12) Or as Rothbard puts it,

Commercial banks - that is, fractional reserve banks - create money out of thin air. Essentially they do it in the same ways as counterfeiters. Counterfeiters, too, create money out of thin air by printing something masquerading as money or as a warehouse receipt for money. In this way, they fraudulently extract resources from the public, from the people who have genuinely earned their money. In the same way, fractional reserve banks counterfeit warehouse receipts for money, when they circulate as equivalent to money among the public.

Is it just that the banker uses the property of his depositor without explicit consent? If the banker does not need explicit consent, then how does his practice differ from that of the counterfeiter? What is the difference between the counterfeiter and the banker who engages in fractionalizing reserves? Are not both "creating money out of thin air?"

## "Free Banking and Fractional Reserves": Reply

**By Lawrence H. White**

Let me first say that I am pleased to have someone of Carl Watner's thoughtfulness read closely and offer intelligent comments, however critical, on my essay. The passages on which Watner has focused were written especially in the hope of eliciting some discussion among libertarian thinkers. I felt that the fractional reserve issue was one on which many "Austro-libertarians" had accepted Rothbard's position without much critical thought.

In the hope of advancing this discussion, I will respond in order to Watner's examinations of the four claims he attributes to me. In what follows I will, for convenience, focus on banknotes, although all the substantive points apply equally to demand deposits.

1. The statement quoted as claim (1) was simply an effort to account for Rothbard's practice of referring to banknotes as "false warehouse receipts." In his view banknotes ought to be treated by the law as warehouse receipts, but they are not; hence they are "false receipts" even when issuing bank and recipient both recognize them as something quite distinct from warehouse receipts.

Because I think that the courts ruled properly in the cases cited by Rothbard, I am not predisposed to view the rulings with Watner as "part and parcel of the State's attempt to manipulate the monetary system to its own benefit." To be sure the State has made such an attempt, has been successful at it, and has not hesitated to use the court system to sanction it (as in the case of Franklin Roosevelt's abrogation of gold clauses). But fractional-reserve banking is a natural creature of commerce, not of the State. By that I mean that the practice of fractional reserve banking is not inconsistent with respect for natural property rights. Legal recognition of the nature of the practice is not to be attributed automatically to State artifice.

I might note that there is a strong irony in the idea that the fractional reserve principle is a tool either created or seized upon by central governments for their own inflationary purposes. When the government-sponsored central bank is bound to redeem its liabilities in gold, there is indeed a temptation for the central bank to operate on fractional reserves. The irony is that in a fiat money system (i.e. once the central banking has renounced its obligation to redeem) the government actually derives more real revenue from any given rate of inflation, the higher the percentage of reserves (in the form of its fiat money) the commercial banks are required to hold. A move to higher required reserve ratios, while fiat money remains the reserve medium, enhances rather than restrains the ability of the government to raise revenue by printing money.

2. I stand by the relevance of my statement that "nothing in a free banking system prevents an individual who desires 100-percent-reserve banking from explicitly contracting for it." True, the world has never seen a totally State-free banking system, for the reason that the world has never, since banking arose, seen a totally State-free society. True, you and I are not free to start a 100-percent-reserve bank (or any other kind of bank) today. But there have been banking systems (e.g. Scotland's before 1844) where the State, as far as I can tell, did not prevent entrepreneurs from offering 100-percent-reserve banking. My interpretation of its non-prevalence is that consumers of banking services weren't willing to pay the price. (A 100-percent-reserve bank would have to charge transaction fees for issuing and redeeming notes, and for handling demand deposits.) Thus the dominance of fractional-reserve banking can be explained without reference to State interference or fraud.

This is by no means to deny that there have been 100-percent-reserve banks destroyed by State interference or fraud. I don't know enough about the history of the matter to judge the accuracy of Watner's statement that "the great banks of deposit, which were originally based on 100% reserve banking" were victims of one or the other.

3. What choice did the consumer have which could have prevented banks from holding less than 100 percent reserves behind his deposits? I believe that he had the choice, at least in some historical economies, of dealing only with banks that made a legally binding contract to hold 100 percent reserves. That the legal system upheld fractional reserve banking contracts does not entail that it would not enforce 100-percent-reserve contracts. It is conceivable that a legal system could refuse to enforce such a contract, but I don't know of any evidence that such was actually the case in any particular historical economy.

