

THE CREDIT CARD FRAUD: INFLATION, CULTURE OF BORROWING AND RISING ECONOMIC INEQUALITY

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Abstract

The use of credit card has become a fashion and a symbol of social status, but very few people understand the problems related with its use. Credit card is a tool of the practice of fractional reserve banking of today's banking industry. This paper tries to explore the implications of the use of credit card in specific, and through that the fractional reserve banking in general. It shows how credit card generates inflation, how it promotes the culture of borrowing by discouraging honest living and how it increases economic inequality in the society.

Keywords: *Credit card, Fractional reserve banking, Central bank, Debit card, Money, Money creation, Inflation, Borrowing, Economic inequality*

JEL Classification: E31, E44, E51, G21.

Introduction

Credit card and its originator the banking industry is a big fraud. The whole business of credit card is unlawful¹, immoral, and unethical. It would be very much surprising for many people to know this, but the credit card is a major tool through which the banking industry is wrecking the whole economy², is discouraging an honest living and promoting the culture of borrowing and living beyond one's means which discourages hard work and is increasing the economic inequality in the society. All these should be a surprise for the laymen because they do not understand the fundamental principles on which today's banks work or they are deluded by the banking industry's propaganda. In this paper I will show how the banking industry is doing all the unlawful, immoral, unethical and economically dangerous business.

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¹ How the credit card and the whole system of fractional reserve banking on which basis the credit cards work is unlawful and fraudulent in its nature, and for the evidence of the court cases around the world declaring the system of fractional reserve banking illegal please refer to, (Soto 2006).

² For example, the credit card is one of the main causes of the present global economic meltdown and the financial crisis. We will see how credit card is the cause.

Credit Cards and Inflation

Those readers who have taken a class of introductory economics know the money creating process of banks³. But very few know the fact that the money which is created by the banks is created out of thin air i.e., without any production of goods or services. This creation of money out of thin air is the major way in which banks wreck the economy and create inflation. Let us understand in a bit deeper sense how this money creating process of banks creates inflation. To understand this we start by analysing the actions of individuals first. We see how an individual can earn more money i.e., create more money if he want more of it. Then we understand what banks do to create money when they want more of it. Once we understand the difference between the process of creating money by an individual and by the banks, we will be able to clearly see how bank's money creation process result into inflation and the wreckage of the economy.

Individual v/s bank's action for creating money

The chief and the only lawful way in which a person can create more money for himself is by working more in the market. S/he can earn more only when s/he produce more and sell more. Other than this process, an individual does not have any other just and lawful method of earning or creating more money for himself⁴. This means that, individual's earning is backed by production of goods or services. To understand this whole process let us assume an economy of 5 people A, B, C, D and E on an island. Each individual on this island initially in 1st year is producing US\$ 100 worth of goods and services, and so each is earning US\$ 100 income per year by selling those goods and services in the market. The total production and income of this economy in a year thus is, US\$ 500 (US\$ 100 x 5 person = US\$ 500). We here assume that there is no saving in the economy in this 1st year. That means, US\$ 500 being earned is spent on US\$ 500 worth of production by these 5 people. In this case the prices of goods and services will remain stable⁵ because there is no excess demand for goods and services compared to their supply. So right now, there is no problem of inflation here in our imaginary economy. Now suppose all 5 members in the 2nd year want to earn extra US\$ 100 worth of income. What are the ways through which they can earn extra US\$ 100? The only way is to work hard and produce goods and services which are worth US\$ 100 more. So now they work hard and produce

³ For those who have not taken such class please refer to, (Rothbard 2004: 805-809; Samuelson and Nordhaus 1998: 477-481)

⁴ Running a money printing press in home is illegal and a crime for sure in the present system of fiat money. I won't discuss the issue of money production by an individual in a system of gold or any other commodity standard. Suffice it to say that in a gold standard anyone can go and dig gold mine and can produce gold legally.

