The Tyranny of the Federal Reserve
Brian O'Brien

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1. Ben Franklin's money

this chapter describes the early banking history of the United States. There was never enough silver and gold to support the economy. Even in colonial days many banks and other institutions issued paper money supposedly backed by Spanish dubloons and other gold and silver instruments. The Revolutionary war was financed by the issue of continental dollars, paper money supposedly backed by precious metals. They fell rapidly in value. Just after the founding of the United States the First National Bank of the United States appeared. It operated for 20 years, until 1811, issuing notes backed by precious metals in a fractional reserve banking system. The war of 1812 again caused a significant deficit. The second Bank of the United States was set up in 1816 and functioned until 1836. It was backed by, and profited private interests. "The Creature from Jekyll Island" has a nice history of Andrew Jackson's epic battle against Nicholas Biddle.

2. The Tyranny of Debt

This chapter begins with an explanation of the counterintuitive fact that money is debt. In a couple of sentences, the government creates money by printing dollars, or more significantly, selling bonds which represent a promise of future payment. They promise to pay dollars, which are nothing but a figment of government imagination, supported entirely by trust. Having borrowed dollars, the government spends them. The entities which receive them can exchange them for goods and services. This puts the claim on government "dollars" in other hands, but the whole scheme eventually depends on faith in the government's promise to pay in "dollars," which are not tied to any external measure of value such as precious metals or land. I like the description that comes up when you Google " chew the fat federal reserve."

The debt based monetary system is counterintuitive. It works for the benefit of the bankers, who create the money and collect interest by virtue of its very existence. Inherent in the system as the promise of future repayment, which obligates our children and grandchildren to repay debt incurred in this generation.

The Federal Reserve creates money via the act of lending it, at a low rate of interest, to major banks both domestic and foreign. Those banks in turn can loan the money at higher rates of interest to corporations and private citizens. Thus, the privilege of being able to borrow at the Federal Reserve discount window is an economic rent, an advantage given to a favored few. In this case there bankers.

This paragraph from the book is illustrative: " Goldman Sachs has borrowed vast sums of money from the Fed at 0.25 percent to purchase bonds from the federal government, which pay 3 percent. The federal government repays the principal and interest on the loans from Goldman Sachs with our federal income taxes. The difference between the interest the Fed charges Goldman Sachs and the interest Goldman Sachs earns from the federal government is profit for Goldman Sachs, paid from the pockets of American taxpayers. This is profit with virtually no risk. The IRS ensures that taxpayers will pay back the bonds that Goldman Sachs has purchased. If you do not pay your taxes, your assets will be seized and you can be imprisoned."

The author claims that business cycles are not inevitable, but are created by the banking system itself, through the expansion and contraction of credit and the money supply, manipulation of interest rates and so on. The system is designed for the benefit of bankers, who profit from interest earned in the expansion phase of the business cycle, and again from repossessions during the contraction phase.

He cites that John Adams wrote, “All the perplexities, confusion and distress in America arise, not from defects in their Constitution or Confederation, not from want of honor or virtue, so much as from the downright ignorance of the nature of coin, credit and circulation.” The chapter ends with a quote from Henry Ford to the effect that if the general public understood the banking system, there would be a revolution by tomorrow morning.

3. The Tyranny of Usury

This chapter is a jeremiad against usury, the charging of interest. As a reviewer, I am afraid this is a vain exercise. Usury has been around since the beginnings of civilization. Moreover, civilizations such as the Muslims and American Indians that do not employ usury are less effective at deploying their saved wealth than societies with what we would consider in normal financial operation.

Usury can often be abusive, and must somehow be controlled, but in this reviewer's mind this solution is not as simple as banning it all together.

The underlying problem is that men differ in their abilities. The more capable among us are able to accrue wealth enough to lend. The young and ambitious are able to employ borrowed money to good effect, earning enough to pay back the lender and make a profit. The problem is that some percentage, a large percentage of the population does not have the wit to use borrowed money effectively, or to realize the threat posed by unsupportable debt.

4. The tyranny of fractional reserve banking

Not everybody needs their money all at once. Usually!

A bank can safely loan out more money than it has on deposit. Since it makes money by interest, banks of course want to do this. O'Brien gives an example. For my own use I recreate my own with his numbers , presented here.