4. Given Browne's classification scheme, it seems clear that a banknote (with its "conditional ownership" feature) would have to be classified as a debt instrument, not as evidence of a bailment. Certainly banks and their customers both understood, in the cases where specie was given to a bank in exchange for banknotes, that "by contract or usage the identical thing (was) not to be returned, but only its equivalent ... in the same form." For the same reason

Browne himself classifies a bank deposit as a debt of the bank, not as a bailment. The law should take commercial custom as its guide; thus the burden of proof lies with those who would have the law contravene common usage by declaring a banknote to represent a bailment. A third party who acquires a transferable debt instrument (e.g. a banknote) certainly has no rights against the debtor (the bank of issue) that the original debt-holder did not have.

Watner asks: "Is it just that the banker uses the property of his depositor without explicit consent?" No, of course not. But is specie deposited any longer the property of the depositor? No, it isn't, until redemption is claimed. The bank is the conditional owner of the specie (conditional on redemption not yet having been claimed). If this is surprising, consider that when A lends B a sum to be repaid in one year, the money is not A's property, and thus its disposition none of his business (unless explicit stipulations are made in the loan contract), until the IOU comes due. A common redeemable-on-demand banknote, or a demand deposit, is an IOU that comes due whenever, but not until, the lender exercises his option to redeem.

How does a fractional reserve banker differ from a counterfeiter? A fraudulent banker, who creates monetary claims against himself "out of thin air" in contravention of contractual obligations to hold 100 percent reserves, is indeed little different from a counterfeiter who issues unauthorized (fraudulent imitation) claims against someone else. But a banker who issues monetary claims against himself without fraud creates money by the consent of his customers. The banker performs a valuable service by providing a different form of money which his customers find more convenient than specie for many purposes. (Please note that I am not saying that an increase in the quantity of money as such confers a social benefit.)

The discovery and implementation of the technology of fractional-reserve banking (the ability to produce fractionally backed claims that will circulate as money) does, other things equal, reduce the purchasing power of specie held by others who are not his customers. But that market outcome is not the result of fraud or theft. It is instead akin to a reduction in the market price of goose down brought about by discovery and exploitation of the opportunity to produce 20-percent-down (80-percent synthetic) pillows which many people find more comfortable than 100-percent down pillows. Those who own inventories of goose down find their wealth diminished, but their property rights have not been abridged. Such events happen daily in a market economy.

How many unbacked claims should a banker be permitted to produce? Isn't there a limit beyond which more banknotes are not a good thing? Yes, there is a limit, but it is one to be discovered by the market in banking services rather than one that can be derived from natural-law principles. A fractional reserve ratio too low poses too great a risk to the bank of running out of reserves in the event of a large batch of simultaneous redemptions. It is up to the banker to estimate these risks. (I discuss the banker's risk-return tradeoff problem in the first chapter of my book *FREE BANKING IN BRITAIN*.) The proper role of the legal system is to hold the banker to his obligation to redeem. Inability to meet an obligation to redeem is a breach of contract and should be treated as such.

#### **Further Commentary directed to White by Carl Watner**

1. Your main response to Point 1 (and 4) was that "fractional-reserve banking is a natural creature of commerce, not of the State." I'll reserve judgement on that point for the moment. However, I would like to point out that you could just as well argue that 'slavery' was a natural creature of commerce and therefore should not be prohibited on the free market. The spontaneity of a practice has no bearing on its rightness or wrongness (necessarily) and we should judge the practice on the basis of whether or not it violates property rights (and not whether or not it is a widespread commercial practice or 'permitted' by the State's legal system (after all, slavery, was legal under statist systems of law for many years).)

2. Point 2, which I raised, involved two issues, neither of which are really crucial to the main issue. First, I wished to contest your statement that "In historical fact, safety deposit boxes have commonly been offered by banks for those who wish their money held as a bailment." I doubt the historical accuracy of this statement but let us not belabor the point. The point that you responded to

## **“Free Banking”**

*Continued from page 5*

(that nothing in a free banking system prevents an individual from contracting for 100% reserves) buttresses your argument for the commercial viability of fractional reserve banking (e.g., the Scottish example).

