Can It Happen Here?

The decision of the government in Cyprus to simply take money out of people's bank accounts there sent shock waves around the world. People far removed from that small island nation had to wonder: "Can this happen here?"

The economic repercussions of having people feel that their money is not safe in banks can be catastrophic. Banks are not just warehouses where money can be stored. They are crucial institutions for gathering individually modest amounts of money from millions of people and transferring that money to strangers whom those people would not directly entrust it to.

Multi-billion dollar corporations, whose economies of scale can bring down the prices of goods and services — thereby raising our standard of living — are seldom financed by a few billionaires.

Far more often they are financed by millions of people, who have neither the specific knowledge nor the economic expertise to risk their savings by investing directly in those enterprises. Banks are crucial intermediaries, which provide the financial expertise without which these transfers of money are too risky.

There are poor nations with rich natural resources, which are not developed because they lack either the sophisticated financial institutions necessary to make these key transfers of money or because their legal or political systems are too unreliable for people to put their money into these financial intermediaries.

Whether in Cyprus or in other countries, politicians tend to think in short run terms, if only because elections are held in the short run. Therefore, there is always a temptation to do reckless and short-sighted things to get over some current problem, even if that creates far worse problems in the long run.

Seizing money that people put in the bank would be a classic example of such short-sighted policies.

After thousands of American banks failed during the Great Depression of the 1930s, there were people who would never put their money in a bank again, even after the Federal Deposit Insurance Corporation was created, to have the federal government guarantee individual bank accounts when the bank itself failed.

For years after the Great Depression, stories appeared in the press from time to time about some older person who died and was found to have substantial sums of money stored under a mattress or in some other hiding place, because they never trusted banks again.

After going back and forth, the government of Cyprus ultimately decided, under international pressure, to go ahead with its plan to raid people's bank accounts. But could similar policies be imposed in other countries, including the United States?

One of the big differences between the United States and Cyprus is that the U.S. government can simply print more money to get out of a financial crisis. But Cyprus cannot print more euros, which are controlled by international institutions.

Does that mean that Americans' money is safe in banks? Yes and no.

The U.S. government is very unlikely to just seize money wholesale from people's bank accounts, as is being done in Cyprus. But does that mean that your life savings are safe?

No. There are more sophisticated ways for governments to take what you have put aside for yourself and use it for whatever the politicians feel like using it for. If they do it slowly but steadily, they can take a big chunk of what you have sacrificed for years to save, before you are even aware, much less alarmed.

That is in fact already happening. When officials of the Federal Reserve System speak in vague and lofty terms about "quantitative easing," what they are talking about is creating more money out of thin air, as the Federal Reserve is authorized to do — and has been doing in recent years, to the tune of tens of billions of dollars a month.

When the federal government spends far beyond the tax revenues it has, it gets the extra money by selling bonds. The Federal Reserve has become the biggest buyer of these bonds, since it costs them nothing to create more money.

This new money buys just as much as the money you sacrificed to save for years. More money in circulation, without a corresponding increase in output, means rising prices. Although the numbers in your bank book may remain the same, part of the purchasing power of your money is transferred to the government. Is that really different from what Cyprus has done?

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