Starting with Line 1 below, a bank gets a $1000 deposit. If the reserve rate is 10%, they have to hold $100 in reserve. They are free to loan the other $900. That loan is shown on the next line.

The magic starts at line 2. The bank makes a $900 loan. The borrower, however, puts the money in – the bank! Following across line 2, the bank has another $810 to loan, after the reserve requirement of $90 is met. It earns interest on the $900 it loaned. At 5% that comes to $45 per year.

Drop to line 3 and repeat. The available $810 goes out at 5%, earning $40.50. It is deposited in the bank, making another $729 available to loan after a 10% reserve requirement of $81.

This process goes on indefinitely. Of course, people may borrow from one bank and deposit in another, but it all washes out. In my exaggerated example below, after 22 loans the bank is collecting $455.69 per year interest on an original deposit of $1000. Nice work if you can get it.

Deposit/ Loan Anount	Available to Loan	Reserve Req't	Annual Interest
1000.00	900.00	100.00	no loan yet
900.00	810.00	90.00	45.00
810.00	729.00	81.00	40.50
729.00	656.10	72.90	36.45
656.10	590.49	65.61	32.81
590.49	531.44	59.05	29.52
531.44	478.30	53.14	26.57
478.30	430.47	47.83	23.92
430.47	387.42	43.05	21.52
387.42	348.68	38.74	19.37
348.68	313.81	34.87	17.43
313.81	282.43	31.38	15.69
282.43	254.19	28.24	14.12

254.19	228.77	25.42	12.71
228.77	205.89	22.88	11.44
205.89	185.30	20.59	10.29
185.30	166.77	18.53	9.27
166.77	150.09	16.68	8.34
150.09	135.09	15.01	7.50
135.09	121.58	13.51	6.75
121.58	109.42	12.16	6.08
109.42	98.48	10.94	5.47
98.48	88.63	9.85	4.92
Totals			
9113.71	8202.34	911.37	455.69

The problem is, of course, that there is actually only $1,000 in the system. If everybody wants their money at once, the bank can't produce it. There is a panic, a run on the bank. Runs have happened throughout history and will happen again. The system needs a backstop. Big banks backstop little banks with loans when they need extra money, and the central bank backstops everybody. Nice theory – but it is only a theory. As Einstein said, "In theory, theory and practice are the same. In practice, they are not." It doesn't work. Systems crash, as O'Brien notes in his chapter on central banks.

O'Brien introduces the subject in this chapter, with the creation of the Federal Reserve in 1913 after a series of panics, the biggest in 1907. It was a bankers solution to the bankers problem. O'Brien says, and most writers would agree, that this solution favors the banks. In fact, it especially favors the big banks, who are the shareholders of the central bank. It has a license to print money, to create money from nothing. A good business to be in.

Unless the amount of goods and services increases at the same pace is the money in circulation, there is inflation as more and more money chases the same amount of goods. O'Brien notes that one dollar at the time of the establishment of the Federal Reserve Bank is worth about two cents today.

5. The tyranny of gold

The total amount of gold ever mined, as one reads more and more these days, is 170,000 tons. Gold is 20 times heavier than water, weighing just short of 20 kilos per liter. An Olympic swimming pool holds about 2 ½ million liters of water, or 50 million tons of gold. So, all the gold in the world would fill 3 ½ Olympic size swimming pools.

At today's price of about $40,000 per kilogram, the total amount of gold in the world is about $7 trillion. That is about half the United States gross national product, also about half of its nominal debt. It is minuscule compared to the unfunded obligations represented by Social Security and Medicare.

O'Brien's take-home point is that there is simply not enough gold in the world to finance all of the world's commerce. At today's price of gold that is certainly true. The gold bugs would argue that it is not a question of having the wrong medium, it is that the medium is wrongly priced.

Gold presents logistical problems. You can't very well by chewing gum with a bar of gold. If you use silver, you run into a problem with the exchange rate: the price of gold relative to silver constantly changes. Working with physical metal cannot be the entire solution.

I add as a reviewer that various entrepreneurs are working with Bitcoin type approaches, one of which is named Bitgold. The idea is to store the gold securely in a vault, outside of the government's grasping hands, and exchange ownership electronically.