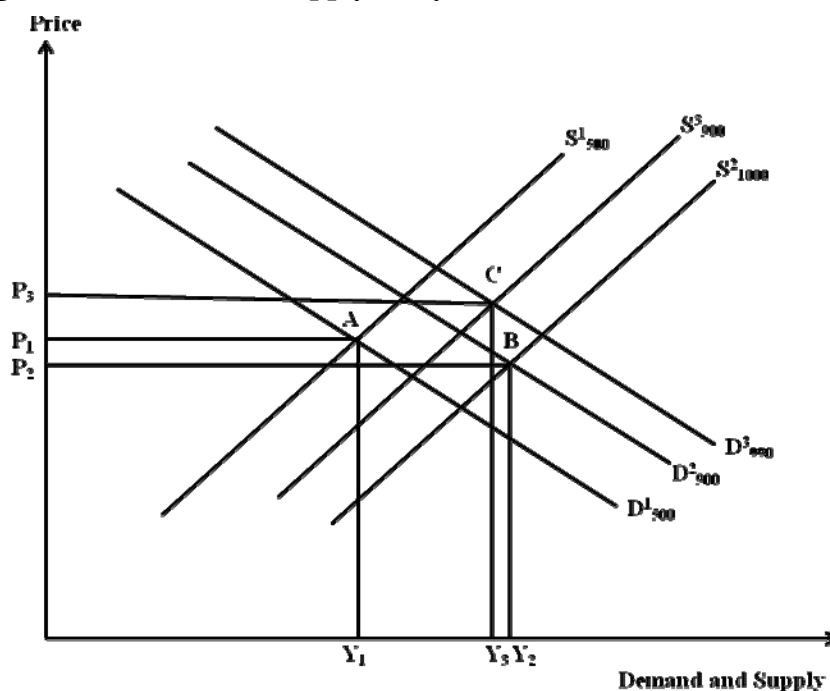
⁵ For the simplicity we right now ignore the technological, natural, and all other such factors which can decrease or increase the price.

extra US\$ 100 worth of goods and services in 2nd year. This way now the total production in the economy is US\$ 1000 and total income is also US\$ 1000 in 2nd year. Now let's drop our assumption of no saving on this island economy, and with that introduce a bank in this economy and see clearly how a bank through its credit cards creates inflation.

Suppose now a bank arrives on this island from the mainland. Let's say that α bank opens up one branch on our small island economy. Now from our 5 people, person A feels that he has earned enough for his future so he now decides to live a more comfortable leisurely life by working less in the 3rd year. In 3rd year he decides to work less only producing goods and services worth US\$ 100. And he also decides to save US\$ 100 out of his US\$ 200 of income of 2nd year for his future time in 3rd year where he might need that US\$ 100 for the unforeseen contingencies and uncertainties. He keeps his savings in α bank as a safe deposit. So now α bank branch has US\$ 100 worth of reserves with it. Now, because α bank is working on a fractional reserve banking standard (just the way today's banks are functioning), it Instead of keeping this US\$ 100 as a safe deposit for A (which he can demand at any time from the bank), decides to loan this money to person B to earn an illegitimate⁶ profit. By loaning this money, bank is now engaging in the process famously called, *money creation*. Suppose the reserve ratio of bank is 10% so bank issues a credit card to person B worth of credit limit of US\$ 90. This adds US\$ 90 worth of money into the circulation and total money supply thus becomes US\$ 990. On the other side the production of goods and services is only worth of US\$ 900 in 3rd year because now A decides to work less only for US\$ 100 worth of goods and services in this 3rd year. So on one side total production of goods and services is only worth US\$ 900, and now with the credit card worth of US\$ 90 with person B, total income in the economy is US\$ 990. Now, because Person B's time preference hasn't changed, he will use the credit card worth US\$ 90 in present consumption with his US\$ 200 of cash income. Other 3 person (C, D, and E) are also using all of their US\$ 200 on consumption of goods and services. So now in the market place, the production of goods and services is only worth US\$ 900 and their demand is worth US\$ 990. Demand is greater than the supply. In this situation the prices of goods and services will increase until there is a balance between demand and supply. Figure 1 shows the graphical representation of this whole situation.