3. It certainly is a happy coincidence that bank notes and demand deposits were legally held to be debts rather than bailments by both the English and American judiciary. Given the lengthy history of State intervention in the monetary sphere “the happy coincidence” of holding bank transactions to be debts (rather than bailments) certainly made the growth of both private and public fractional reserve banking possible. The eventual centralization and collectivization of the English and American banking systems permitted these nations to use the fractional reserve principle to their own inflationary purposes.

4. a. I’m still concerned about what you mean by “conditional ownership.” Using your example of a common IOU transaction between A and B, does A (the lender) retain a conditional ownership in B’s property until such time as the IOU note is paid off? I don’t think it is normal to speak of conditional ownership in such circumstances, but if that is the case, then why speak of the depositor’s or note holder’s conditional ownership of specie in the bank? Your willingness to speak of “conditional ownership” (seems to me) to demonstrate that the banker-client relationship is something more than an ordinary debtor-creditor relation. If so, why?

b. Regarding the differences between the fractional reserve banker and the counterfeiter, you wrote that “a banker who issues monetary claims against himself without fraud creates money by the consent of his customers” and that he performs a valuable service. Though you agree that this results in the diminution of the purchasing power of specie held by non-customers, this market outcome is not the result of fraud or theft. You think that the difference between a counterfeiter and fractional reserve banker is that the former fraudulently imitates the notes of the banker, whereas the latter simply issues additional notes with the consent of his customers. If this is the case, then if the counterfeiter did not imitate the notes of another banker, but simply issued his own notes without any backing, would you have any objection to his practice? If you object to the practice of the non-imitation counterfeiter, what is he doing that is wrong? What is he doing that the fractional reserve banker is not doing?

c. You have a strong point in your favor: that bankers who, with the explicit consent of their customers, wish to fractionalize reserves may do so without violation of any of their property rights. The problem, as I see it, is that the banker and his customers do not operate within a closed system. When a non-bank customer accepts a bank note which purportedly is backed by 100% reserve (but in fact is not, due to the nature of fractional reserve practices) then fraud has taken place. Not only that, but the fractional reserve banker and his original customers “extract resources” from non-customers by diminishing the purchasing power of their money. If the fractionalizing of reserves took place in a closed system, what would be gained?

P.S. In addition to the foregoing commentary, I raised the following new points, but due to constraints on his time, White was not able to respond to them.

5. Ellis Powell in *EVOLUTION OF THE MONEY MARKET* (London: The Financial News, 1916, p. 27) says that “without the principle of negotiability the modern banking system would have been an impossibility.” Prior to 1704, promissory notes were not held negotiable or transferable by endorsements. In 1702, the practice of endorsing and transferring notes by merchants was held to be an innovation upon the common law (which held that a party in possession can convey no better or further right than he himself has; whereas the principle of negotiability permits a bona fide holder in due course to claim valid title to the negotiable instrument, even if it was stolen). It took an act of Parliament in 1704 to override this common law principle. This further reinforces my belief in State manipulation of the monetary system.

6. Another principle of the common law was that an assignment of goods not in existence is without operation or effect. William

Stanley Jevons used this principle to criticize fractional reserve banking because he thought that was precisely what the fractional banker was doing.

7. Another interesting point, and one discussed extensively by Lysander Spooner in his work on *POVERTY* (1846, see his chapter on “The Legal Nature of Debt”) is that a bailment ordinarily entails less responsibility upon the bailee than the obligation of debt imposed upon the banker, who has become the debtor of his customer. The debtor is bound to repay his obligations under all circumstances, whereas the bailee is only bound to reasonable care. This leads to Spooner’s criticism of the bankruptcy law. On the other hand, Spooner argues for viewing the debtor-creditor relationship as a species of bailment, under which the obligation of the debtor (bailee) only extends to the point in time at which the obligation to repay occurs. If the debtor (bailee) has acted with reasonable care and pays to the extent of his means at the time the debt is due, then under the law of bailment, he has no further obligation to pay. This eliminates the need for bankruptcy laws to release people from debt and would make creditors (bailors) more careful how and to whom they lend money. How this point might affect the fractional reserve banking business, I leave you to ponder.