The scarcity of gold is its source of value. The world's gold stock can increase only by about two or three percent per year in the best of times. There is simply not that much of it in the ground. As O'Brien points out, the scarcity can be a liability. The rich and the bankers tend to accumulate gold, leaving less in circulation for ordinary commerce. This phenomenon would drive up the value of gold. People who took out gold denominated loans would be unable to repay them. As always, it seems, the bankers would be in a position to repossess the collateral for the loans and increase the inequality in society. Conversely, in a society in which money cannot be readily obtained via loans, commerce comes to a standstill. People cannot buy houses. International trade becomes difficult without letters of credit. The fact that there are not easy solutions to these problems either is witnessed by the fact that they have existed throughout time and that today's imperfect system of fiat money has been chosen as the preferable option throughout the world.

6. The tyranny of central banks

The key question is whether or not a central bank is needed. The bankers indeed benefit by having an exclusive franchise to deal in government debt. O'Brien makes the case that the function they serve is not needed. The government creates debt which he gives to the Federal Reserve to sell and on which the bankers earn interest. O'Brien asks, why not simply have the bank print the money it needs to spend without paying interest to anybody?

This is a long and involved chapter. I suggest that the reader look at [[ASIN:091298645X: The Creature from Jekyll Island: A Second Look at the Federal Reserve]] for a more thorough analysis. The key questions are whether the Federal Reserve works in the interests of the people or the bankers, and whether the inflation that is inherent in the system will ultimately doom it.

8. A (not so modest) proposal for a new American monetary system

This is the heart of the book. Given that many good minds have struggled over many centuries with the question of how national monetary system should be structured, the reader should not expect perfection here. It is enough if there are useful new ideas.

The money supply has to be like little bear's porridge.

If the money supply is fixed, as with the gold standard or Bitcoin, the rich will tend to hoard it. This will result in deflation. People who take out gold denominated loans will be not be able to get the gold to pay it back, because the rich will amass it and take it out of circulation. Bitcoin suffers the same shortcoming. Although a modest amount of inflation is built into the Bitcoin algorithm, at the end of the day there is a finite amount of money.

On the other hand, when an agency such as the Federal Reserve Bank or a government is free to expand the money supply, they generally show no restraint. They print money to meet their needs with disregard for the inflation it causes. This inflation amounts to a hidden tax on the people who hold the money, usually the middle and lower classes. It reduces the value of interest and capital gains income. The government taxes nominal gains even though in real terms and investment may have lost money.

The ideal solution is to allow the money supply to grow at the same rate as the economy. We long experience with have a number of statistical devices used to measure this. They include the gross national product, the consumer price index, and so on. We can observe at the same time that the government has manipulated these measures to its own benefit. For the past decade they have used a vast array of tricks to hold the consumer price index down, which cuts their Social Security obligations, to decrease reported unemployment and to pump up gross national product figures. My observation is that one would need an absolutely bulletproof, unchangeable formula to set the rate of monetary growth, and that even then the politicians and bureaucrats would probably find a way to game the system and defeat it. And unalterable formula would certainly lead to less than ideal levels of inflation and deflation. In my mind that risk is minimal compared to the risk of leaving monetary policy up to politicians judgment.

O'Brien's solution involves politicians. He would form a monetary board that is so broadly based as to represent the interests of all of society. There would be no federal reserve, and the money supply would be expanded not by government borrowing through the agency of banks that make a profit on the interest, but by paying government obligations with newly printed money. Taking the deception out of the system would save the half trillion dollars a year in interest now paid to the banks.

The proposed monetary board would include representatives of all three branches of government. It would definitely be so large as to be unwieldy, which would necessitate its delegating responsibility to a manageable number of people. People being what they are, and government being what these people would certainly be subject to political pulls this way and that. Granting it the authority to set interest rates and make monetary policy would almost certainly politicize it.

9. The road to the Great Depression

10. The great confiscation

11. The tyranny of World War II

12. What do the bankers want?

13. The tyranny of free-trade

14. The tyranny of mass emigration

15. The tyranny of war

16. The tyranny of the media

17. The tyranny of public education

18. Reawakening the American spirit