⁶ Illegitimate because by loaning the deposit money of A to others without the consent of A, the bank is committing the crime of misappropriation.

Figure 1. Demand and Supply analysis of the effect of a Credit Card



As we can see, in 1st year the demand and supply both were equal at US\$ 500 worth so prices were stable at P_1 level where it cleared the market. In 2nd year prices fell to level P_2 because person A consumed US\$ 100 less to save it for his future in the 3rd year out of his total income worth of US\$ 200. In this way, in 2nd year, supply (S^2_{1000}), which was US\$ 1000 worth, is greater than the demand (D^2_{900}), which resulted in a price fall. But in 3rd year this situation of price fall did not continue because now banks, instead of keeping US\$ 100 of A as a safe deposit in its reserve, issued a credit card worth US\$ 90 to person B, and this money person B has decided to spend because his time preferences hasn't changed. This resulted in higher demand in the market (D^3_{990}) than the supply (S^3_{900}), which has now fallen to only 900 rupees worth of goods and service because person A is working less in this 3rd year. This imbalance between higher demand and lower supply in turn has resulted in to price rise (P_3) of goods and services to the point where market again clears. Stretching this analysis in the future years with increased savings⁷ and with it bank's rapid money creation process (the so called money multiplier effect) will show that prices will continue to rise in every year with less production and continuously increasing demand due to the issuance of credit cards (and other such loaning mechanisms).

Thus, credit cards have created price rise i.e. inflation in mainstream economics

⁷ For the sake of focusing the inflationary effect of bank's credit cards and other such loaning practices I am here completely ignoring the *investment* process in this island economy. We assume that people either save their money for safe future in banks or consume it in present time.

language! The problem here is that *too much of money is chasing too fewer goods and services*. And this imbalance in the demand and supply can only be corrected through a rise in the prices of the goods and services in the market. This way, the more credit cards banks issue the more inflation it will create. The more people use money in the form of credit cards without producing anything the more inflation will take place in the economy.

Now we see how credit cards promote the culture of borrowing, how it discourages honesty and how it increases economic inequality in the society.

Credit cards: The culture of borrowing, discouragement of honesty and the economic inequality

After understanding how banks through their credit cards give birth to inflation and wrecks the economy, now we turn our attention to other problems of promotion of culture of borrowing and living beyond one's means, the discouragement of honesty, and the rise in economic inequality.

The fraudulent nomenclature of various cards by banks

Banks discourage honesty by promoting the culture of borrowing as a good means of living one's life. And this borrowing is in the form of their credit cards. To hide their insidious motives of misappropriation and making more profit through this misappropriation by issuing credit cards to the people, banks have very tactfully changed the nomenclature of the whole debt and credit system. In general, debt is considered to be a bad thing and credit as something very good by the people. To sell their credit cards banks have reversed the naming of the cards and thus have glorified the use of credit cards. I now discuss this fraud of using linguistics to lure people into using credit cards.

The whole naming of cards itself is fraudulent. Let us see, why. Firstly, we discuss credit card. The way bank enshrines credit card and the way people take credit card as a symbol of higher status itself is a big fraud and an illusion. Credit means, *Money available for a client to **borrow***. The word borrow here is of great importance. Credit actually is borrowing which in turn means ***debt***. *So credit is not credit but credit is debt and thus credit card is not a credit card but is a debit card*. And borrowing and debt are never regarded as a good way of living the life by people. Society sees the heavily indebted people as persons who do not know how to take care of their economic matters, and as persons of extravagance and irresponsible character. But banks, just by changing the name of what should be a *borrowing card* or a *debit card* to credit card fool everyone. Through this way they encourage a culture of borrowing and discourage honest people, who want to live their life within their means, by tempting them to use credit cards and using borrowing as a means of living their life.

The naming of debit card is also a fraud and an illusion being perpetuated by the banks to encourage the use of credit cards. Let us see, why. What is a debit card?