## **POTPOURRI FROM THE EDITOR’S DESK**

### **1. “Gold Plated Socialism”? or No Socialism at All**

GOLD STANDARD NEWS, No. 123, the newsletter of the Gold Standard Corporation (1805 Grand Avenue, Kansas City, Missouri 64108) has published two rebuttals to Murray Rothbard’s “Gold Socialism or Dollar Socialism?,” which appeared in the Mises Institute’s *THE FREE MARKET*, April 1987. Conrad Braun and John W. Robbins both take Rothbard to task for backing the U.S. Treasury’s minting of gold coins. Their comments on his advocacy of a government coin program complement my article in *THE VOLUNTARYIST*, No. 23, on “‘Hard Money’ in the Voluntaryist Tradition.” Rather than posing the alternatives of “gold socialism” or “dollar socialism,” *THE VOLUNTARYIST* urges “no socialism.” (Braun and Robbins point out that the Treasury program of minting gold coins is simply socialism.) Rather than retaining the Treasury in the gold business (an approach which Rothbard strategizes would gradually accustom the public to using gold coins), Robbins suggests that the Treasury 1) simply auction off existing Treasury stocks of gold to the highest bidder; or 2) find the heirs of those from whom it was confiscated in 1933 and return it to them. *THE VOLUNTARYIST* seconds this latter proposal is being consistent with upholding property rights.

### **2. The Soviets appreciate Mises’ insights on economic calculation**

A popular joke among the bureaucrats is concerned with prices and production in the Soviet Union: “Comrade after we take over the world, why will we be obliged to leave at least one Western country’s economy free? Answer: So we’ll know what things should cost.” Another version refers to the Soviet bureaucrat’s dream to have “the entire world Communist. Except New Zealand.” Why the exception? “We have to have somebody to tell us the prices.”

### **3. The Tax Resisters’ Penalty Fund**

Administered by the Fellowship of Reconciliation (Box 25, North Manchester, Indiana 46962), the Tax Resisters’ Penalty Fund has two purposes: 1. “To provide broad-based financial and moral support to war tax resisters by dispensing heavy penalties among many supporters”; and 2. “To provide a way for those not directly resisting war taxes to support those who are.” Although the fund only helps those who resist “war taxes,” and “does not reimburse any of the original tax money seized” by the IRS (it only covers penalty and interest) it exemplifies in practice how a “tax resisters’ insurance fund” might work. An oversight committee evaluates requests from those who have lost property to the IRS. Supporters, now numbering about 550, are sent an appeal letter, which requests a contribution reflecting a pro-rata amount (based on the total of all approved requests divided by the number of supporters on the mailing list).

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# Voluntary Musings

## A Column of Iconoclasm

By Charles Curley

"Nothing can defeat an idea

-- except a better one."

--Eric Frank Russell

**Worth Pondering:** "Discretion, the mother of virtues."

Bede, 731 A.D.

**Just Remember:** Socrates was condemned to drink hemlock for the crime of asking questions. However, he was officially charged with "Corrupting the Morals of the Youth." His real crime, of course, was getting people to think. This is probably the most difficult--and least profitable--crime of which any man has ever been accused!

**On Freedom and Responsibility** There is much talk of freedom and liberty in this country today, but not much of responsibility. People seem to want the one without the other. When something (such as reality) tells them that they can't have one without the other, they prefer to do without either.

If a person has no choices to make, then he is not free. He also has no responsibilities. With choices comes the responsibility to make the correct ones, and the burden of their failure as well as the benefits of their success. The phrase 'necessary evil' is oxymoronic: either a thing is necessary, or it is evil. It cannot be both.

People seem to want the benefits of civilization without the responsibilities. Parents no longer educate their children, but send them off to the public schools, run by the professional educators. The parents are then shocked to find that their children are illiterate--and blame the schools, not their own abdication. But then, the parents are by and large themselves the products of a school system which does not teach people to think or to teach.

Then, the purpose of the public school system is to produce good citizens. Good citizens don't think, they follow orders.

Again, in poll after poll, the American people want government to cut taxes and increase spending. They want the benefits of government spending (for themselves, usually), but don't want the responsibility of paying for it. (Nor the vast wastefulness of it.) They want the roads, the fire departments, and the schools; but they do not want to pay for them. Sometimes, they want Federal funds -- but not the Federal controls that come with them.

They want what they call democracy, which means that all of the people are to be consulted on all questions. Joe Blow in Small Town, Kansas, may be annoyed that Lt. Col. North carried on foreign policy without a vote on the matter, but Lt. Col. North may know more about foreign policy than Joe Blow. They want 'democracy', but won't take the responsibility to become informed electors: fifty percent of the American people claim television as their sole source of news information. What would Thomas Jefferson think of that?

Part of the theory of democracy is that the people are sovereign. That's the theory, anyway. In the middle ages, when few kings could read Latin (and hence most were functionally illiterate), a clerical wit observed that *rex illiteratus est asinus coronatus*, an illiterate king is a crowned ass. Does this mean that American education, democracy and television have given us the spectacle of a nation of crowned asses?

There are people who oppose government authority in peoples' lives, and well they should. It is one thing to preach a thing, another entirely to live it. How many of those who preach individual rights live them? How many of those who preach private fire departments are members of their local volunteer fire department? If you preach the repeal of the Federal Reserve Act do you trade in gold today? When was the last time you stopped at a traffic accident and offered whatever services you could? If those who advocate voluntary interaction among people do not take the responsibility to act voluntarily, who will? And why should they?

This is not idle preaching. I have been reading and writing on the early history of Christianity -- the field called patristics. This was an enormously successful movement--much to the damage of classical civilization and the Roman Empire. The organized church went from the thirteen at the Last Supper to being the official state

religion in three hundred years. Considering the speed at which change normally moved prior to the industrial revolution, this is a phenomenal success. Perhaps it is one from which voluntaryists can learn.

There appear to be two major reasons why people converted to Christianity in its first thousand years. Few appear to have converted because they preferred the religion to its competitors solely on religious or philosophical grounds. Rulers often converted for political or other temporal advantage. But the reason most people voluntarily converted seems to be the example of those who preached to them. If the missionaries appeared holy men, and if they truly practiced what they preached, they were able to gain converts. This is very clear, for example, from reading Bede's A HISTORY OF THE ENGLISH CHURCH AND PEOPLE (A.D. 731).

I think that those concerned with spreading the voluntaryist movement need to take that precedent into account. There are some success stories, such as Anthony Hargis and Co. which provides a gold bank and other financial services, all free of government interference. But these are few and far between.

It is said that actions speak louder than words. How many self-proclaimed voluntaryists will put in their sales brochures, along with 1776, Inc. "1776, Inc. does not sell or support the sale of its products to government agencies"? Considering the relative proportion of government activities in the world today, that is truly a case of putting your income where your mouth is. Or, perhaps, if not our lives and sacred honour, at least our fortunes!

**Another Quote:** "As the examples of all ages show us that mankind in general desires power only to do harm, and when they obtain it, use it for no other purpose, it is not consonant with the least degree of prudence to hazard an alteration where our hopes are poorly kept in countenance by only two or three exceptions out of a thousand instances to alarm our fears. In this case, it would be much wiser to submit to a few inconveniences arising from the dispassionate deafness of laws than to remedy them by applying the passionate open ears of a tyrant."

Henry Fielding  
TOM JONES, 1749

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## Voluntary Musings

Continued from page 7

**Stark, Raving Incompetent** Any war has some excuse attached to it which is fed to the population at large to get them to support it or at least acquiesce in it. "We're fighting to make the world safe for democracy", or "to impose the dictatorship of the proletariat", or for "my god and my right", or some such. Sometimes the parents or children or wives of the slain soldiers can take some comfort in the slogans for which their men died.

What slogan, I wonder, what pabulum, was fed the bereaved survivors of the victims of the U.S.S. Stark? Were they told, "Your sons died for incompetence"? Perhaps: "Your daddy died for bureaucratic sloth and centralised decision making." Mayhap: "Your husband died to make the Gulf safe for Kuwaiti tankers."