Debit card is a card which is actually backed by a money account in the bank. When someone uses his debit card at a shop, the money (hard cash) is immediately deducted from his account electronically. So in a way when someone uses a debit card s/he is actually paying in cash only, but indirectly through his/her bank instead of giving hard cash to the shop owner. So debit card, as the name suggests, is not actually a debit or borrowing card. You do not owe anything to anyone when you use your debit card. When I use my debit card I do not borrow anything from anyone. I actually use cash electronically which I have in my bank account. So in my view, the name of debit card should not be debit card (which depicts borrowing) but it should be, as I have named it, **Cash card** because that plastic card just represents my cash holdings in bank account. It's just a convenient way of making a transaction *in cash*. But, because the name of an actual cash card is given debit card (borrowing) people are discouraged to use it because they see it as a lower status symbol in the society. People like to have more credit cards in their wallet than debit cards!

Not only this, the whole banking system is geared towards promoting the use of a credit card in stead of a debit card (the type of debit card which I call the cash card). For instance, if someone is living in India and wants to purchase something online from a store located in a foreign country then this transaction is only possible through a credit card. Debit card just doesn't work. This is my personal experience here in India where my debit card never works for an online transaction for foreign shops, and my friends have similar experiences in USA where the shop owners refused to take cash even when they were given cash and demanded a credit card instead! The difficulties which honest people have to suffer are immense. In an era of information technology the use of online transaction is increasing, and in such an environment use of credit card becomes a must when debit cards are not working. This way banks promote the culture of credit card use. They discourage honest people who want to purchase things only available by their purchasing power i.e. their cash holdings. It is very weird to observe that, in such a fraud environment, a person who actually has a cash balance in his account (i.e., the debit card user) *can not* buy a good or service s/he wants, but a person who does not have any money (i.e., the credit card user) can buy the goods and services of his wish!

The whole system of credit cards and giving consumer loans by the banks is also a major reason for increasing economic inequality in the society. Why? Because most of the middle class and rich people have access to the consumer loans and those credit cards to consume more without producing more while the poor are grossly denied such (phony) luxuries of life by the banks. No bank will issue a credit card to the poor person. No bank will give any consumer loan (or even a business loan) to the poor person. Poor people have to rely on their day to day cash earnings of their hard work. Not only this the inflation being created by the fraudulent bank's malpractices of fractional reserve banking also affects poor people in a much harder way than the other well to do people in the society. Poor person gets crushed in between the steadily increasing prices and the meagre family income. This way the mal-practising banks are the real culprits and one of the major causes of increasing

economic inequality in the society and hardly anyone looks at this very important fact.

Conclusion

We have seen above how banks and their certain malpractices (fractional reserve banking) are the main culprits of damaging people's lives and lowering their standard of living by creating inflation and wrecking the economy. We also analysed how they damage the culture of sound finance (the dislike for borrowing) by perpetuating the myth of credit card and through that promoting the culture of functional finance (the glorification of borrowing as a way of living the life), how they discourage honest people by disabling the use of debit cards and how they give rise to the economic inequality. There are ways of stopping the fraudulent bank's malpractices from injuring our life and property. One way is to educate people of its wrong doings and underlying hidden agendas. This paper is one such attempt to do exactly that sort of education of the common man. We must not glorify borrowing and credit cards as the way of living our lives. The result of such a glorification of borrowing and credit cards is in front of our eyes in the form of the collapse of the whole American economy. Hard work is the only way of improving our standard of living. We must not forget the ancient wisdom of *not stretching one's feet beyond the blanket*⁸. What our elders told us about living inside our means is absolutely right. They probably understood the very important economic law that, "*without producing anything first, consumption is impossible*". We all should not forget this very important economic law if we want to avoid the problems being faced by millions of Americans and other people around the world today. We must not forget that living beyond one's means is doomed to fail in the long run, and it will make everyone bankrupt. Economy will never grow; civilization will regress to primitive levels without hard work and increased productivity. To stop banks from doing all these damage, apart from education, we fundamentally need to change the whole banking industry. These fundamental and important measures of change I will discuss in future.

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⁸ And if you want to stretch your feet then increase the size of the blanket i.e., if you want to spend more then first you have to earn more through hard work instead of borrowing.