It is said that people get the government they deserve. Did the crew of the U.S.S. Stark? Or their survivors?

**Epitaph** for American Civilization (?):

"It is the common fate of the indolent to see their rights become a prey to the active. The condition upon which God hath given liberty to man is eternal vigilance; which condition of he break, servitude is at once the consequence of his crime and the punishment of his guilt."

John Philip Curran, 1790

**The Ollie Follies:** You are probably wondering why I've said nothing about the Iragua hearings: no comments, no jokes, no 'I told you so'. It's very simple, really. A columnist must prepare his material well in advance of press date, and so must think in terms of three or six months ahead. I fear to venture that anything I might say will not be surpassed by the reality as revealed after I've committed words to paper and sent them on to our illustrious editor. Truth is stranger than fiction!

## Potpourri

Continued from page 6

### 4. "Reflections on the History of European State-Making"

"Taxation was the chief means by which the builders of states in the 16th Century supported their expanding armies, asserted their territorial claims, and assured their monopoly over the use of force within their frontiers. Conversely, military needs were in those first centuries the main incentive for the imposition of new taxes and the regularization of old ones. The need fed itself; the overcoming of resistance to taxation required the maintenance of a military force. So turned the tight circle connecting state-making, military institutions, and the extraction of scarce resources from a reluctant population." (from Charles Tilly (ed.), THE FORMATION OF NATIONAL STATES IN WESTERN EUROPE, Princeton: Princeton University Press, 1975, p. 23)

### 5. "Never Assume Anything"

Such were the strong words my father tried to impress me with many, many times. "If anything can go wrong, it will;" as Murphy's

law has it. The skeptics in the Mid-East recently pointed up a false assumption which has greatly embarrassed the U.S. Treasury. It turns out that "some of the popular American Eagle gold coins sold by the U.S. Mint between October 1986 and February 1987 were slightly underweight." Some of the blanks for the half-ounce and smaller coins were authorized by average weight, rather than minimum weight. This meant, "a half-ounce coin, for example, could have weighed anywhere between 0.4975 ounce to 0.5025 ounce, according to Mint officials." Isn't there a lesson here? Never trust the government - in anything.

### 6. "Advocacy versus Use"

We have often been accused of "using" government roads, the government post office, etc. Conrad Braun, editor of GOLD STANDARD NEWSLETTER (1805 Grand Avenue, Kansas City, Mo. 64108) makes an interesting distinction between "using" a government service and "advocating" that the government provide such a service. His comments are sparked by the discussion over the minting of the new gold Eagle by the U.S. Treasury. Braun says that advocacy and use are not the same. "We do not advocate a government postal system, highway system, or for that matter federal reserve notes. We do, however, use them. While we advocate private carriers on private roads using private money, these are not available options except to a very limited degree." I believe this distinction applies equally well to the voluntarist position: we never advocate statism or involvement with the State in any manner; in fact we urge its immediate abandonment. The fact that we use State operated services (as infrequently as possible) in no way detracts from our advocacy that the State is an illegitimate institution and should not exist in a free society. Any inconsistency between our personal actions and our advocacy in no way weakens our argument against the State.

### 7. "Private property" shall not "be taken for public use without just compensation."

The National Association of Realtors (REALTOR NEWS, June 15, 1987) applauds a recent Supreme Court decision (First English Evangelical Lutheran Church of Glendale vs. County of Los Angeles) in which the court held "that a private property owner is entitled to monetary compensation when a government regulation has resulted in a temporary taking of his property by preventing all use of it." In line with the 5th Amendment to the Constitution, the Court has consistently required compensation when the government takes land permanently, such as when private property is expropriated for a public park. Now it has decided that the government must pay for "temporary" losses. What everyone overlooks is that the 5th Amendment enshrines theft. There should be no taking of property at all without an owner's consent and any taking whatsoever without that consent is stealing. Whether the thief pays for the property or not is beside the point, especially if the owner did not want to part with it. The issue of "just compensation" harks back to the days of the "fair price." In a case of unjust taking (which is what all government taking is), there can be no question of "just compensation" except on terms set by the government. What "just compensation" means is that the government will give you what it wants, regardless of your desires.

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## The Voluntarist

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